Recent Developments - Finance and Capital Markets (November 2024)

21 November 2024

In this insight article from the **Finance and Capital Markets Department**, the key themes that we are considering as we look forward to 2025 are the EU securitisation framework, sustainability-linked loans financing bonds and Irish covered bonds.

EU Securitisation Framework – Consultation

Current Status

On 9 October 2024, the European Commission launched a **targeted consultation**Opens in new window (the **"Securitisation Consultation"**) on the current EU securitisation framework. The Securitisation Consultation looks for feedback from stakeholders on the EU securitisation framework and seeks to identify potential areas for improvement.

In the introductory section of the Securitisation Consultation, the European Commission writes that the size of the European securitisation market has decreased significantly since the 2008-2009 global financial crisis while the securitisation markets outside the EU have fully recovered and surpassed pre-crisis records. The European Commission points out that the current EU securitisation framework has improved transparency and standardisation in the securitisation market. However, the European Commission also acknowledges that some originators and investors have argued that issuance and investment barriers in the EU securitisation market are partly driven by the conservativeness of specific aspects of the regulatory framework, such as transparency and due diligence requirements, as well as the capital and liquidity treatment of securitisations.

The Securitisation Consultation asks general questions of stakeholders under the following headings:

- **The effectiveness of the securitisation framework:** the focus is on whether the original policy objectives of the EU securitisation framework have been achieved or not;
- **Impact on SMEs:** the focus is on the impact of the EU securitisation framework on SME financing;
- **Scope of application of Regulation (EU) No. 2017/2402**Opens in new window **(as amended, the "EU Securitisation Regulation"):** covers jurisdictional scope, the definition of a securitisation transaction and the definition of sponsor; and
- **Additional general questions:** the questions relate to the functioning of the securitisation market and on wider aspects that may affect the securitisation activity and various segments of the

securitisation market in the EU.

The Securitisation Consultation also asks more specific questions of stakeholders under the following headings:

- **Due diligence requirements:** including questions relating to the costs incurred by investors in complying with the due diligence requirements set out in the EU Securitisation Regulation;
- **Transparency requirements and definition of public securitisation:** including questions relating to potential amendments to the definition of public securitisation and separately to potential amendments to the transparency requirements applicable to private securitisations;
- **Supervision:** including questions on streamlining supervision by national competent authorities to ensure more coordination and supervisory convergence;
- **The STS standard:** including questions on how to increase the attractiveness of the STS label for both originators and investors;
- **Securitisation platform:** the focus is on the potential establishment of a pan-European securitisation platform;
- **Prudential and liquidity treatment of securitisation for banks:** including questions on the conditions to be met for synthetic risk transfer (SRT) tests as framed in the **EU Capital Requirements Regulation**Opens in new window;
- **Prudential treatment of securitisation for insurers:** including questions around whether the prudential rules in the **EU Solvency II Directive**Opens in new window contain disincentives to investments in securitisation for insurers; and
- **Prudential framework for institutions for occupational retirement provision (IORPs) and other pension funds:** including questions around whether the **EU IORP II Directive**Opens in new window contains provisions which restrict IORPs' ability to invest in securitisations.

Outlook for 2025

The Securitisation Consultation closes on 4 December 2024. The European Commission has indicated that the responses to the Securitisation Consultation will provide guidance to the European Commission when preparing, if considered appropriate, a formal legislative proposal. We may see such a legislative proposal as early as the first half of 2025.

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EU Securitisation Framework – Significant Consultation Launched

Capital Markets Union – A Significant Development

On-Balance-Sheet STS Securitisations: EBA Publishes Guidelines

Sustainability-Linked Loans Financing Bonds

Current Status

The Loan Market Association (the "**LMA**") and the International Capital Market Association (the "**ICMA**") have recently provided welcome guidance on sustainability-linked loans financing bonds ("**SLLBs**" and each an "**SLLB**"). On 25 June 2024, the LMA and ICMA published **guidelines in relation to this type of bond instrument**Opens in new window (the "**Guidelines**").

The LMA and ICMA have published the Guidelines to encourage and promote the use of SLLBs in the market. The Guidelines provide detail and insights into core principles regarding the issuance and management of SLLBs. SLLBs are for issuers who want to finance or re-finance a portfolio of sustainability-linked loans (the "**SLLs**"), aligned with the **sustainability-linked loan principles**Opens in new window (the "**SLLPs**") published by the LMA and other industry bodies in February 2023. SLLs look to support a borrower in improving its sustainability performance. SLLs are any types of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) for which the economic characteristics can vary depending on whether the borrower achieves ambitious, material and quantifiable predetermined sustainability performance objectives.

The Guidelines contain four core components that SLLBs should align with, as follows:

1. **Use of Proceeds** – it is essential issuers are transparent and provide detailed information showing that the proceeds of the bonds are going towards SLLs. The Guidelines allow for the reality that many details of a portfolio of SLLs may need to remain confidential. They encourage issuers in this situation to disclose the eligibility criteria that they will use to select the SLLs for the portfolio. It is advised that issuers use the SLLPs when selecting eligible SLLs for the portfolio. The Guidelines provide detailed examples of approaches issuers can take in order to align with this component.
2. **Process for SLLs Evaluation and Selection** – issuers of SLLBs must ensure investors are provided with clear and attainable information regarding the issuer's process for evaluating and selecting the SLLs for the portfolio. The Guidelines outline that issuers should inform their investors of the governance structure in place to evaluate and monitor the activity involved in selecting the eligible loans.
3. **Management of Proceeds** – the Guidelines state that the net proceeds of the SLLB, or an amount equivalent to those net proceeds, should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer appropriately, as well as being attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for eligible SLLs. As long as the SLLB is outstanding, the balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible SLLs made during that period.
4. **Reporting** – the Guidelines state that it is vital that the issuer supplies transparent and credible information on the eligible portfolio of SLLs. This information should be renewed annually during the lifetime of the SLLB, including reports on where the proceeds have been allocated. The issuer's management of proceeds of the portfolio should be supplemented by use of an external auditor or third party to track the allocation of funds and ensure there is a credible internal tracking procedure in place.

The Guidelines recommend that issuers explain the alignment of their SLLB with these four core components in an SLLB framework and/or in their legal documentation. The Guidelines provide for clear guidance on issuing SLLBs by focusing on the process to be followed in order to achieve a credible portfolio of SLLs in line with the Guidelines and the SLLPs.

Outlook for 2025

The Guidelines are not mandatory. They are voluntary guidelines, created to give guidance to those who wish to issue SLLBs by providing a clear pathway in which to issue this type of instrument.

The use of current market-based green bond and social bond principles, such as **ICMA's Green Bond Principles**Opens in new windowand **ICMA's Social Bond Principles**Opens in new window, is prevalent in the bonds market. An unknown at this point is the likely breadth of adoption by issuers of the SLLB standards outlined in the Guidelines. We anticipate that adoption will be driven by factors such as investor appetite, reputational considerations, pricing impacts and the financial costs involved in meeting the new standard. The similarities between the SLLB standards and the current market-based green bond and social bond principles will assist current and prospective issuers of SLLBs in that regard.

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Sustainability – Linked Loans Financing Bonds – Guidelines Published

Recent Developments in the ESG Loan Market in Ireland

LMA publish model provisions for Sustainability Linked Loans

Important Development in Green Bond Market

Irish Covered Bonds

Current Status

On 18 September 2024, the **Government Legislation Programme**Opens in new window (the **"Autumn Legislative Programme 2024"**) for Autumn 2024 was published. There is a significant inclusion in the Autumn Legislative Programme 2024 in relation to Irish covered bonds (Asset Covered Securities as they are referred to under the Irish covered bonds legislation). The Autumn Legislative Programme 2024 references heads of bill (i.e. a document which sets out the main objectives, headings and provisions of proposed draft legislation) being prepared in relation to the following: ***Asset Covered Securities (Amendment) Bill*** *will amend the Asset Covered Securities Act 2001 to allow for the carrying on of Asset Covered Securities Business by Credit Institutions that are not restricted to the carrying on of Asset Covered Securities Business only; and to provide for related matters* [Direct Extract].

In recent years, various stakeholders have made representations to the Irish Department of Finance (the **"Department"**) requesting legislative changes to facilitate the issuance of covered bonds from the balance sheet of specialist covered bond subsidiary entities under a specialist banking model (the **"SBM model"**) **or** from existing non-specialist parent entities which could operate under a universal banking model (the **"UBM model"**).

Under Irish law, only the SBM model is currently permitted for issuing covered bonds : **Asset Covered Securities Act, 2001 (as amended)**Opens in new window. Under the SBM model, the business activities of covered bond issuers (who must be authorised credit institutions) are restricted to those directly relevant to their covered bond activities, such as issuing covered bonds, originating mortgage loans and related hedging activity. Arguably, the set-up and ongoing administrative costs of following the SBM model creates somewhat of a barrier to entry for certain would-be market participants. Some stakeholders have also argued that the SBM model creates material operational, reporting and governance inefficiencies for current market participants.

A number of EU jurisdictions permit the use of the UBM model for covered bonds. Under the UBM model, covered bond issuance and associated regulatory compliance does not need to be in a separate ring-fenced authorised credit institution. Covered bond issuers can be authorised credit institutions with unrestricted business activities.

Outlook for 2025

The reference to the ***Asset Covered Securities (Amendment) Bill*** and the above description of the proposed heads of bill contained in the Autumn Legislative Programme 2024 might prove to be an early indication that Irish law will in the future permit both the UBM model and the SBM model to be used by Irish issuers of covered bonds.

However, we will need to review the heads of bill in due course to establish what the intentions of the Department are in that regard. Moreover, all draft legislation is fully subject to scrutiny and potential amendment by the Irish Houses of the Oireachtas prior to its adoption.

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Irish Covered Bonds - A Significant Development

For further information on the above, please contact **Alma Campion**, **John Adams**, a partner in the **Finance and Capital Markets Department**or your usual Matheson contact.

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