Not harder, still smarter? The new UK securitisation framework nears the finish line

22 May 2024

Securitisation Regulations 2024, provide a new framework for UK securitisations with effect from 1 November 2024. Whilst there is divergence with the EU in some areas, the final rules are an improvement on the current framework, particularly the disclosure and transparency requirements and scope remains for further beneficial changes which have not ruled out by the regulators. This article examines the latest developments and the implications for UK securitisation transactions, including areas of divergence with the EU.

Background

On 30 April 2024, the Financial Conduct Authority (**FCA**) published its Policy Statement 24/4: Rules relating to securitisation and the Prudential Regulation Authority (**PRA**) published PS7/24 – Securitisation: General requirements (together, the **Rules**). The Rules, taken together with The Securitisation Regulations 2024, (as will be amended by the draft The Securitisation (Amendment) Regulations 2024) (the **Securitisation Regulations**), will replace assimilated law and provide the new framework for UK securitisation with effect from 1 November 2024[1].

The Rules follow the FCA and PRA consultation papers issued in summer[2] 2023 (the **Consultations**). We discuss below key changes from the Consultations and highlight areas of divergence with the EU where relevant and next steps for market participants.

For our initial response to the Consultations please see our article "Smarter, not harder - a new securitisation framework for the UK".

Commencement date of 1 November 2024

The market now has just a few months to prepare before the new Securitisation Regulations come into force on 1 November 2024 (the **Commencement Date**), subject to revocation of the existing UK Securitisation Regulation (**UKSR**)[3].

Transitional provisions in relation to pre-implementation securitisations

Other than for delegation by institutional investors to Alternative Investment Fund Managers (AIFMs) (which are authorised in the UK, as clarified in the Regulations), transitional provisions are included for securitisations where the securities were issued before 1 November 2024 (**Pre-commencement Securitisations**). There is no ability to opt into the new framework and Pre-commencement Securitisations therefore will not benefit from potentially beneficial changes; this may be outweighed however by the cost savings of adjusting to a new regime and the fact that the most beneficial changes

relate to primary requirements. Transactions involving non-UK AIFMs will need to consider the impact of transitional arrangements, as discussed further below. Some firms will be monitoring compliance with three sets of securitisation rules; those pre-Brexit that were grandfathered, transactions up to the Commencement Date and those after the Commencement Date. Note that the UK extended, in the EU (Miscellaneous) Exit Regulations of 2022, the temporary recognition of EU simple, transparent and standardised (**STS**) securitisation deals until 31 December 2024, which is also reflected in the Securitisation Regulations 2024.

Alignment between FCA and PRA rules

Previous concerns about lack of alignment between in the Rules between the FCA and PRA, which would have caused friction and costs, have been allayed for the most part. There is now improved alignment between the different rules (including with HM Treasury requirements for Occupational Pension Schemes (**OPS**) requirements which are included directly in The Securitisation Regulations) which are broadly in sync though with some drafting differences. Nevertheless, parties will need to consider three different sets of requirements, depending on the nature of the parties on a transaction.

EU non-legislative materials and continued application

Pre-Brexit EU non-legislative materials, as well as guidance provided by ESMA in relation to EU securitisations, have not been directly integrated into the Rules at this stage. Market participants may continue to consider pre-Brexit non-legislative materials based on current previous guidance provided in the FCA's Brexit: our approach to EU non-legislative materials and the PRA's Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU. Any new EU guidance will not apply, save where the regulators expressly set out their expectations. Also no further clarity has been provided in relation to post-Brexit guidance by the EU or UK regulators or how processes for ongoing regulatory guidance in relation to securitisations in the UK will be managed, but the PRA and FCA are required to provide details of any directions made[4].

Clarification of the status of recitals

The FCA and PRA have included, as operative provisions, essential recitals relied on by market participants. These have been highlighted where relevant below.

Geographical scope

Clarifications have been included, to avoid doubt, that the Rules apply to entities that are "established in the United Kingdom"; this will not include non-UK firms with UK branches.

Changes since the Consultation

Due diligence

- Information before pricing and secondary market. Taking into account that the concept of "pricing" is not as relevant for private securitisations, the Rules modify requirements in relation to information

before pricing such that information must be available "before pricing or commitment to invest" and that only a "draft or initial form" needs to be provided. Note however that there is no definition of "commitment to invest" and this may be an area for future clarification. Also, secondary market investors are not required now to conduct due diligence on information available at issuance and instead need relevant information at the time of investing. This is also reflected in the STS and transparency requirements, and in guidance for templates.

- STS transparency.

As mentioned above, this updated approach to pricing in due diligence is also reflected in the STS and transparency requirements. The Rules did not make changes for responses in the Consultations to limit due diligence to STS transactions or to be able to rely on Third Party Verifiers; in fact the FCA clarified that due diligence requirements continue to apply where a third party verifier has provided services. Also, when using a third party the originator, sponsor or SSPE must check that such third party is registered under regulation 25 of the Securitisation Regulations 2024.

No changes were made to homogeneity requirements. In particular, the Rules do not clarify, as in EU regulatory technical standards, that (i) classification of corporate exposures is in accordance with a firm's underwriting standards, and (ii) the treatment of project finance exposures.

- Delegation of due diligence requirements and AIFMs. Where institutional investors delegate due diligence requirements to a non-institutional investor (which now includes AIFMS not authorised in the UK[5]), compliance responsibility remains with the delegating party (though not where delegated to a UK institutional investor). This could impact some Pre-commencement Securitisations where a change in allocation of compliance responsibility, possibly requiring replacement of the managing party pre-Commencement Date.

Risk retention

- Securitisation of own liabilities. A provision relating to fulfilment of the risk retention requirement of own liabilities (the regulators give covered bonds as an example), is included. This reflects Recital 1 to the pre-2019 Risk Retention RTS (Commission Delegated Regulation (EU) 625/2014) and is also included in Article 16 of the Final Risk Retention RTS (the **EU Final RTS**).

- Prohibition on hedging. Reflecting Recital 7 of the EU Final RTS, hedging is permitted prior to the securitisation as a legitimate and prudent element of credit granting or risk management where it does not create a differentiation for the retainer's benefit between the credit risk of the retained securitisation positions or exposures and the securitisation positions or exposures transferred to investors.

- Insolvency of the retainer. Diverging with the EU, the Rules do not expand on the circumstances for replacement of a risk retainer or servicers as retainers in non-performing loan securitisations. There is no indication as to whether the regulators might use powers to modify, disapply or waive any of the Rules in this area, but we expect this to be an area where future guidance or waivers are requested and this was signalled in the PRA's feedback statement[6].

- Sole Purpose Test. The FCA has chosen not to reflect changes made in the EU Final RTS to refer to the sole purpose test requirements. The fact that the FCA has chosen not to include "predominant" at this stage indicates a difference in the EU and UK approaches when considering the UK risk retention requirements; however for dual transactions this divergence, this will mean that transactions will seek to comply with an interpretation consistent with the EU requirements.

- Cash collateralisation for synthetic/contingent form of retention. A "CRR firm" or a "UK Solvency II Firm" does not need to collateralise a synthetic or contingent form of retained interest; for other firms that interest retained on a synthetic or contingent basis must be fully collateralised in cash and held on a segregated basis as client money. Being able to hold the retained interest on an uncollateralised basis will be welcome for firms within scope. The exemption from collateralisation applies only to UK firms however which means that dual compliance will required on EU and UK securitisations.

- Other areas not covered. No provision was made for requirements relating to excess spread or STS treatment for on-balance-sheet securitisations which would have aligned with the EU; this is being considered separately however as part of the PRA's consideration of the capital treatment of securitisation in its discussion paper DP3/23 and a consultation paper is expected imminently which may provide further clarification. No provision was made for L-shaped retention; though this was not expected at this stage, as L-shaped retention is permitted in the United States, it may be that this might be considered in future, particularly in relation to equivalence recognition. Provisions relating to the "time of origination" remain; this means that the Rules do not align with the EU Final RTS. It had been suggested in the consultation response by AFME, UK Finance and CREFCE[7], that a non-exhaustive list of examples of the time of origination in different contexts could be provided which would be preferable to the EU approach.

Resecuritisation and waivers

Manufacturers can apply for a waiver of the ban in order to manufacture a securitisation containing securitisation positions as underlying exposures. Similarly, an institutional investor can apply for a waiver to allow it to invest in a securitisation containing securitisation positions as underlying exposures. No criteria are provided as to when a resecuritisation might be permitted. Note that the PRA had originally included a draft statement of policy on permissions for resecuritisation but this has now been removed for consistency with the FCA approach. Please see below for more information about the exercise of waivers and giving of directions.

Transparency

The PRA reversed previous proposals in its Rules as to confidentiality which were inconsistent with the FCA proposals so that firms may comply with the familiar transparency requirements by disclosing data only in aggregated or anonymised form (or in relation to underlying documentation, as a summary) where required for confidentiality purposes. The PRA did not, as requested by some respondents, clarify the position with regards to non-UK laws on confidentiality.

Credit granting

References to “sponsor” were not removed which is disappointing given that the requirements can only effectively be met by the credit-granting entity, as acknowledged by the EU Commission's report on the functioning of the EU Securitisation Regulation dated 10 October 2022. There were also no changes to clarify that the standards apply “in the selection and pricing of the exposures” in relation to non-performing exposures securitisations, which would have been consistent with the EU approach.

ESG

Various EU technical standards, or provisions equivalent those in some EU technical standards, are not incorporated in the Rules, including the regulatory technical standards with regard disclosures sustainability indicators for STS securitisations. The regulators considered ESG implications of the Rules but considered that these are not relevant to the fulfilment of requirements under the Financial Services and Markets Act 2000.

Consequential changes

Some non-material consequential changes to other FCA Handbook chapters are made and a new rule, similar to the cooperation requirement in PRIN 11 (Relations with Regulators) which apply under the designated activities regime (DAR) rules so that entities not otherwise subject to DAR, but subject to the FCA’s rules on securitisation, shall deal in an open and cooperative way, although this would be expected in any event.

Approach to waivers and directions

The FCA and PRA have the power, under FSMA, to suspend the Rules, give directions and dispense with or modify requirements in certain cases or circumstances. Clarification is given that where the FCA or PRA have granted a waiver or agreed a modification of the credit granting criteria or the risk retention with the manufacturer of a securitisation, the institutional investor can take that waiver/modification into account in its due diligence. Where these powers are exercised the FCA and PRA are expected to publish their decisions. It is not clear to what extent the regulators will be prepared to exercise these powers.

Future policy changes

The regulators received a number of responses with comments that were not taken into account in the Rules but which may inform future policy as part of future consultations. It may be, in some areas, that the regulators did not have sufficient time for adequate consideration of suggested changes and felt that these require additional consultation with the market. The FCA and the PRA plan to consult on further changes to the securitisation rules in Q4 2024/Q1 2025. The PRA’s Prudential Regulation Authority Business Plan 2024/25 states that it will continue this work throughout 2024 and 2025 with the last of the PRA's tranche 1 and 2 files are planned for implementation in 2026.

Further consultations will include considering the definition of public and private securitisations and the disclosure template reporting requirements with a view to making these more proportionate, possibly enhancing ESG reporting. We expect that a number of possible beneficial changes that were not adopted as part of the Rules including, amongst others, points highlighted in this article, might be

considered further in the future. As the regulators monitor their achievements over time[8] it is possible that this could inform further developments as time goes on.

What should firms do now?

From 1 November 2024, clients will need to be familiar with, and be able to comply with, the Securitisation Regulations, including having updated internal policies and procedures for securitisations where securitisation positions are issued after that date. Whilst the market has had some time now to anticipate proposals, the period until the Commencement Date is still a short timeframe before the new regime is operative.

Market participants need to familiarise themselves with the new framework, consider their systems and processes and implement any changes by the Commencement Date. Any transactions being worked on now for completion after 1 November need to comply with the Securitisation Regulations.

The changes to due diligence delegation requirements, including as they relate to AIFMs, not authorised in the UK, may impact some arrangements and will require consideration as to who can accept compliance responsibility going forward.

Next steps

The Rules will be implemented by the Securitisation (Smarter Regulatory Framework and Consequential Amendments) Instrument 2024, subject to a commencement order which must be laid before UK Parliament for the repeal the UKSR. No delays are currently expected. As discussed above, future consultations on additional changes are expected.

Final thoughts

Inevitably there will be costs for firms of adapting to a new regime but hopefully the alignment between the FCA's and the PRA's Rules, and those relating to OPS, will help to mitigate these. There might be some loss of benefit in the changes for Pre-commencement Securitisations but, as noted by the regulators, this may be offset by the saving in costs with not having to review existing transactions for compliance with the new rules. In theory, a more proportionate regime could prove more cost-effective in the long run.

Whilst there are a number of areas where the market could benefit from further changes, the FCA and PRA acknowledge that potential changes raised as part of the initial consultations, but not modified, could inform future policy. The publication of the Rules indicates a commitment by the FCA and PRA to provide a more cost-effective, proportionate approach to help promote securitisation. With an increasing recognition, both in the UK and the EU, of the important role that securitisation has to play in the broader economy, particularly with the demands of reaching "Net Zero", a more flexible, pragmatic regime could be one step further to giving the UK securitisation market a welcome boost that it has long sought.

For our initial response to the Consultations please see our article "Smarter, not harder - a new securitisation framework for the UK" which provide further analysis on some of the points above.

If you have any questions on this topic please speak to your usual Structured Finance contact at Hogan Lovells.

This note is for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. Please contact your normal contact at Hogan Lovells if you require assistance or advice in connection with any of the above.

Authored by David Palmer and Jane Griffiths.

References

1 The FCA rules will be implemented by the Securitisation (Smarter Regulatory Framework and Consequential Amendments) Instrument 2024 (which can be cited as the Securitisation (Smarter Regulatory Framework and Consequential Amendments) Instrument 2024) (the Amending Instrument). The sourcebook in Annex I to the Amending Instrument may be cited as the Securitisation sourcebook (SECN).

2 CP23/17 **and** CP15/23

3 Regulation (EU) 2017/2402 (the EU Securitisation Regulation), in effect in the UK and the EU since 1 January 2019, was onshoredpost-Brexit with effect from 1 January 2021, with minimal changes, by The Securitisation (Amendment) (EU Exit) Regulations 2019.

4 As required in accordance with 138BA of Financial Services and Markets Act 2000 (FSMA) 138BA (Disapplication or modification of rules in individual cases)

5 The Securitisation Regulations 2024 changed the definition of "AIFM" such that AIFMs who are not authorised in the UK no longer fall within the definition of an 'institutional investor'.

6 The FCA and PRA have powers of modification and disapplication under the Designated Activities Regime or the waiver powers available to it under section 138 of FSMA.

7 Joint response by AFME, UK Finance and CREFCE dated 30 October 2023

8 The FCA will measure success against the Rule Review Framework, taking into account macro-economic trends impacting securitisation and will be monitored in the FCA's Annual Report published metrics: FCA outcomes and metrics**.**