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NEW UK SECURITISATION REGULATIONS - EDINBURGH REFORMS

HM's Treasury, the Prudential Regulation Authority ("PRA") and the Financial Conduction Authority ("FCA") have each this April released key elements to the first stage of the refresh of "The UK Securitisation Regulations". This is part of the Edinburgh Reforms which are part of the Government's ambition to capitalise on Brexit.

The headline for securitisation is that phase one of the Edinburgh Reforms refrains from making any drastic changes. There are changes which market participants may want to utilise going forward as well as helpful clarifications which will be generally appreciated by the sector. In this article, we will outline the regulatory background, then explore three noteworthy changes and finish by highlighting some key considerations.

THE REGULATORY BACKGROUND

Existing: the UKSR

Whilst the UK was part of the European Union (EU), the relevant regime for securitisation was the EU Securitisation Regulation (2017/2402/EU) ("**EUSR**"). After Brexit, EUSR became part of assimilated EU law as onshored by the European Union (Withdrawal) Act 2018 (as amended by the European Union (Withdrawal Agreement) Act 2020) ("**Old UKSR**").

Thus far, the Old UKSR (alongside binding technical standards) has regulated securitisation without diverging much from the EUSR. In December 2022, as part of the Government's 'Smarter Regulatory Framework', HM's Treasury, the PRA and the FCA released their tripartite regime, referred to as "The Edinburgh Reforms", to modernise the UKSR and thereby drive growth and competitiveness in the financial services sector ("**New UKSR**").

The New UKSR

Pillar One: New Regulations

The Securitisation Regulations 2024 (the "**2024 Regulations**", which were published on 30 January 2024) technically speaking are a statutory instrument to be enacted pursuant to the Financial Services and Markets Act 2023. They will be accompanied by a similar statutory instrument known as the Securitisation (Amendment) Regulations 2024 (the "**2024 Amendment Regulations**" and together with the 2024 Regulations the "**New Regulations**", which were presented in draft form on 22 April 2024). The New Regulations will constitute one of the three pillars of the New UKSR. The 2024 Amendment Regulations contain amendments to the 2024 Regulations - these mainly fill gaps in the 2024 Regulations and don't substantively alter them. The implementation date for the New Regulations is 1 November 2024 - which is effectively setting this up to be the date for the repeal of the Old UKSR and the introduction of the New UKSR.

Pillars Two and Three: New Rules

The two other pillars which support the New UKSR are the uniquely recognisable 'Rules'. The rules, which are authorised by the New Regulations, will be in two separate rulebooks: one overseen by the PRA (which will form part of the PRA Rulebook) ("**PRA Rules**") and the other overseen by the FCA (which will form part of the FCA Handbook) (the "**FCA Rules**" and the PRA Rules, the "**New Rules**"). The New Rules were published on 30 April 2024 by the FCA and PRA in policy statements. Most of the firm-facing provisions of the Old UKSR will be found in the Rules, which will apply from 1 November 2024, assuming the Old UKSR and related technical standards are revoked on the same date.

THREE NOTEWORTHY CHANGES

Disclosure, reporting and transparency

The PRA and FCA will each produce separate sets of templates for sell-side reporting, which will be identical and in line with the templates which exist under the Old UKSR. Disclosure obligations on sell-side participants

remain mostly as is under the Old UKSR. Some areas of difference include:

- The requirement for manufacturers (i.e., original lenders, originators, sponsors and/or securitisation special purpose entities) to make available certain information in draft and final form 'before pricing' has been clarified and expanded so that they must do so 'before pricing or original commitment to invest'. The original commitment to invest timing is more reflective of the reality of private and warehouse securitisations, where there is no clear point of pricing.

- A similar change applies for buy-side due diligence such that a distinction is drawn between primary and secondary market investors. The latter do not need to confirm whether primary investors received the requisite information. The secondary market need to only receive their due diligence information before they are committed to invest (rather than pricing, which may have occurred sometime in the past) i.e. the trade date.

Ongoing transparency requirements for UK originators remain as before, with quarterly reporting on exposures and prospectuses required for public transactions, except that UK originators may now provide required information in aggregated or anonymised form where necessary to comply with confidentiality obligations and/or the processing of personal information.

Risk retention

The New Rules match, for the most part, the risk retention requirements of the Old UKSR, notably in retaining the requirement for originators, original lenders and sponsors to hold a material net economic interest of at least 5% in each securitisation on an ongoing basis. The New Rules will, however, permit a change in retainer (i.e., the entity which holds the material net economic interest of at least 5%) or a transfer of the retained interest in the event of a retainer's insolvency.

The New Rules also clarify that there is no prohibition on hedging of the material net interest required to be retained where it is undertaken prior to securitisation as a legitimate element of risk management and does not compromise the incentive alignment effect of risk retention. For the similar reason that securitisations of own liabilities do not pose incentive issues in the same way as securitisations of assets, the New Rules also clarify that there is no need for risk retention in relation to securitisations of own liabilities.

The New Rules have made some subtle refinements to the approach to assessing whether an originator's "sole purpose" is securitising exposures, and so whether it is eligible to act as a risk retainer. In contrast to the mandatory requirements under the EU regulations, the New Rules set out a set of factors to be taken into account, implying a more principles-based approach.

In addition, the New Rules allow manufacturers to calculate the risk retention using the net value (i.e., the purchase price, rather than the nominal value) of exposures in non-performing exposure securitisation transactions where a non-refundable purchase price discount has been agreed (aligning with the approach adopted by EU regulatory authorities).

Due diligence

On the buy-side, the New Rules are moving towards a principles-based approach to verification of disclosure by manufacturers. Measures include the replacement of Article 5(1)(e) and Article 5(1)(f) of the Old UKSR with a single approach requiring verification by institutional investors that:

- the information received is sufficient to assess the risk of holding the securitisation position;

- at least the information required by the rules has been received; and

- there is a commitment from manufacturers to make further information available where appropriate.

To this end, the Rules include a table setting out the categories of information to be received by investors and no longer prescribe disclosure templates for buy-side entities (though these may remain relevant for compliance with sell-side transparency requirements).

In addition, the New Rules clarify that due diligence requirements may be delegated, but that responsibility for compliance does not shift except where the delegate is an institutional investor authorised in the UK.

<u>Some Key Considerations</u>

Application

The application of certain key provisions of the New Rules is stated expressly to be limited to entities, including manufacturers, established in the UK. The phrase 'established in the United Kingdom' is defined to mean an entity constituted under UK law with a head office or, if it has a registered office, in the UK (aligning to the definition used in the 2024 Regulations). It is

worth noting, however, that this definition does not apply to all provisions of the New Rules: chapters of the FCA Rules applicable to institutional investors are not limited by geographical scope (on the basis that institutional investors are authorised persons).

The PRA Rules clarify that all PRA-authorised manufacturers in securitisations which are established in the UK are subject to the relevant requirements (including non-Solvency II and non-CRR firms), mirroring the definition of 'established in the United Kingdom' to be included in the FCA Handbook.

Navigating multiple sets of rules

While the PRA Rules have retained the language of the Old UKSR, the FCA Rules have redrafted sections of the Old UKSR better to incorporate its provisions into the existing style and format of the FCA Handbook. Though the FCA Rules have not changed the substance of the adopted Old UKSR provisions, both buy-side and sell-side entities will need to adapt to the new format in which familiar rules are to be found.

More critically, the FCA Rules and PRA Rules will apply in parallel, meaning that a number of frequent participants in securitisations may have to comply with the provisions of both (as well as the provisions of the New Regulations). The helpful news for these entities, however, is that the FCA Rules and PRA Rules are, for the most part, aligned in terms of drafting following a concerted effort to align the drafting initially proposed. This should result in an easier comparison process than was the case following the FCA and PRA's first consultations in 2023.

Next steps

Though the new regime will come into force on 1 November 2024 (broadly, in relation, only, to securitisations issued from that date), the PRA and FCA have noted in their policy statements that further consultation on specific aspects of the regime with a broader remit for policy change will follow over the course of 2024 and possibly into 2025 (for example, in relation to the distinction between public and private securitisations and the associated disclosure templates).

It is worth noting that the transitional arrangements in place under the 2024 Regulations do not apply to some aspects of transactions such as delegation, meaning that market participants will want to prioritise review of their delegation arrangements in advance of the entry into force of the new regime on 1 November 2024. Though the 2024 Regulations will otherwise not apply to securitisations issued prior to 1 November 2024 (unless and until a new issuance occurs), both buy-side and sell-side entities will want to press ahead with familiarisation exercises and reviews of securitisation processes to be up to speed when the new regime enters into force.

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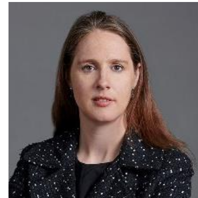

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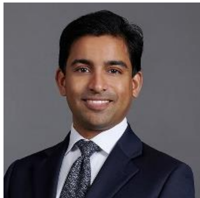

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