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Last but not least: consultation involvement key to avoiding regulatory divergence in public and private securitisations

In this In Practice article Kate Patane considers the growing divergence between EU and UK reporting obligations in public and private securitisations and how detailed feedback can drive internal "change management" processes and encourage the authorities to increase regulatory alignment.

DIVERGENCE?

Discussion on the definitions and disclosure reporting requirements for public and private securitisations in the UK and EU has commenced but there is no definitive timeline for change. Regulatory divergence between EU and UK reporting obligations has increased since 2021 and is likely to continue to grow.

If you or your client is a sell-side (i.e. originator, lender, sponsor or "securitisation special purpose entity") or buy-side (investors who fall within the definition of "institutional investor") party, it is important to be aware of the timeline for feedback and to provide the European Securities and Markets Authority (ESMA), the European Supervisory Authorities (ESA), the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) with supporting data analysis. Doing so will increase pressure on those authorities to increase alignment and mitigate the burden of dual compliance with EU and UK regulatory standards.

REGULATORY BACKGROUND

UK

The last few years have seen a tsunami of legislation in the UK in the securitisation arena. In the centre of that storm stands a key piece of legislation, the UK Securitisation Regulation. It is now assimilated "EU law" and comprises Regulation (EU) 2017/2402 (EU Securitisation Regulation) and relevant technical standards, as it forms part of UK law via Retained EU Law (Revocation and Reform) Act 2023.

The UK Securitisation Regulation applies to transactions which meet the definition of a "securitisation" where one or more sell-side or buy-side parties (market participants) are in the UK. However, due to the due diligence requirements placed on institutional investors, the UK Securitisation Regulation can have an indirect extraterritorial effect. For example, where EU sell-side parties to a securitisation are looking to market that securitisation to a UK institutional investor or lender, the EU party will need to comply with a number of the provisions of the UK Securitisation Regulation (as well as the EU Securitisation Regulation) so that the UK institutional investor can comply with their due diligence requirements under the UK Securitisation Regulation.

Most "assimilated EU law" relating to financial services (including the UK Securitisation Regulation) was repealed by the Financial Services and Markets Act 2023. The Securitisation Regulations 2024 will replace the UK Securitisation Regulation and create a "Smarter Regulatory Framework" within which the FCA and PRA can make rules in relation to securitisation.

As part of the framework, FCA Consultation Paper 23/17 (plus an addendum) and PRA Consultation Paper 15/23 were published covering, for example (although not exhaustive):

- principal measures relating to due diligence;
- risk retention;
- transparency and disclosure; and
- reporting.

Whilst suggestions were made by the PRA and FCA on the definitions of public and private securitisations, and whether the disclosure templates for private securitisations could be made more proportionate or principles based, it is not yet clear what changes will be made in these areas.

The second quarter of 2024 is the expected date the Securitisation Regulations 2024 will fully come into force alongside the new FCA and PRA rules. However, those awaiting clear reform to the reporting regime for private and public securitisations will have to await the second consultation, to be published later in 2024.

EU

In October 2022, the European Commission invited ESMA to review its standardised reporting templates in the EU with a view to addressing, amongst other things, technical difficulties in completing fields, removing unnecessary fields and aligning them more closely with investors' needs. ESMA published its consultation paper on 21 December 2023 inviting comments by 15 March 2024.

In essence, ESMA's consultation paper on the securitisation disclosure templates under Article 7 of the EU Securitisation Regulation outlined four options that ESMA can, in its consultation process, take in relation to disclosure templates. A targeted revision of the templates or a complete and thorough review of the disclosure framework would seem the most likely outcome. Either choice, however, will not be implemented in 2024; anywhere up to seven years is foreseeable.

CONCLUSION

The outcome of ESMA's consultation in the EU will not sync with the outcomes of the FCA and PRA consultations in the UK. This will result in regulatory divergence. Conflicts in wording and interpretation may also arise between the rules of the FCA and PRA causing even further confusion for market participants.

It leaves those needing to comply with both the EU and UK regulations no short-term answers but given the PRA and FCA in the UK are set to consult on the topic later in 2024, the timing may in the long term encourage the EU to be more flexible and address any inconsistencies. Alternatively, the more the UK continues to distance itself from EU regulation through its ongoing reform programme, the less likely it may be that the EU will see any benefit in attempting to minimise divergence. There is no certainty either way.

Whatever the timetable, proactivity is key! Detailed feedback given to the FCA, PRA, ESMA or ESA by entities and their counsel can drive internal "change management" processes as well as help mould the outcome of future legislation to suit business requirements. Without it, reform may be useless and there is a greater likelihood of regulatory divergence requiring greater modifications to training programs, systems, procedures and resources.

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