CLIENT ALERT

New UK Securitisation Regulations to Enter into Force in November 2024

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The UK's existing Securitisation Regulation (the "**Existing SR**") will be replaced as part of the UK government's ongoing post-Brexit "Smarter Regulatory Framework".[1] The Existing SR will, from 1 November 2024, be replaced by the Securitisation Regulations 2024 (as amended by the Securitisation (Amendment) Regulations 2024) (together, the "**Securitisation Regulations**"), new rules of the Prudential Regulation Authority (the "**PRA**") (the "**PRA Rules**"[2]) and new rules of the Financial Conduct Authority (the "**FCA**") (the "**FCA Rules**"[3]) (the Securitisation Regulations, the PRA Rules and the FCA Rules, together, the "**New Rules**").

As had been widely expected, the New Rules largely preserve the existing UK securitisation regulatory framework, however, there are a number of policy changes being implemented, which will result in divergence from the existing EU securitisation framework on which the Existing SR was based (the "**EU Rules**").

The New Rules apply to entities established in the UK and are important for those UK-established entities in scope, which include alternative investment fund managers ("**AIFMs**"), banks, building societies, insurance companies, the trustees or managers of occupational pension schemes ("**OPS**") and investment firms.

1 The "Smarter Regulatory Framework" will involve the eventual revocation of all assimilated (previously "retained") EU law for financial services.

2 This briefing does not explicitly refer to the PRA Rules, which apply to PRA-authorised persons, including banks, building societies and insurance companies, but the PRA Rules largely align with the FCA Rules in policy and substance.

3 As set out in the FCA's Policy Statement PS24/4 (https://www.fca.org.uk/publication/policy/ps24-4.pdf). The FCA Rules include the new Securitisation Sourcebook (SECN), which will form part of the FCA Handbook. They also contain a helpful annex detailing where the provisions of the Existing SR can be found in the FCA Rules or Securitisation Regulations, as applicable, and whether such provisions have been retained unamended or transferred subject to amendment.

1. Application of the New Rules

The New Rules will be relevant for UK entities which are:

- authorised firms that are involved in securitisation markets either as institutional investors or as "manufacturers" (i.e. original lender, originator, sponsor and/or securitisation special purpose entity ("**SSPE**") of securitisations);
- unauthorised entities acting as an original lender, originator or SSPE of securitisations subject to the Existing SR;
- sellers of securitisation positions to retail clients;
- individuals holding offices or positions involving responsibility for taking management decisions at firms involved in securitisation markets;
- persons applying to be third-party verifiers; and
- securitisation repositories as well as those applying to be securitisation repositories.

2. Key Aspects of the New Rules

While the New Rules have mostly preserved the current requirements, certain of the FCA's amendments to the Existing SR's provisions were intended to effect substantive policy changes. The FCA has said that the outcomes it is seeking from these policy changes include making the Existing SR more proportionate, removing barriers to the issuance of, and investment in, securitisations and providing a clearer framework within which the market can operate.

The key policy changes are summarised below and divergence from the Existing SR, and therefore from the EU Rules, is highlighted where notable.

Designated Activities Regime

Under the Securitisation Regulations, the activities of acting as an originator, sponsor, original lender or SSPE of a securitisation, or selling a securitisation position to a retail client in the UK will be "designated activities" under the new FCA-designated activities regime. This means that the FCA Rules will apply to unauthorised manufacturers of securitisations.

Due Diligence Requirements

Definition of "Institutional Investor"

Under the New Rules, the FCA is taking a more principles-based and proportionate approach to the disclosure institutional investors must obtain from manufacturers of securitisations than under the Existing SR. This applies to both UK

securitisations and non-UK securitisations. As a result of these changes, institutional investors will no longer need to be concerned about the format of the due diligence report provided to them by manufacturers, but instead will have to verify that (i) the information listed in the FCA Rules has been provided to them by the relevant manufacturer of securitisations, (ii) such information is sufficient to enable them to independently assess the risks of holding the securitisation position and (iii) the manufacturer has committed to make further information available on an ongoing basis, as appropriate. The information and frequency of such information is set out at a high level in the FCA Rules, but without the need for a templated format to be completed by institutional investors. These are welcome changes from the Existing SR and the EU Rules.

The FCA Rules will not apply to trustees or managers of OPS, who will instead need to refer to the Securitisation Regulations for their due diligence obligations. These will be monitored and enforced by the Pensions Regulator.

Delegation of Due Diligence

The New Rules clarify that a UK institutional investor may delegate its due diligence obligations to any other person (not just to other UK institutional investors), however, it will only be able to rely on any delegate where the delegate is a UK institutional investor. Otherwise, such delegating UK institutional investor will continue to be responsible for its due diligence obligations. This will likely have implications for existing delegation arrangements, for example, where a UK institutional investor delegates due diligence responsibility to an EU AIFM. In such circumstances, the UK delegating party would either have to find a new UK delegate institutional investor or accept that responsibility for compliance does not shift to the EU AIFM.

The trustees and managers of OPS do not count as institutional investors for the purposes of reliance.

Timing of Due Diligence Disclosure

The New Rules set out that the due diligence materials (e.g. transaction documents, transaction summaries and STS notifications) must be made available: (i) in draft form, before pricing or the initial commitment to invest and (ii) in final form, within 15 days of closing.

In another sensible change from the previous rules, secondary market investors only need to conduct the relevant due diligence before committing to invest (as opposed to conducting due diligence on documents from the time of the initial pricing or commitment to invest). The EU Rules do not make this distinction for secondary market investors and only refer to a “before pricing” obligation.

Risk Retention

Sole Purpose Test

The New Rules specify the following factors, which must be taken into account when assessing whether an entity has been established or operates *"for the sole purpose of securitising exposures"*, and is, therefore, not permitted to act as the risk retainer:

- the entity has a business strategy and the capacity to meet payment obligations consistent with a broader business model, relying neither on the exposures being securitised, nor on any interests retained or proposed to be retained; and
- the members of the management body have the necessary experience to enable the entity to pursue the established business strategy, and the entity has adequate corporate governance arrangements.

These factors should remove some of the uncertainty present in the EU Rules, where the test for whether or not an entity has been established or operates "for the sole purpose of securitising exposures" depends, among other things, on whether or not the entity relies on the securitised exposures as its "sole or predominant source of revenue".

Resecuritisations

Securitisations containing securitisation positions as underlying exposures ("**resecuritisations**") are prohibited except in certain narrow circumstances. The New Rules set out two carve-outs from the prohibition on resecuritisations for risk retention purposes: (i) the retranching by the securitisation's originator of an issued tranche into contiguous tranches and (ii) fully supported asset-backed commercial paper programmes.

In permitted resecuritisations, the risk retention rules must generally be complied with at both transaction levels (i.e. the underlying securitisation and the resecuritisation). However, the originator of a resecuritisation is not obliged to comply with the risk retention requirements at the transaction level of the resecuritisation if: (i) that originator is also the originator and retainer of the underlying securitisation, (ii) the resecuritisation is backed by a pool of exposures comprising solely exposures or positions retained in the underlying securitisation in excess of the required minimum net economic interest, and (iii) there is no maturity mismatch between the underlying securitisation positions or exposures and the resecuritisation.

Transfers of Risk Retainers

Transfers of risk retainers are often relevant in the context of restructuring and takeover and acquisition transactions. The New Rules will allow the retained risk to be transferred to a new retainer in the event of the retainer's insolvency or pursuant to retention on a consolidated basis. This exception to the prohibition on the transfer of retained risk is narrower than the

EU Rules, as it does not allow for risk retainer transfers in circumstances where the retainer, for legal reasons beyond its control, is unable to continue acting as the retainer.

Hedging Against Retained Risk

The New Rules permit the retainer to hedge the retained risk if it is undertaken prior to the securitisation as a prudent element of granting credit or risk management and does not create a differentiation for the retainer's benefit between the credit risk of the retained securitisation positions or exposures and the securitisation positions or exposures transferred to investors.

"Cherry-Picking"

The New Rules retain the general prohibition against originators "cherry-picking", that is, selecting assets to transfer to the SSPE in order to render the losses on those assets, measured over the life of the transaction, or over a maximum of four years where the life of the transaction is longer than four years, higher than the losses over the same period on comparable assets held on the balance sheet of the originator. As an exception, originators may select assets to be transferred to the SSPE that have a higher-than-average credit risk profile as compared to the comparable assets, if any, that remain on the balance sheet of the originator, provided that the higher credit risk profile of the assets transferred to the SSPE is clearly communicated to investors or potential investors.

Exemption for CRR and UK Solvency II Firms for Synthetic Securitisations/Contingent Risk Retention

The New Rules provide an exemption for "CRR" and "UK Solvency II Firms" (as each term is defined in the FCA Handbook and primarily banks and insurance companies) from the general requirement to fully collateralise in cash and hold on a segregated basis as client money risk retained on a synthetic or contingent basis.

3. Conclusions

While the New Rules do not yet represent a major divergence from the previous UK or current EU regimes, they do include a number of notable changes, which in some cases seek only to clarify previously unclear provisions. In preparation for the entry into force of the New Rules, institutional investors should assess whether they need to revisit their delegation arrangements given the changes to responsibility for delegated due diligence duties described above.

More substantive changes may well be on the way in 2025, when the FCA plans to consult on the possible enhancement of ESG reporting for securitisations and adjusting the distinction between "public" and "private" securitisations. The latter could reduce the burdensome reporting regime currently applicable to private securitisations and would be a welcome step forward in the FCA's stated aim of making the reporting regime more proportionate.

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