
# Recent updates to the UK Securitisation Framework

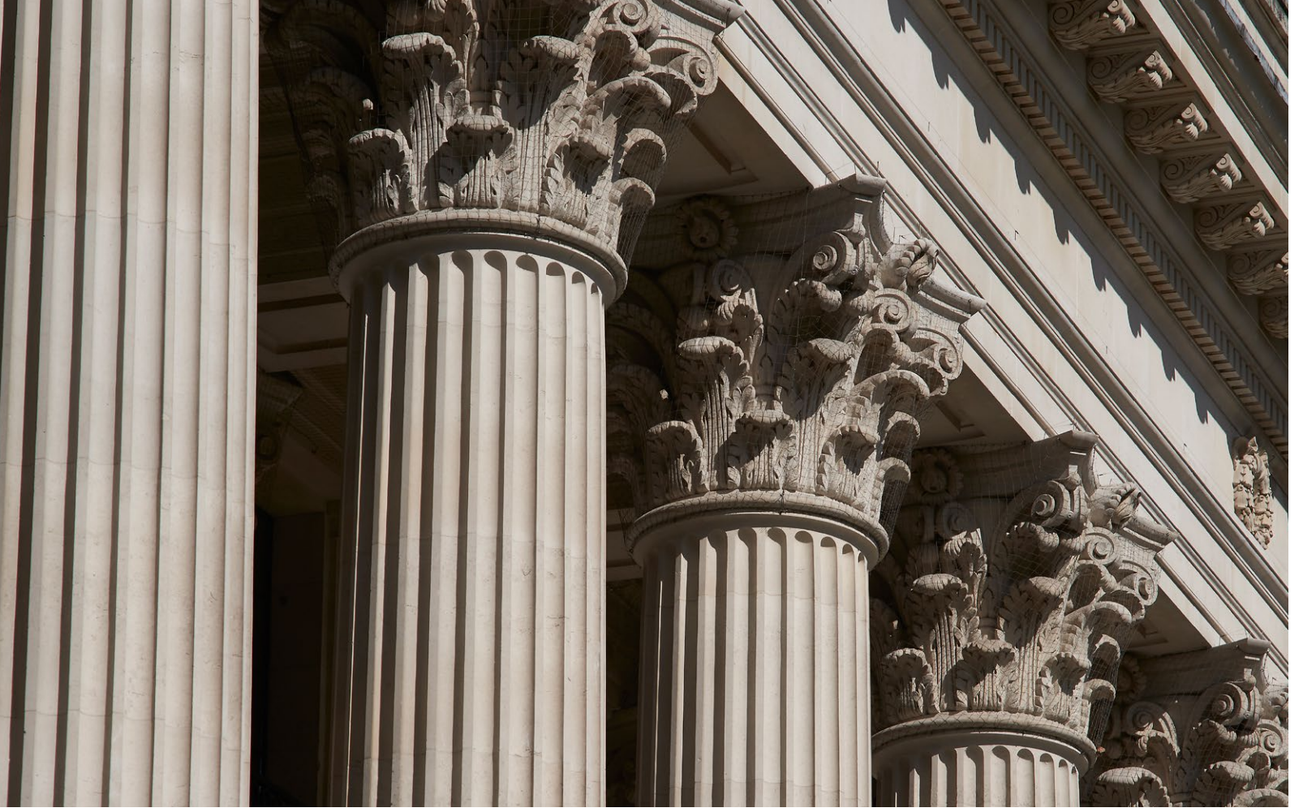
Following the end of transitional periods for the application of EU law in the UK, the last couple of years has seen some changes and proposals for change to both the EU and UK securitisation regimes. Up to this point, the core provisions on risk retention and disclosure have remained largely the same under the two regimes, and divergence has tended to take the form of additions to the legislation by the EU (eg servicer retention, STS for synthetic transactions). However, current proposals in the UK may change that, leaving dual compliance more complicated.

In this article, we review some of the key updates and proposals for change to the securitisation regulatory regime as part of what is known in the UK as the "Edinburgh Reforms".

## The Edinburgh Reforms

On 9 December 2022, the Chancellor of the Exchequer unveiled the "Edinburgh Reforms" of financial services. The Financial Markets and Services Bill ("**FSMB**") was introduced to Parliament on 20 July 2022, with the Chancellor's vision being to repeal and replace a large body of EU retained laws governing financial services: a bid to help growth and deliver a home-grown regulatory framework for the UK.

These reforms seek to, amongst other things, reform the ring-fencing regime for banks, overhaul the UK's regulation of prospectuses and reform the Securitisation Regulation. They will also create a "designated activities regime" ("**DAR**"), allowing the FCA to make rules specifying certain activities which are subject to supervision, even where an entity would not otherwise need to be authorised to carry out that activity. This concept will be broadly familiar to the securitisation market, since the activity of acting (for example) as an originator to a securitisation is already subject to supervision by the FCA even where an entity is not otherwise authorised. However, the DAR will give the FCA discretion to make rules about designated activities without legislative intervention.



## Repeal of the existing legislation: a new framework

The FSMB will seek to revoke the UK Securitisation Regulation and the onshoring regulations, replacing them with a statutory instrument, which is currently in draft form, named the Securitisation Regulations 2023. The intention is that the new legislation will operate alongside rules to be made by the FCA and the PRA: most of the firm-facing requirements (including key provisions like risk retention and disclosure) will be not restated in new legislation but will instead be replaced by FCA and PRA rules.

## Proposals for change

Following a review undertaken by the Treasury during 2021 ("**Treasury Report**") a number of reforms are proposed for the new legislation. The conclusions of the Treasury Report point to changes in the following areas:

- risk retention - for example in relation to (i) changes to the risk retention party and (ii) risk retention in securitisations of non-performing exposures;
- public/private distinction - clarifying the definitions of public and private securitisation, and potentially adjusting disclosure requirements for certain securitisations (by implication, private transactions);
- due diligence – greater clarity on the due diligence requirements for institutional investors when investing in non-UK securitisations;
- institutional investors - clarifying the definition of institutional investor as it relates to certain unauthorised non-UK Alternative Investment Fund Managers (AIFMs) who are currently in scope of due diligence requirements, and to address extraterritorial supervision and enforcement problems; and
- STS – introduction of a regime to recognise STS-equivalent securitisations issued by entities established outside the UK.

## Designated Activities Regime

The FSMB and Draft Securitisation Regulations will introduce a new DAR which is designed to enable the FCA to make rules in respect of activities, products or conduct which may not otherwise be regulated activities, and which apply to a broader range of entities than authorised persons. As entities which are not authorised may be the originator or issuer of a securitisation, the intention is for the new DAR to be the primary framework regulating participation in securitisation transactions in the UK.

The following will be designated activities under the DAR:

- acting as an originator to the securitisation;
- acting as a sponsor of a securitisation;
- acting as an original lender of a securitisation;
- acting as the securitisation special purpose entity (SSPE); and
- selling a securitisation position to a retail client located in the UK.

Much of the detail and rules around certain key aspects of the Securitisation Regulation (including due diligence, risk retention and disclosure requirements) will not be included in the primary legislation but instead included in rules of the FCA handbook. This will be a significant shift in the way securitisation is regulated in the UK, placing the power to make and adjust the rules in the hands of the regulator rather than the Treasury. It gives the FCA considerable power, but also flexibility – by contrast to the EU legislative framework where ESMA cannot deviate from positions taken in the "level 1" text, if the FCA were to consider that a rule requires revising it would be able to do so (subject to its own due process requirements in relation to consultation and impact assessment).

It remains to be seen how FCA rule making and supervision will play out in practice. The DAR could also impose over-arching obligations on securitisation market participants which are more similar to those imposed on regulated entities, such as a general obligation of transparency with the regulator, and the requirement to be able to demonstrate appropriate systems and controls in relation to compliance obligations.



## Public/private securitisations

The Draft Securitisation Regulations will replace the disclosure requirements set out in Article 7 of the Securitisation Regulation with rules made by the FCA and PRA. There is currently a note in the draft statutory instrument that the Treasury intend to maintain the exemption for certain private securitisations not to be required to report to securitisation repositories. It remains to be seen what clarifications will be introduced, although the Treasury Report indicated that distinguishing between public and private securitisations solely on the basis of whether a prospectus is required may not always be appropriate, and that there may be certain specific situations in which more flexibility as to the format and content of disclosures would be beneficial, provided there is still sufficient information disclosed.

## STS equivalence

The current Securitisation Regulation provides that the originator or sponsor of an STS securitisation must be established in the United Kingdom. The FSMB, however, proposes that the Treasury may designate a country or territory which can achieve equivalence status for non-UK securitisations.

A separate statutory instrument has also extended the temporary recognition of EU STS securitisations by another two years, to the end of 2024. This gives time for the FSMB and the related Treasury rules to be passed for recognition of non-UK STS transactions.

There are no proposals to provide for an STS framework for synthetic transactions, and the Treasury Report indicated that HM Treasury and the regulators are not currently minded to pursue these suggestions.

## Supervision of Occupational Pension Schemes

The proposals in the Draft Securitisation Regulations also seek to change the regulatory responsibility for supervising compliance of occupational pension schemes (OPS) of securitisation requirements. OPS are currently supervised by The Pensions Regulator (TPR), but following the repeal of the Securitisation Regulation, they will be supervised by the FCA for compliance with the securitisation requirements.

## Prudential Capital

Any discussion of securitisation regulation would not be complete without a word on capital treatment, which remains a key concern for the industry. At this stage, the Capital Requirements Regulation and Solvency II framework are not included within the scope of the Edinburgh reforms, although the UK is undertaking a separate reform process in relation to Solvency II.

In the Treasury Report, HM Treasury recognised that capital is a priority area for many respondents to the consultation, but said that any review of the treatment of securitisation for capital purposes must take place in the context of international Basel standards. The PRA's 2022 Basel 3.1 consultation did not make any proposals for alleviation of securitisation capital charges, although it acknowledged concerns regarding the application of the output floor to certain types of securitisations, and said that HM Treasury may separately consult on this during the output floor transition period.

## Timing

The Draft Securitisation Regulations are anticipated to come into force in 2023 at the earliest. The FSMB is still working its way through parliament, and has completed its third reading in the House of Commons. However, no draft of the FCA handbook rules which cover the key areas has yet been released. It will be important to monitor further developments closely.

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