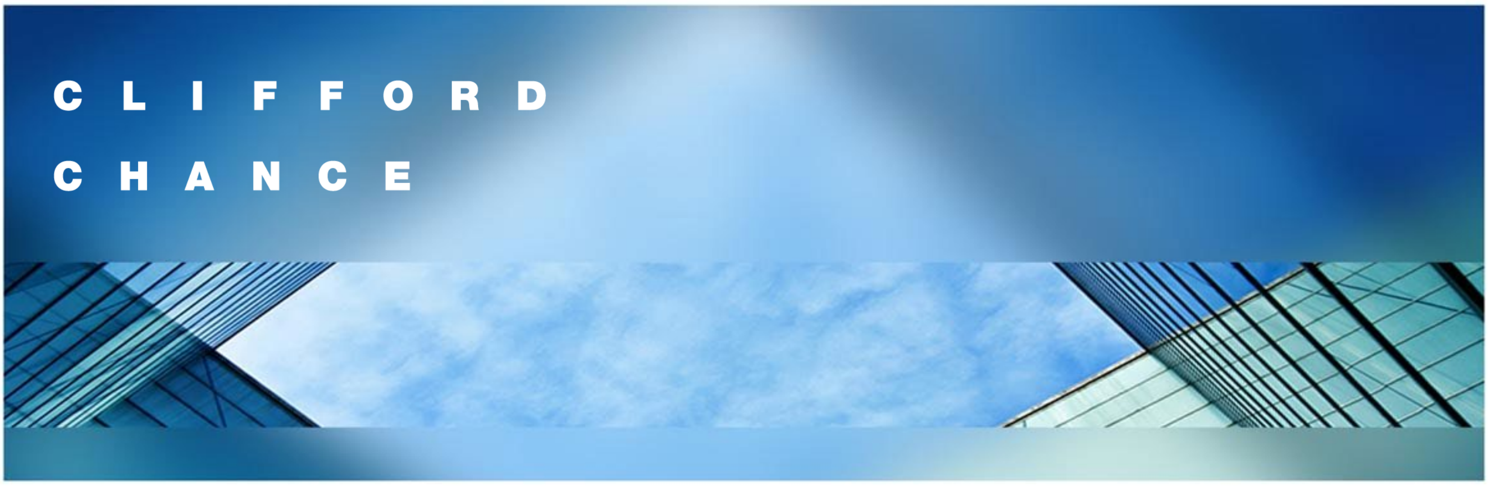

NEW UK SECURITISATION RULES – IT'S (MOSTLY) GOOD NEWS

Following consultations last year, the UK's financial regulators have now published new rules for securitisation to apply from 1 November 2024. In this briefing we highlight the key points of the new rules and what's changed since the consultations.

Key issues

- New securitisation rules will apply in the UK from 1 November 2024
- Securitisations closed before 1 November 2024 will broadly be grandfathered out of the new rules
- Many of the main comments made by industry in response to the consultations have been taken on board by the FCA and the PRA
- Much remains to be played for in advance of the second round of consultations expected in late 2024 or early 2025

BACKGROUND

On 30 April 2024, the Financial Conduct Authority published its PS 24/4: Rules relating to securitisation at the same time as the Prudential Regulation Authority published its PS 7/24 – Securitisation: General requirements. These are the final rules made by the regulators to replace the assimilated EU Securitisation Regulation with domestic law as part of the Government's wider "Smarter Regulatory Framework" initiative.

WHERE HAVE WE ENDED UP?

The FCA and the PRA consulted on the new securitisation rules last year over late summer and early autumn.[1] As a starting point, it's important to remember that the rules were always going to continue to bear a significant resemblance to the Securitisation Regulation regime the industry has got used to over the last five and a half years or so. The FCA and the PRA consulted on a relatively small number of policy changes, and the PRA's draft rules instrument was so similar to the existing Securitisation Regulation that it even largely preserved the structure and numbering from that regime.

As you would expect given that a whole new set of rules was being set up for securitisation, there was broad industry interest and a number of responses were filed. Looking at the final policy statements from the regulators, it is clear that the majority of the industry's major comments have been taken into account by the regulators and quite a number of helpful changes have been made. The highlights of the new rules (focussing on helpful changes since the consultations) are set out below.

Structural and timing points

- **1 November 2024 implementation date:** Perhaps the most widely repeated comment in response to the consultation was to request six months between publication of the new rules and their implementation. The regulators have delivered on that (even providing an extra day!).

[1] The FCA's consultation paper is available here and our briefing on it is here. The PRA's consultation paper is available here and our briefing on it is here.

- **Transitional provisions:** Another widely requested change in response to the consultation papers was for transitional provisions. The regulators have responded to this as well. They have provided wide-ranging transitional provisions that largely preserve the existing rules for transactions that close before 1 November 2024. The main exception to this is that investors who have delegated their due diligence to non-UK managers won't have the formal delegation of regulatory responsibility continue past that date.
- **Matched rule drafting:** Perhaps the most heavily criticised aspect of the rules consulted on was that the FCA and PRA (and in some cases HMT) made rules covering the same ground, but in different terms. The FCA and PRA have also sought to address this, with the FCA moving very significantly toward PRA drafting in its final rules in areas where the rules overlap.[2] This is a significant move and represents a substantial amount of effort on the part of the FCA to smooth the process of moving to the "Smarter Regulatory Framework" for market participants. Nonetheless, due to the effect of small differences (including formatting differences), and contextual elements such as different defined terms, our initial view is that it will still be necessary to analyse the rules separately, albeit that this should now be easier.
- **Existing EU guidance and recitals:** Industry had pointed out that pre-existing EU guidance (so-called "level 3") as well as the recitals to EU legislative instruments were still used to help interpret legislation. Given that the new regime largely preserves the substance of the existing regime, industry asked for a clear statement about the status of these interpretive aids. Broadly, the FCA and PRA confirmed there had been no change to their existing positions about pre-Brexit EU guidance (you can use it except where it has been withdrawn or superseded). They made no such statement in respect of recitals, preferring to include text reflecting the effect of those recitals in the operative text of the new rules where relevant.
- **Geographic scope:** Although the policy had always been clear, market participants had raised concerns at consultation stage that the rules were not necessary clear enough to limit their geographic scope. This has now been fixed, with the rules broadly only applying to entities established in the UK.

Due diligence and disclosure points

The changes to simplify the due diligence rules were widely welcomed in the market and the policy remains unchanged. The changes to the disclosure rules were only minor, but also broadly positively received. The exception to this was a rule change proposed only by the PRA that seemed to remove the ability to limit disclosure in order to protect confidentiality. A few helpful changes have been made:

- **Confidentiality:** The PRA have taken on board market pushback and have reverted to the existing language to do with confidentiality. This is not totally ideal, since even the existing language had quite a bit of ambiguity in it, but it is a significant improvement on the consultation position, which would have caused significant difficulties for a range of (mostly private)

[2] The separate due diligence rules that will apply to occupational pension schemes are not quite so similarly drafted, but are broadly similar in substance. These rules are set out in a draft Securitisation (Amendment) Regulations 2024 laid before both houses of Parliament on 22 April 2024. Our briefing on that subject is available here.

securitisations that depend for their commercial viability on the ability to honour confidentiality commitments. Market participants had also suggested that the rule should specifically preserve the ability to comply with confidentiality obligations imposed on transaction parties by laws outside the UK, but the authorities appear to have declined to do this.

- **Timing of disclosure/diligence:** Certain market participants pointed out that the concept of "pricing" didn't sit comfortably with the way private deals were done, making it awkward to comply with obligations to disclose matters (or verify those matters were disclosed) before pricing. These obligations have been adjusted for both disclosure and due diligence obligations so that those things need to happen "before pricing <u>or commitment to invest</u>", which is potentially a helpful clarification. We note that there is some potential for confusion here with, e.g., the time commitment letters are signed (very early in the transaction) but it seems clear there is a regulator intention that the new language is intended to cover something more like the signing of final transaction documents.
- **Primary/secondary market distinction:** Likewise on timing, the old rules (and those consulted on) made no distinction between a primary market investor and a secondary market investor, so even the latter was required to check information had been provided before pricing. This wasn't particularly sensible. Under the new rules, secondary market investors merely need to check they have information before they are committed to invest.
- **Delegation of due diligence:** This is broadly as expected, but has now been clarified. The result is that institutional investors who are subject to regulatory due diligence obligations are permitted to delegate that due diligence to anyone they like. However, the relevant institutional investor remains responsible for any failure to comply *unless* the delegation is to another UK institutional investor regulated by either the FCA or the PRA.

Risk retention points

The main change in this respect that the authorities consulted on was to facilitate risk retention on securitisations of non-performing exposures. This change has been preserved. In addition, two separate, detailed points have been adjusted since the consultation phase:

- **Prohibition on hedging:** A clarification has been inserted that hedging is permitted where it is undertaken prior to the securitisation as part of prudent credit granting or risk management and does not create a differentiation for the retainer's benefit between the exposures it retains and those transferred to investors.
- **Securitisation of own-issued debt:** This is one of the recitals the authorities considered should be made operative. This new provision deems risk retention to be complied with where an entity securitises a pool consisting entirely of its own debt.

WHAT ARE THE NEXT STEPS?

While we and others in the market will continue to digest today's announcements and new issues will no doubt arise, the broad picture is a positive one. The FCA and the PRA have shown themselves to be sensible and responsive to market input. The work now begins to fully digest the new rules and put systems in place for compliance ahead of the 1 November 2024 implementation date. Institutional investors with delegation arrangements in place will also need to consider whether they need to revisit those arrangements in light of changes to delegation rules, and the lack of grandfathering in that respect.

Finally, there is also "batch 2" to think about. A large number of industry comments were not acted upon in the current version of the rules, but regulators have said they will be taken into account for future policy development. We know that a second round of consultation is coming in late 2024 or early 2025 (our bet is on 2025) covering at least the new disclosure rules, which we expect to expand the category of deals subject to "public" securitisation rules and pare back the currently onerous disclosure rules relating to private securitisations at the very least. We think it is also likely that other policy changes will be consulted upon at that time, including possible changes to ESG reporting and further changes to due diligence and risk retention rules.

All this to say, continue to watch this space!

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