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Legal Update

Regulatory Technical Standards on Homogeneity for STS transactions published in Official Journal

Introduction

The EU has, on 6 November 2019, published in the Official Journal a delegated regulation[1] (the **"Delegated Regulation"**) supplementing the EU Securitisation Regulation[2] (the **"Securitisation Regulation"**) with regard to regulatory technical standards (**"RTS"**) on the homogeneity of the underlying exposures in securitisation. The Delegated Regulation will enter into force 20 days after publication.

The STS Framework

The Securitisation Regulation has applied across the European Union (the **"EU"**) since 1 January 2019 to all securitisations (as defined therein) where the securities have been issued since that date (or in respect of securitisations which do not involve the issuance of securities, where the securitisation positions have been created since that date).[3]

The Securitisation Resolution includes criteria for "simple, transparent and standardised", or "STS" securitisations. There is a separate set of criteria which need to be met for non-ABCP and ABCP securitisations, and in the latter case, there are separate requirements with respect to ABCP transactions, sponsors of ABCP programmes and ABCP programmes. In addition, the originator, sponsor and securitisation special purpose entity (**"SSPE"**) need to be established in the EU in order for the securitisation to qualify as STS.[4]

If a securitisation is designated as STS[5] and provided that certain additional criteria under the Capital Requirements Regulation[6] (the **"CRR"**), as amended by Regulation 2017/2401,[7] are met, then an EU bank can obtain preferential regulatory capital treatment for its exposure to such a securitisation, as compared with the regulatory capital treatment for non-STS securitisations. A transaction qualifying as STS will also benefit from lower capital requirements for insurance and

1 Commission Delegated Regulation (EU) 2019/1851 of 28 May 2019 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards on the homogeneity of the underlying exposures in securitisation, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R1851&from=EN.

2 Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EC and Regulations (EC) No 1060/2009 and (EU) No 648/2012, available at https://eur-lex.europa.eu/legal-content/EN/TXT/%20%20%20PDF/?uri=CELEX:32017R2402&from=EN (hereinafter cited as "**SR**").

3 Please see our previous Legal Update, "The EU Securitisation Regulation – Where are we now?", for a more detailed discussion of the Securitisation Regulation as at June 2019, available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/06/eusecuritisationregulationwherearewenow_june19.pdf.

4 Following Brexit, a securitisation that meets all the other STS criteria but where any of the originator, sponsor or SSPE is established not in the EU but in the UK may not qualify as STS in the EU, although it may qualify as STS in the UK. Please see our Legal Update "Onshoring the EU Securitisation Regulation – How will it apply in the UK in the event of a no-deal Brexit?" for further information, available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/08/onshoringtheeuropeansecuritisationregulatoryregime_aug19.pdf.

5 A securitisation may be designated as STS by notification to ESMA using the required template, after which it will appear on the ESMA website.

6 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as amended.

7 Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation No 575/2013 on prudential requirements for credit institutions and investment firms, available at https://eur-lex.europa.eu/legal-content/EN/TXT/%20PDF/?uri=CELEX:32017R2401&from=EN.

reinsurance undertakings subject to regulation under Solvency II[8] and will be eligible for inclusion in high quality liquid assets by banks for the purposes of the CRR liquidity coverage ratio[9] (subject, in each case, to additional criteria being met), as well as being eligible for investment by money market funds subject to the Money Market Funds Regulation.[10]

As at the date of this Legal Update, over 90 transactions have been notified to the European Securities and Markets Authority (**"ESMA"**) as being STS, in a range of asset classes (auto loans and leases, residential mortgages, trade receivables, credit cards, consumer loans, SME loans and leases) and both public and private.[11]

The current STS framework does not apply to synthetic securitisations[12] but a consultation is under way with respect to the creation of an STS framework for balance sheet synthetic securitisations pursuant to a discussion paper (the **"Synthetic STS Discussion Paper"**) published by the European Banking Authority (the **"EBA"**) in September 2019.[13]

8 Commission Delegated Regulation (EU) 2018/1221 of 1 June 2018 amending Delegated Regulation (EU) 2015/35 as regards the calculation of regulatory capital requirements for securitisations and simple, transparent and standardised securitisations held by insurance and reinsurance undertakings.

9 Commission Delegated Regulation (EU) 2018/1620 of 13 July 2018 amending Delegated Regulation (EU) 2015/61 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions, Article 1(8) (amending Article 13 of Delegated Regulation 2015/61).

10 Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 amending and supplementing Regulation (EU) 2017/1131 of the European Parliament and of the Council with regard to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies, Article 1 (amending Article 13(1)(c) of Regulation (EU) 2017/1131 on money market funds).

11 For a list of securitisations notified as being STS, please see the ESMA register available at https://www.esma.europa.eu/policy-activities/securitisation/simple-transparent-and-standardised-sts-securitisation.

12 "synthetic securitisation" is defined in Article 2(10) SR as "a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator". By contrast, "traditional securitisation" is defined in Article 2(9) SR as "a securitisation involving the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to an SSPE or through sub-participation by an SSPE, where the securities issued do not represent payment obligations of the originator".

13 Discussion Paper – Draft Report on STS Framework for Synthetic Securitisation Under Art. 45 of Regulation (EU) 2017/2402, published on 24 September 2019 and available at https://eba.europa.eu/regulation-and-policy/securitisation-and-covered-bonds/discussion-paper-on-sts-framework-for-synthetic-securitisation-under-art.-45-of-regulation-eu-2017/2402. For further information, please see our Legal Update "EBA consults on the creation of an STS framework for synthetic securitisations", available at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/10/eba-consults-on-the-creation-of-an-sts-framework-for-synthetic-securitisations_oct19.pdf.

The EBA has published a set of guidelines with respect to the ABCP and non-ABCP STS criteria (the **"EBA Guidelines"**).[14]

The Homogeneity Requirement

One of the STS criteria for both non-ABCP transactions[15] and ABCP transactions[16] is that the securitisation must be backed by "*a pool of underlying exposures that are homogeneous in terms of asset type, taking into account the specific characteristics relating to the cash flows of the asset type including their contractual, credit-risk and prepayment characteristics*". The Synthetic STS Discussion Paper also contains a proposed criterion in relation to homogeneity.

The Recitals to the Securitisation Regulation explain the overall purpose of the homogeneity requirement as follows: "*To ensure that investors perform robust due diligence and to facilitate the assessment of underlying risks, it is important that securitisation transactions are backed by pools of exposures that are homogenous in asset type, such as pools of residential loans, or pools of corporate loans, business property loans, leases and credit facilities to undertakings of the same category, or pools of auto loans and leases, or pools of credit facilities to individuals for personal, family or household consumption purposes.*"[17]

The EBA was required, in close cooperation with ESMA and EIOPA,[18] to develop draft RTS specifying which underlying exposures are deemed to be homogeneous. The EBA published its final draft RTS on homogeneity on 31 July 2018[19] and the European Commission published the Delegated Regulation based on the draft RTS on 28 May 2019.

14 Final Guidelines on STS criteria for non-ABCP securitisation and Final Guidelines on STS criteria for ABCP securitisation, available at https://eba.europa.eu/regulation-and-policy/securitisation-and-covered-bonds/guidelines-on-the-sts-criteria-for-abcp-and-non-abcp-securitisation.

15 Article 20(8) SR.

16 Article 24(15) SR.

17 Recital 27 SR.

18 The European Insurance and Occupational Pensions Authority.

19 EBA Final Draft Regulatory Technical Standards On the homogeneity of the underlying exposures in securitisation under Articles 20(14) and 24(21) of Regulation (EU) No 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, available at: https://eba.europa.eu/sites/default/documents/files/documents/10180/2298183/1ecb2150-fd3d-4aef-ac8f-393dc314deea/Draft%20RTS%20on%20homogeneity%20of%20underlying%20exposures%20in%20securitisation%20(EBA-RTS-2018-02%20).pdf.

The Delegated Regulation

The Delegated Regulation sets out four conditions for the underlying exposures in a securitisation to be considered homogeneous:

(i) they fall within the same specified asset type[20];

(ii) they have been underwritten according to similar underwriting standards for assessing the associated credit risk;

(iii) they are serviced according to similar procedures for monitoring, collecting and administering cash receivables; and

(iv) at least one of the applicable "homogeneity factors" for such asset type is applied.

The rationale for using these conditions is explained in the Recitals to the Delegated Regulation.

As regards asset types, it is stated that a pool of underlying exposures should only be considered homogenous where it contains exposures of a single asset type. As a result, distinct asset types have been identified, based on market practice. Furthermore, there is also a category for underlying exposures which do not correspond to one of those asset types, but that are considered by the originator or sponsor to constitute a distinct asset type.

The Recitals state that underwriting standards are designed to measure and assess the credit risk associated with the underlying exposures and are therefore useful indicators of their homogeneity. Consequently, the application of similar underwriting standards is an indicator of similar risk profiles.

The Recitals also recognise the fact that the servicing of underlying exposures has a substantial impact on the cash flows expected from those exposures. If similar procedures, systems and governance are used with respect to the servicing of the underlying exposures, this should allow an investor to confidently assess the impact of the servicing within similar parameters.

The specified "homogeneity factors" vary according to the asset type. One or more of the homogeneity factors should be applied on a case-by-case basis. They include factors relating to the type of immovable property and the ranking of security rights (with respect to residential or commercial mortgages) or the type of obligor (with respect to other asset types) and the jurisdiction of such properties or obligors.

In the case of credit facilities provided to individuals for personal, family or household consumption purposes, and trade receivables, it was determined that those asset types are sufficiently homogeneous provided that similar underwriting standards and servicing procedures are applied, and it is not necessary for a homogeneity factor to apply. This is on the basis that requiring homogeneity factors to apply to those asset types would lead to excessive concentrations in the relevant securitised portfolios.

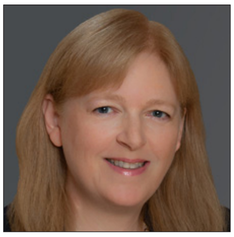
In the event that there are changes in the characteristics of the underlying exposures for reasons outside of the control of the originator or the sponsor after origination, this will not prevent such exposures from being deemed to be homogeneous.

Mayer Brown has advised in relation to a number of STS transactions. Please contact us if you would like to discuss any of the matters referred to in this Legal Update.

20 The specified asset types are as follows:
(i) residential loans that are either secured by one or more mortgages on residential immovable property or that are fully guaranteed by an eligible protection provider;
(ii) commercial loans that are secured by one or more mortgages on commercial immovable property;
(iii) credit facilities provided to individuals for personal, family or household consumption purposes;
(iv) credit facilities, including loans and leases, provided to any type of enterprise or corporation;
(v) auto loans and leases;
(vi) credit card receivables;
(vii) trade receivables; and
(viii) other underlying exposures that are considered by the originator or sponsor to constitute a distinct asset type on the basis of internal methodologies and parameters.

Please note that commercial mortgage-backed securitisation transactions (CMBS) and other transactions where the repayment of the holders of the securitisation positions is predominantly dependent on the sale of the assets, together with managed CLOS (involving active portfolio management of the exposures on a discretionary basis), are not capable of being STS.

Contacts



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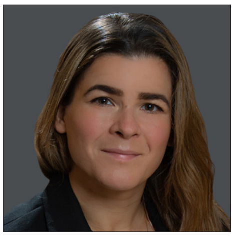

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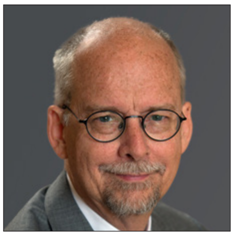

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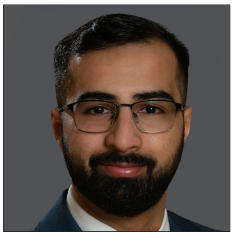

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