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United Kingdom

SECURITISATION

Contributor

Slaughter and May

Guy O'Keefe

Partner | guy.okeefe@slaughterandmay.com

Oliver Wicker

Partner | oliver.wicker@slaughterandmay.com

Richard Jones

Partner | richard.jones@slaughterandmay.com

David Thomas

Senior Associate | david.thomas@slaughterandmay.com

Kate Patane

PSL | kate.patane@slaughterandmay.com

This country-specific Q&A provides an overview of securitisation laws and regulations applicable in United Kingdom.

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UNITED KINGDOM
SECURITISATION

1. How active is the securitisation market in your jurisdiction? What types of securitisations are typical in terms of underlying assets and receivables?

There has been a very active securitisation market for UK-originated assets for several decades. According to data published by the Association for Financial Markets in Europe, the value of outstanding securitisations in markets in the UK, as at the end of Q3 2023, was EUR 222.7 billion.

Both traditional securitisations (also known as 'cash securitisations' and 'true sale securitisations', in which ownership of the underlying assets is transferred from the originator to a securitisation special purpose entity (SSPE)) and synthetic securitisations (in which ownership of the underlying assets remains with the originator but risk transfer is achieved by the use of credit derivatives or guarantees) are common. Both long term securitisations, funded through the issuance of notes with a maturity of over a year, and asset backed commercial paper securitisations, funded through the issuance of shorter dated commercial paper, are used. Structural and regulatory considerations differ according to the type of transaction. Our answers below are focused on long term cash securitisations, and additional considerations apply in respect of synthetic or asset backed commercial paper transactions.

2. What assets can be securitised (and are there assets which are prohibited from being securitised)?

In addition to residential and commercial mortgages, credit cards, personal and auto loans, commercial/trade receivables and corporate loan portfolios (all of which are commonly securitised in the UK and other jurisdictions), other asset classes that have been securitised in the UK include lease and rental receivables, IP royalty receivables, insurance receivables, healthcare receivables, ticket receivables, receivables from public utilities, mobile handset loan receivables and student loan receivables.

From a commercial perspective, any type of receivable or asset pool (ideally homogenous) can be securitised, provided it has a defined or identifiable cash flow which can be financially modelled and risk assessed. However, two restrictions are worth noting.

Firstly, originators cannot select assets to transfer to the securitisation special purpose entity (SSPE) in order to render the losses of those assets to the SSPE, measured over the life of the transaction or over 4 years (if transactions are longer), higher than the losses over the same period on the comparable assets held on the balance sheet of the originator. This restriction on what the is commonly referred to as 'cherry picking' of assets by originators is intended to align their interests with those of the investors and serves a similar purpose to risk retention requirements.

Secondly, resecuritisations are prohibited unless regulatory permission is obtained.

In 2023, the Financial Conduct Authority (the FCA) consulted on the first of these restrictions in Consultation Paper 23/17 as did the Prudential Regulation Authority (the PRA, and together with the FCA, referred to as the Regulators) in Consultation Paper 15/23. In their consultations, the Regulators proposed to clarify the meaning of "comparable assets" for these purposes with a view to aligning with market practice and the European risk retention technical standards. Clarifications proposed include:

(a) requiring that comparability be assessed based on similar factors as between securitised and non-securitised assets, by reference to predicted future performance;

(b) deeming the requirements to be satisfied where the originator securitises all comparable assets; and

(c) taking into account compliance with origination systems and controls.

In addition, an exception in the case of NPL securitisations was proposed, where the securitised assets, as a whole, have a higher risk profile compared to other assets classes on the originator's balance sheet and the non-refundable purchase price discount of such assets is communicated to investors.

3. What legislation governs securitisation in your jurisdiction? Which types of transactions fall within the scope of this legislation?

Legislative Framework

The current UK regulatory framework for securitisation, widely referred to (including by the Regulators) as the "UK Securitisation Regulation" or the "UK Sec Reg" is a minimally amended version of Regulation (EU) 2017/2401 (the EU Securitisation Regulation) as it was on 31 December 2020 (the Implementation Date) when the UK left the European Union, together with related EU "level 2" and "level 3" texts that were legally binding as at such date. The minimal amendments relate primarily to jurisdictional requirements, scope and the way in which data must be reported. However, the securitisation regulatory frameworks in the EU and UK were, as at the Implementation Date, otherwise largely identical. Where regulatory guidance existed as at such date, the Regulators have confirmed their expectation that it be followed.

If, in a securitisation, all key sell-side entities (in particular, the originator, original lender, SSPE and, if applicable, the sponsor) are established in the UK, subject to the need to target non-UK investors, the UK's regulatory framework (and not the regulatory framework of any other jurisdiction) would be the only regulatory framework that applies. I.e. it would be the UK's regulatory framework that requires sell-side entities to retain risk and provide investor reporting in a prescribed manner. The UK is, however, part of the broader European securitisation market and it would be typical for UK securitisations to target investors across Europe. The EU securitisation framework applicable to EU investors (and related regulatory guidance) means that for such a securitisation to be investable by EU investors, those EU investors must be able to satisfy themselves that the securitisation meets certain EU norms. This leads to many securitisations, and their sell-side participants, seeking to comply both with UK regulatory standards and with EU regulatory standards (in particular as to reporting).

In practice, the burden of dual compliance is mitigated by the market taking a consistent approach to the interpretation of EU and UK securitisation regulation, even where the interpretation and operation of the EU "level 1" text has been clarified and detailed in technical standards and guidance published after the Implementation Date. The market approach has been to generally follow such standards and guidance as though they were applicable in the UK (particularly with regards to risk retention), however some caution is required in this regard, particularly as the UK and EU rules develop.

Since the Implementation Date, further EU legislation, draft legislation and guidance has been published as part of the EU securitisation regulatory framework, without similar legislation, draft legislation and guidance being published as part of the UK securitisation regulatory framework. This has led to further regulatory difference. However, the effect of this, to date, is limited in practice, because of a combination of reasons:

(i) Legislation of limited scope: EU legislation published since the Implementation Date is of limited scope. To the extent that this relates to the EU Simple, Transparent and Standardised (STS) label/regime for securitisations, this has little application to the UK. Although the UK has a similar label/regime, in practice there is very little crossover between these regimes (as to which, see question 7 below). Amendments have also been made to facilitate the securitisation of non-performing loans (NPLs). NPL securitisation has also been addressed (albeit slightly differently) by UK Regulators and, following proposals made in August 2023, it is possible that further changes may arise (which could entail closer alignment with the EU's approach to NPL securitisation).

(ii) Consistent approach by the market: Market participants have, broadly, interpreted the requirements of the UK securitisation regulatory framework in a manner that is consistent with the EU securitisation regulatory framework.

(iii) Regulatory guidance is consistent with EU standards: The Bank of England, Prudential Regulation Authority and Financial Conduct Authority have issued statements of policy stating their expectation that firms that they regulate make every effort to comply with EU guidelines and recommendations to the extent that they remain relevant. Although, strictly speaking, this applies only to EU guidelines and recommendations that were applicable as at the Implementation Date, UK Regulators have not actively sought to publish alternative or conflicting guidance and recommendations.

(iv) Legislative framework is still in flux: Certain aspects of the EU and UK securitisation regulatory frameworks (such as the regulatory technical standards applicable to risk retention) are yet to be published as law, and UK market participants have generally looked to the draft instruments published in an EU context for practical guidance as to the appropriate interpretation of the parts of the regulatory framework that have been published.

UK Regulators are actively reviewing the UK regulatory framework and reform is expected. See Question 24 ("*24. How is the legal and regulatory framework for securitisations changing in your jurisdiction? How could it be improved?*") for further details.

In addition to the securitisation-specific regulatory framework, large parts of the English common law and statutory framework relating to companies, financial services, contract, tort, trusts, insolvency, property and negotiable instruments are relevant to (and underpin the operation of) UK securitisations. Parts of the Financial Services and Markets Act 2000 (FSMA 2000) and rules contained in the FCA handbook and the PRA handbook are also relevant.

Where securitisations target US investors, consideration of the relevant US rules is also required, as to which see the section of this guide on EU law.

Transactions covered by the UK Regulatory Framework

The definition of 'securitisation' within the UK Securitisation Regulation is "*a transaction or scheme, whereby the credit risk associated with an exposure, or a pool of exposures is tranched, having all the following characteristics:*

(i) payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures;

(ii) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme; and

(iii) the transaction or scheme does not create exposures which possess all the characteristics of a specialised lending transaction."

The extent of the definition of securitisation under the UK Securitisation Regulation has been the subject of an on-going debate, partly because on its face it is very wide and therefore potentially includes certain transactions which do not fall within the conventional market understanding of a 'securitisation'. Each limb of the definition requires separate analysis.

A transaction will not fall within limb (i) of the definition of 'securitisation' above in circumstances in which, on an economic analysis, the credit risk being borne by investors is not principally related to the performance of the underlying exposures. This will often be a difference of degree rather than a difference in kind and therefore may involve a qualitative assessment and a consideration of the transaction as a whole. The key characteristic in determining 'dependency' is a direct correlation between payments in respect of underlying exposures and payments to investors. Where transactions include a payment waterfall specifying the application of payments generated by one or more underlying exposures, or limited recourse provisions whereby the recourse of investors is restricted to such underlying exposures, this may indicate that payments under the transaction structure are dependent on the underlying exposures. The existence of an SPV borrower may also indicate a securitisation structure, because the SPV has fewer additional liabilities that would impact a structure intending to have dependency on the underlying exposures. Conversely, some structures, particularly guaranteed and secured wholesale corporate lending, may reflect lending against one or more underlying exposures but with recourse and the true credit risk against the whole business of the obligors rather than just the performance of the underlying exposures.

Tranches of debt with differing levels of subordination are an essential feature of almost all public securitisations. However, the regulatory definitions of these terms cover a much broader set of situations, including synthetic transactions where not every tranche takes the form of a debt security, and transactions which – but only due to the other limbs of the 'securitisation' definition – are not securitisations. A number of financing structures, such as portfolio acquisitions, are frequently financed through a combination of bank debt and sponsor equity. Such sponsor equity financing could either take the form of subordinated debt or common equity. Where such financing takes the form of common equity, it is generally understood that no tranching of credit risk will arise because common equity is not a contractually established segment of credit risk (its subordination to debt incurred by the company in question being a matter of general law). Additionally, structural subordination, with borrowing occurring at different levels of a corporate structure, does not typically constitute tranching. This is because, while there is subordination in effect between levels of financing, the subordination is caused by the corporate structure rather than contract. Care, however, is needed when considering how cash flows operate between different levels in such a structure. Certain other forms of credit support, such as liquidity facilities and hedging agreements, are generally also not considered as segments of credit risk and so not 'tranches'.

Specialised lending includes certain types of financing structures for physical assets, including project finance, real estate finance, asset finance and commodities finance. Although these financing structures often use techniques which are commonly associated with securitisations, they fall outside the securitisation regulatory framework.

4. Give a brief overview of the typical legal structures used in your jurisdiction for securitisations and key parties involved.

In a standard securitisation it is common for the originator to continue to administer the receivables on the SPV's behalf under a servicing agreement in return for a servicing fee. The originator will typically maintain the original contact with the underlying debtors. To mitigate the risk of non-performance by the originator of the servicing and collection role, back-up servicers may also be appointed during the lifetime of the transaction, such that an alternative, suitably experienced and creditworthy entity is in a position to take over the servicing of the receivables in the event of a default by the originator/servicer.

It is common for the only physical evidence (other than records on the originator's/servicer's systems and any data tape accompanying the sale) that an obligor has of the transfer in title to the receivables from the originator to the SPV (at least prior to enforcement proceedings being taken against an underlying obligor), to be that payments are made into a specified account. This account is usually subject to a trust in favour of the SPV, whose rights under which are assigned or charged in favour of the security trustee or other security holder.

Paying agents may be used to transfer funds from the SPV to the various transaction parties and investors in a securitisation. After the receivables are collected by the servicer and passed through the SPV's bank accounts to its paying agent(s), the paying agent(s) will use the receipts to pay interest and principal due on the securities together with any other costs and expenses the SPV may have. Payments are made according to a priority order of payments specified in the transaction documents (often referred to as the cash flow waterfall or priority of payments).

Any money left over after all such payments have been made is extracted from the SPV is either retained by the holders of the most subordinated tranche of securities or passed back to the originator using various profit extraction techniques. These profit extraction techniques may include: (i) the originator taking fees for administering the receivables contracts and collecting the receivables, arranging or managing the portfolio of receivables and/or acting as a swap counterparty; (ii) the SPV paying the originator deferred consideration on the receivables purchased; (iii) the SPV making loan payments to the originator in respect of any subordinated loans granted by the originator; and (iv) the originator holding equity securities/the most subordinated tranche of securities in the SPV.

The type of profit extraction used in any given securitisation transaction will depend on a number of factors, including: (i) the nature of the assets in the pool, (ii) the type of credit enhancement used, (iii) rating agency and timing considerations, (iv) accounting and regulatory capital treatment which may be applied and (v) the tax consequences of the proposed method of profit extraction.

Other securitisation structures (such as master trusts, programmatic securitisation structures, synthetic securitisations and asset backed commercial paper structures) are used in England and Wales. In addition, securitisation techniques are frequently used in asset backed financing structures that are not themselves securitisations (for example, because of the absence of tranching of credit risk).

5. Which body is responsible for regulating securitisation in your jurisdiction?

The Prudential Regulation Authority (PRA) is responsible for regulating compliance by credit institutions, investment firms and insurance undertakings with their obligations under the UK securitisation regime either in their capacities as regulated institutional investors or as sponsors or originators.

The Financial Conduct Authority (FCA) is responsible for regulating compliance by alternative investment fund managers, undertakings for the collective investment in transferable securities and otherwise unregulated entities that participate in a securitisation (for example, general corporates) either in their capacities as regulated institutional investors, or as sponsors or originators.

If the underlying assets of the securitisation are regulated, then the originator and servicer will need to be regulated. UK residential mortgage and consumer credit lending are regulated by the FCA.

6. Are there regulatory or other limitations on the nature of entities that may participate in a securitisation (either on

the sell side or the buy side)?

Retail Clients

The UK Securitisation Regulation limits the sale of securitisations to retail clients by requiring the seller to perform a suitability test on the retail investor. This limitation, in conjunction with other UK law regulatory restrictions on the sale of securities to retail investors, including the UK MiFID II product governance regime (whereby credit institutions and investment firms are required to identify target markets for financial products based on suitability metrics that include knowledge, experience, risk appetite and ability to absorb losses), the UK Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation (under which A PRIIP manufacturer is required to prepare a key information document for each PRIIP that they produce) effectively operate as a regulatory barrier to retail investors investing in securitisations.

SSPEs, Originators and Sponsors

The UK Securitisation Regulation concepts of 'SSPE' (i.e. securitisation special purpose entity) and 'originator' broadly seek to describe entities that are in fact undertaking an activity rather than limit the entities that may undertake an activity and, in relation to non-STS securitisations, include non-UK established entities as well as UK-established entities. The definition of 'sponsor' is limited to credit institutions (whether or not established in the UK) and investment firms. There is an ongoing debate in the market over whether a non-UK established investment firm may be a sponsor.

Entities established outside the UK can be treated as sponsors of a securitisation, which was a clarification made when the UK Securitisation Regulation was adopted (the position under the EU Securitisation Regulation remains subject to debate).

There are no additional UK law limitations of general application.

See also "*9. Are there registration, authorisation or other filing requirements in relation to securitisations in your jurisdiction (either in relation to participants or transactions themselves)?*" below.

7. Does your jurisdiction have a concept of "simple, transparent and comparable" securitisations?

The UK has a "simple, transparent and standardised" (STS) regime for securitisations that substantially parallels the equivalent EU regime, and with similar incentives for investors (i.e., more favourable UK regulatory capital treatment in respect of STS securitisations than in respect of securitisations that are not STS). Differences between the regimes do exist, including:

(i) the coverage by the EU regime (but not the UK regime) of certain synthetic securitisations; and

(ii) the fact that for a securitisation to be STS for EU purposes, the originator, sponsor and SPV must be established in the EU, whereas for a securitisation to be STS for UK purposes, only the originator and sponsor must be established in the UK (with no requirement for the SSPE to be established in the UK).

The STS regime has proved popular, with some 145 public and private transactions notified to the FCA as fulfilling the STS requirements, to date.

The jurisdictional requirements described in paragraph (ii) above and the regulatory capital rules relating to the recognition of STS securitisations means that, in practical terms, the UK STS framework is a purely domestic regime that applies only in respect of securitisations set up in the UK and is of benefit only to investors subject to UK regulatory capital rules.

However, it is worth noting that, as in the EU, there is no textual requirement for the original lender to be established in the UK, giving rise to the possibility of UK STS securitisations of non-UK assets.

The Securitisation Regulations 2024 (yet to come into effect) will create a regime whereby securitisations treated as STS under non-UK frameworks could, in the future, be treated as equivalent to STS under the UK regulatory framework for regulatory capital purposes.

<u>Proposed changes</u>

In FCA Consultation Paper 23/17 and PRA Discussion Paper 3/23, the FCA and PRA have proposed technical changes to the STS regime in the UK. Changes proposed include that:

(i) a securitisation that meets all STS criteria need only be notified to the FCA as STS if the originator/sponsor wishes to obtain the STS label (which is a view largely already taken by the market);

(ii) loans to certain corporates will be treated as homogenous with loans to individuals if the relevant underwriting approaches and servicing procedures to both those corporate and individual loans are the same. In particular, the loans must be serviced in accordance with similar procedures for monitoring, collecting and administering cash receivables by the originator or the SSPE;

(iii) underlying exposures may include corporate bonds, if they are not listed on a trading venue; and

(iv) mixed pools of buy-to-let mortgages and owner-occupier mortgages will not be deemed to be homogenous on the basis that they are subject to different underwriting and/or servicing procedures.

The FCA and PRA have also sought market feedback in relation to the possibility of extending the UK STS framework to synthetic securitisations.

8. Does your jurisdiction distinguish between private and public securitisations?

Broadly, whether a securitisation is public or private for UK purposes depends on whether or not a prospectus must be published in the UK.

Different disclosure requirements apply in respect of public and private securitisations. For a public securitisation, (i) by definition, a UK prospectus must be published in compliance with the UK Prospectus Regulation, FSMA 2000 and the FCA's Prospectus Regulation Rules and (ii) the SSPE is required, since 17 January 2022, to make information available through a securitisation repository (which operates a system for collating and publishing the relevant data) that is registered and supervised by the FCA. A private securitisation does not require a prospectus to be drawn up and does not make disclosure through a securitisation repository. Instead, a private securitisation makes information available to investors, the FCA or PRA (as relevant and in a prescribed notification form only, not the documents and information prescribed by Article 7) and, on request, potential investors. As there is no prospectus, in a private securitisation, a transaction summary is required.

Both public and private securitisations are subject to Article 7 of the UK Securitisation Regulation (as supplemented by binding technical standards) requiring originators, sponsors and SSPEs to make available on an ongoing basis to holders of a securitisation position, the relevant competent authority and, on request, potential investors, certain information on the transaction and underlying exposures. Technical standards set out reporting templates and these templates apply whether the securitisation is public or private.

A similar distinction between public and private securitisations applies in the UK. As such, whether or not a securitisation is public or private depends on:

(i) for EU purposes, whether or not a prospectus must be published in the EU; and

(ii) for UK purposes, whether or not a prospectus must be published in the UK.

The consequence of this is that the same securitisation may be treated as public under one regime and private under the other, typically because a prospectus will usually only be (formally) 'published' in an EU jurisdiction or the UK, but not both.

At present, regulatory obligations relating to public and private securitisations are substantially similar, meaning that this idiosyncratic position does not in practice lead to conflicting obligations. There are, however, EU and UK proposals (as to which, see below) which may result in divergence between the reporting obligations in each jurisdiction in relation to public and private securitisations. It will be important for market participants and their lawyers to assess the impact of any changes.

<u>Proposed changes</u>

Both the PRA and the FCA are considering whether the UK Prospectus Regulation definition of a public securitisation is achieving the right outcome and whether the disclosure templates for private securitisations could be made more proportionate or principles-based.

The FCA is considering the possibility of expanding the current definition of a public securitisation. The FCA has suggested that such expansion could cover:

(i) securitisations that are subject to primary listings on UK regulated markets or similar non-UK markets where the originator, sponsor or SSPE is located in the UK (thereby excluding overseas securitisations);

(ii) primary admissions to trading on an appropriate UK multilateral trading facility (MTF) and similar non-UK venues, where there is at least one UK manufacturer; and/or

(iii) securitisations where there is at least one UK manufacturer and where a public announcement or other general communication is made to a wide audience of potential investors, intended to solicit expressions of interest as part of the primary marketing of the securitisation.

The FCA and PRA, with a view to revisiting the disclosure requirements applicable to private securitisations, have indicated that they will consult further on this topic in 2024.

Similar consultations are also being conducted by ESMA, in the EU.

Implications of changes

Implementing any UK or EU changes to the public/private distinction and associated changes to reporting requirements will require systems development by originators and servicers and is likely to take time. Further, as a consequence of the fact that securitisations are typically structured to attract both UK and EU investors, if changes in the UK do not dovetail with changes in the EU, the effect will be to impose on the securitisation market reporting obligations that are more complex and more onerous (even if the intention of both UK and EU regulators is the opposite). See also question 10 below.

9. Are there registration, authorisation or other filing requirements in relation to securitisations in your jurisdiction (either in relation to participants or transactions themselves)?

In relation to securitisation participants, the carrying out of a securitisation does not, of itself, require a specific regulatory authorisation. However, residential mortgage lending, consumer lending and the servicing of both those types of loan are regulated activities under the FSMA 2000. 'Arranging investments' and 'investing in investments' are also regulated activities under FSMA 2000 and therefore the arrangers and lead managers of securitisations will need to have the correct authorisations to undertake these activities.

In relation to transactions themselves, there is no requirement for securitisations to obtain regulatory approval or registration, except that:

(i) originators, sponsors or SPVs must effect ongoing reporting in respect of public securitisations to a UK registered and supervised securitisation repository;

(ii) originators, sponsors or SPVs are required to register private securitisations with the PRA (if any of them are authorised by the PRA) or, otherwise, the FCA; and

(iii) to qualify as "Simple, Transparent and Standardised", the originator or sponsor of a securitisation must notify the FCA that the securitisation meets the requisite criteria (as to which, see question 7 above).

English companies (including SPVs) are required to register (with the UK registrar of companies) the details of any charges they create.

10. What are the disclosure requirements for public securitisations? How do these compare to the disclosure requirements to private securitisations? Are there reporting templates that are required to be used?

Disclosure and Template Requirements

Under the UK Securitisation Regulation, originators, sponsors and SSPEs established in the UK have extensive transparency obligations both to current and potential investors and to competent authorities. They are required to disclose documentation essential to the understanding of the transaction and, if there is not a prospectus (i.e., a private securitisation), a transaction summary (before pricing) at the outset and loan-level data and investor reports (disclosing how risk is retained), on the basis of specified templates (periodically) and other events-based announcements (on an ad hoc basis). In the case of public securitisations, this disclosure should be made through an authorised securitisation repository approved and registered by the FCA, which operates a system for collating and publishing the relevant data. In the case of private securitisations, no particular method of disclosure is specified and the parties can implement their own arrangements for making information available. Typically however, as information is not being made available to a securitisation repository and the FCA does not receive transaction documents and ongoing loan level data, the FCA asks only for a very short notification form to be filed but full template disclosure must still be delivered to investors.

Article 7 of the UK Securitisation Regulation requires that loan level data and investor reports are disclosed by way of standardised templates contained within regulatory and implementing technical standards. Although there has been and remains some debate as to certain issues (to what extent fields may be left incomplete on a 'not applicable' or 'no data' basis? To what extent are legacy transactions able to comply with them? What about those transactions which relate to an asset class that does not fall neatly within the templates, for example, non-EU originated receivables? To what extent may confidential and sensitive data be excluded from the templates?) the position in respect of many of such questions has been clarified by published guidance, including questions and answers published in the context of the EU Securitisation Regulation.

Interaction with EU requirements and implications for the market

In cases in which the originator, sponsor and issuer are established outside the UK, investors must (under Article 5 of the UK Securitisation Regulation) verify only that the originator, sponsor or issuer has, where applicable, made available information "substantially the same" as would have been required if the originator, sponsor or issuer were established in the UK. At present, this enables UK investors to invest in EU securitisations that report on the basis of EU templates (and not on the slightly different UK templates).

The EU position differs, with EU regulatory guidance suggesting that EU investors must ensure that securitisations in which they invest report on the basis of the prescribed EU templates (and limiting the ability for EU investors to view reporting on the basis of UK templates as sufficient). In practice this means that UK securitisations – which will typically seek to attract EU investors – will often provide both EU and UK templates. There is, however, variation in the market as to whether UK originators and servicers will provide contractual undertakings to provide EU reporting.

UK regulators – as detailed below – are consulting on whether to expand the ability for UK investors to invest in EU securitisations that report only on the basis of EU standards – even where EU standards change such that this reporting is not substantially the same as is required in the UK. That would assist UK investors in accessing EU markets if reporting standards diverge in the future. However, this will be of less assistance to UK originators: if UK and EU reporting standards diverge, unless corresponding flexibility is introduced in the EU, UK originators will face a dual-compliance burden that EU originators do not. It is therefore more important than ever that UK and EU disclosure templates remain aligned.

Proposed changes

Some market participants have taken the view that the current requirement for private securitisations to report on the basis of the current templates (which are shared with public securitisations) (or on templates at all) is disproportionate, given that investors in closely held private deals are able, at the outset, to ask securitisers to commit to providing such reporting as is most useful to them. Others consider that some standardised reporting of private securitisations should be done (in some form or other) primarily so that supervisors have market intelligence.

These views are being considered by regulators in the UK and in the EU.

The European Commission, in its October 2022 report, invited ESMA to "draw up a [new] dedicated template for private securitisation transactions that is tailored particularly to supervisors' need to gain an overview of the market and of the main features of the private transactions." ESMA issued a consultation paper on 21 December 2023 inviting feedback on four options proposed by 15 March 2024.

Likewise, between August and October 2023, the FCA and PRA conducted an initial consultation as to whether the disclosure templates for private securitisations could be more proportionate or principles-based so as to become less extensive than those for public securitisations, whilst still supporting the provision of sufficient information by manufacturers of securitisations to investors. Further consultations are expected.

UK Prospectus Requirements

Under the UK Prospectus Regulation, an issuer of securities that is either (i) admitted to trading on a UK regulated market or (ii) offered to the public in the UK is required to publish a prospectus. The UK Prospectus Regulation governs the content requirements of prospectuses, comprising a general duty of disclosure (the necessary information which is material for an investor to make an informed assessment of the rights attaching to the securities) and specific disclosure items relating to the nature of the securities.

Proposed changes

The FCA is expected to consult to consult, in the summer of 2024, on a new UK Prospectus Regime (expected to be implemented no earlier than 2025).

UK Inside Information

Article 7 of the Securitisation Regulation also requires disclosure of any inside information that the originator, sponsor or issuer is required to disclose under the UK Market Abuse Regulation (UK MAR). The UK MAR applies to financial instruments (i) admitted to trading or for which a request for admission to trading on a UK regulated market, Gibraltar regulated market or EU regulated market has been made; (ii) traded, admitted to trading or for which a request for admission to trading on a UK MTF, Gibraltar or EU MTF has been made; (iii) traded on a UK Organised Trading Facility (OTF), Gibraltar OTF or EU OTF and (iv) other financial instruments, if their price or value depends or has an effect on the price or value of any of these financial instruments.

An issuer of securities that is admitted to trading under the UK MAR is required to inform the public of inside information which directly concerns the issuer. Inside information comprises information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments. Where the UK MAR does not apply, any information relating to significant events such as a material breach, or material amendment, of the transaction documents or a change in structural features or risk characteristics that materially impact the performance of the securitisation must be disclosed.

11. Does your jurisdiction require securitising entities to retain risk? How is this done?

Under Article 6 of the UK Securitisation Regulation, there is a general requirement that an UK-established sponsor, originator or original lender retains a material net economic interest of not less than 5% on an ongoing basis, in accordance with one of the prescribed retention methods. The general requirement contained within the UK Securitisation Regulation is complemented by detailed provisions contained within regulatory technical standards.

The risk retention obligation is both ‘direct' and ‘indirect', in that in addition to applying directly to securitising entities, institutional investors pursuant to Article 5 of the UK Securitisation Regulation also have an obligation to verify compliance with the obligation before investing. One consequence of this restriction is that it is imposed on investors in securitisations in respect of which Article 6 does not apply directly (for example, a securitisation where none of the originator, sponsor, SSPE or original lender is established in the UK).

There are prohibitions on hedging the retained risk, the risk being shared among different types of retainers and so-called ‘cherry-picking', whereby a retainer selects assets to be retained with the aim of rendering losses on those assets transferred to the SSPE higher than the losses on comparable assets held on balance sheet, subject to certain limited exceptions.

There are five different methods of retaining risk:

(i) vertical slice (retention of at least 5% of the nominal value of each class of notes);

(ii) pari passu share (retention of an interest in revolving assets equal to at least 5% of the nominal value of the portfolio);

(iii) on balance sheet (retention of randomly selected exposures, equivalent to not less than 5% of the nominal value of the securitised exposures, provided that the number of potentially securitised exposures is not less than 100 at origination);

(iv) first loss tranche (retention of the most subordinated class of notes, having at least the same maturity as non-retained notes equal to at least 5% of the nominal value of the securitised portfolio); or

(v) first loss exposure (retention of a first loss exposure of not less than 5% of the nominal value of each securitised exposure).

Proposed changes

In their recent 2023 consultation papers, the FCA and PRA have made proposals as to the future risk retention framework in the UK. An anomaly currently exists in that due to delays in finalising the risk retention technical standards under the EU Securitisation Regulation, such technical standards, when ultimately published, were not incorporated into UK law (given that they were enacted after the Implementation Date of 31 December 2020).

Although the market has broadly taken the view that the EU risk retention technical standards should be considered applicable to the UK Securitisation Regulation also, this is an area where additional clarity would be helpful. Accordingly, many of the UK Regulators' proposals for reform are to incorporate certain features of the EU technical standards into UK law.

With respect to NPEs, the Regulators observed that using face value for risk retention purposes disregards the price discount at which the underlying assets are transferred can make it uneconomical for originators to securitise NPEs. In 2021, the EU made certain changes to its regulatory framework to address this issue.

Accordingly, the Regulators proposed the use of a non-refundable purchase price discount (NRPPD) for NPEs whereby the requirement for retention would, where appropriate, be calculated on the basis of the net value of the defaulted portfolio on the date of the securitisation (factoring in the NRPPD), as opposed to the face value of the underlying assets. The FCA anticipate that its proposal would reduce the absolute risk retention requirements in relation to NPE securitisations, but some market participants have, in the context of the Regulators' consultations, asked for clarification to the rules to allow NPE asset servicers to act as eligible risk retainers – a recent reform in the EU.

Furthermore, the Regulators have proposed to add an exception to the rules that “risk is retained on an ongoing basis” in the event of the retainer becoming insolvent, thereby having the effect of avoiding potential forced sales of securitisation positions by investors because of non-compliance with the on-going risk retention requirement. This is consistent with the current EU technical standards.

Regarding the “sole purpose” test (i.e., an originator retaining risk must not be established or operate for the sole purpose of securitising exposures), the Regulators propose to clarify that this requires consideration of whether:

(i) the entity has a business strategy and payment capacity consistent with a broader business enterprise; and

(ii) the members of the management body have the necessary experience to enable the entity to pursue the established business strategy, as well as adequate corporate governance arrangements.

It appears to be intended that these are factors to consider rather than requirements which must all be satisfied, which is in practice how many in the market interpret the equivalent EU requirement (albeit not reflective of the literal drafting of the EU rules).

Additionally, the Regulators propose an exception to the rule against ‘cherry-picking’ (as to which, see our response to question 2 above) in order to allow originators to select assets which, as a whole, have a higher risk profile compared to other asset classes on the balance sheet of the originator, provided that the NRPPD of the higher risk profile is clearly communicated to investors or potential investors. The FCA have also proposed to clarify what it means for assets to be “comparable” and outlined guidance to the effect that, in assessing compliance, the originator’s compliance with its internal policies, procedures and controls, put in place to prevent ‘cherry-picking’ should be considered.

Although re-securitisations are generally prohibited (with a few exceptions), the Regulators propose to clarify that:

(i) where re-securitisation is permitted, a retainer shall retain a material net economic interest consistent with the purpose of the risk retention restrictions;

(ii) fully supported asset-backed commercial paper programmes (which are not considered to be re-securitisations) would also not be considered as re-securitisations for risk retention purposes;

(iii) retranching of an issued tranche by the originator does not amount to re-securitisation for the purposes of risk-retention; and

(iv) where there is a permitted re-securitisation, the risk retention rules must generally be complied with at the levels of both the underlying securitisation and the re-securitisation (except where the originator acts as the retainer in the underlying securitisation and securitises only positions retained in excess of the minimum net economic interest in the underlying securitisation and there is no maturity mismatch, the retention for the underlying securitisation is the only requirement).

Finally, the Regulators proposes to make clear, consistent with EU standards, that risk retention details need to be included in the final offering document, prospectus, or transaction summary, as applicable.

12. Do investors have regulatory obligations to conduct due diligence before investing?

Under Article 5 of the UK Securitisation Regulation, institutional investors are required to verify certain matters before becoming exposed to a securitisation position, including that the credit comprising the receivables has been granted on the basis of sound and defined criteria and processes, that the originator has complied with high credit-granting standards, that the structure is compliant with the risk retention requirements, and that the sell-side entities comply with their disclosure transparency obligations.

The institutional investor’s transparency verification obligations include:

(i) where the originator, sponsor or SSPE is established in the UK, that it has made the information required by Article 7 available, in accordance with the required frequencies and procedures; and

(ii) where the originator, sponsor or SSPE is established in a third country, it has made available information which is substantially the same and in accordance with the required frequencies and procedures as that which would have been required by Article 7 if it had been established in the UK.

Thus, due to amendments made when onshoring the EU regulatory framework, when investing in non-UK securitisations, UK investors need only verify that substantially the same information is disclosed with substantially the same frequencies and modalities as would be the case if the originator, sponsor or SSPE were established in the UK. In practice, this should assist UK investors in investing in securitisations that disclose in accordance with the (slightly different) EU templates, but the limits of what constitute “substantially the same” require clarification, particularly in the case of non-EU securitisations.

Before holding a securitisation position, institutional investors are also required to carry out a due diligence assessment commensurate with the risks involved before investing and, once holding a securitisation position, on an on-going basis, maintain written procedures to monitor the performance of the securitisation, to perform stress tests and be able to demonstrate to competent authorities that they have a thorough understanding of their securitisation position and its underlying exposures.

The PRA confirmed in Policy Statement 29/18 that 'the level and nature of investor due diligence prior to holding a securitisation position may be proportionate to the risks posed to the institutional investors, provided the minimum checks specified in Article 5 are complied with.'

<u>Proposed changes</u>

Due diligence requirements under the UK Securitisation Regulation (and its EU equivalent) have been criticised by investors and are likely to develop further in the medium term.

Following a December 2021 H.M. Treasury report on the UK securitisation framework expressed an intention to clarify what disclosures must be sought by UK investors in respect of non-UK securitisations, the FCA and PRA, in their August 2023 consultations, covered due diligence requirements for investors. To ensure consistency in the implementation of the rules on due diligence and eliminate unnecessary restrictions for UK investors investing in non-UK securitisations, it is suggested in the consultations that Articles 5(1)(e) – (f) of the UK Securitisation Regulation (on verifying disclosure by UK manufacturers or by overseas manufacturers respectively), might be replaced by a single approach which requires UK institution investors to verify:

(i) the sufficiency of the information a manufacturer has made available to institutional investors to enable them to independently assess the risk;

(ii) they have received at least the information listed in the rules; and

(iii) there is a commitment from the manufacturers to make further information continually available, as appropriate.

On 16 October 2023, the FCA published an addendum to its consultation relating to changes concerning the application of due diligence requirements and institutional investor delegation. The FCA intends to publish the rules relating to due diligence in a Policy Statement in Q2 2024.

The extent to which the Regulators intend to modify the due diligence requirements under the UK Securitisation Regulation remains to be seen. The market will in particular need to be alive to any changes in interpretation as to who the requirements should apply to (and whether the current market view that such requirements do not apply to, for example, hedge counterparties and liquidity facility providers) is intended to be departed from. Another key area to watch will be whether, as a result of regulatory change, it will be possible for a UK institutional investor to delegate its due obligations to entities that are not themselves institutional investors.

13. What penalties are securitisation participants subject to for breaching regulatory obligations?

The FCA and the PRA have extensive powers to impose sanctions on institutions and individuals, including fines, censure, suspension of rights to carry on certain business temporarily or permanently and withdrawal of authorisation.

14. Are there regulatory or practical restrictions on the nature of securitisation SPVs? Are SPVs within the scope of regulatory requirements of securitisation in your jurisdiction? And if so, which requirements?

An SPV is normally established with its own corporate identity and independent legal status. An SPV is usually established as a private or public limited company incorporated under the Companies Act 2006 (CA 2006). If the SPV is to issue listed bonds, then it will typically be incorporated as a public limited company in order to comply with CA 2006. Occasionally, an SPV may be a limited liability partnership under the Limited Liability Partnership Act 2000.

If it is desirable that the SPV is not a subsidiary of the originator or other transaction party, the SPV's shares are usually directly or indirectly held by a corporate services provider. The corporate service provider often holds the shares of the SPV on trust for discretionary charitable purposes.

There are no specific regulatory requirements applying to securitisation SPVs, but the following general regulatory requirements apply:

(i) issuers of securities admitted to the UK Official List must comply with the applicable Listing Rules and Disclosure and Transparency Rules of the FCA and the EU Market Abuse Regulation; and

(ii) SPVs must also comply with the requirements under the CA 2006 or other generally applicable legislation.

The SPV's jurisdiction of establishment is often England and Wales. This has the advantage of increased legal certainty in terms of enforcement and familiarity of market participants with the legislative regime applicable to companies. However, there may be a variety of reasons for the SPV to be established in other jurisdictions. In determining the SPV's jurisdiction of establishment, regard must also be had to any tax implications for the participants in the securitisation. These implications may also depend on wider factors, such as the jurisdiction where management and control of the SPV is exercised and where the SPV carries on its trade.

15. How are securitisation SPVs made bankruptcy remote?

The SPV is often a separate corporate entity with no trading history and so no initial contingent liabilities. The following contractual provisions are commonly inserted in the applicable transaction documents to assist in insulating the SPV from creditor claims:

(i) Limited recourse provisions are used to limit the liability of the SPV to a creditor. Typically, recourse is limited to the net proceeds of disposal or enforcement or by a mechanism to convert securitisation debt to equity on enforcement.

(ii) Non-petition provisions are also used in English law governed securitisation transactions. These purport to prohibit a creditor from taking legal action or commencing insolvency proceedings against the SPV.

(iii) The SPV will typically covenant in the applicable transaction documents not to incur liabilities or to undertake activity outside those contemplated by the securitisation transaction.

(iv) Granting security over all the SPV's assets in favour of the security trustee for the SPV's secured creditors, thereby disincentivising third parties from commencing insolvency proceedings against the SPV (as the assets validly the subject of such security will not, with some very limited exceptions, be available to satisfy the claims of unsecured creditors).

It is not possible to be certain that an SPV will be completely insolvency remote. For example, the SPV may always incur tax liabilities and the UK tax authority, HM Revenue & Customs, may not be bound by the contractual provisions set out above.

16. What are the key forms of credit support in your jurisdiction?

The key forms of credit support in a securitisation are:

<u>(i) Overcollateralisation</u>: This involves the originator transferring underlying assets of a greater aggregate value than the consideration provided by the SPV, so that there is a cushion against non-payment by underlying debtors;

<u>(ii) Creating subordinated tranches</u>: The senior tranche will be credit enhanced by providing that senior tranche holders will have priority over junior tranche holders for payment and that the junior tranche holders do not have rights to payment, enforce claims, or accelerate debt against the SPV until the holders of the senior tranches have been paid;

<u>(iii) Creating "retained spread"</u>: Retained spread is where the amounts that the SPV pays in respect of its liabilities (that is, the securities) is less than the amount it receives from its underlying assets (that is, the receivables transferred to it). The SPV retains the difference as a reserve or retained capital to cover costs and expenses and so improve the creditworthiness of the securities it issues. Retained spread in excess of the SPV's costs and expenses will be returned to the originator; and

<u>(iv) Letters of credit, insurance or guaranteed liquidity facilities</u>: These involve an external creditworthy source contracting to make payments in respect of the securities if the SPV is unable to pay amounts due.

17. How may the transfer of assets be effected, in particular to achieve a 'true sale'? Must the obligors be notified?

Most classes of account receivables are usually transferred by assignment, which operates as a "true sale" transfer. For perfection, English law makes a distinction between legal and equitable assignments.

To take effect at law: (i) the assignment must be absolute and not purport to be by way of charge only; (ii) the assignment must be in writing signed by the assignor; and (iii) express notice of the assignment (in writing) must be given to the debtor.

An assignment which does not comply with these conditions takes effect as an equitable assignment. However, prior to notice of the assignment being given to the obligor, a subsequent purchaser of a receivable without notice of the prior assignment by the seller may take priority over the claims of the initial purchaser. Further, a subsequent purchaser can, if it notifies the obligor before the initial purchaser does so, require the obligor to make payment to such subsequent purchaser. Moreover, prior to receiving notice of the assignment, the obligor: (i) may continue to discharge its debt by making payments to the seller; (ii) may set off claims against the seller arising prior to receipt by the obligor of the notice of assignment; (iii) may agree amendments to the assigned contract with the seller (as opposed to the purchaser) without the purchaser's consent being required; and (iv) cannot be sued by the purchaser in the purchaser's own name (although there are procedural steps that the purchaser can take that mean that this aspect of an equitable assignment is rarely an impediment to it enforcing an assigned receivable in practice).

18. In what circumstances might the transfer of assets be challenged by a court in your jurisdiction?

English courts look at the substance of the transaction and, therefore, whatever labels the parties have given to the transaction are not conclusive. Case law has established the following key questions to be considered to establish whether the transaction is a true sale rather than being re-characterised as a secured loan:

(i) Do the transaction documents accurately reflect the intention of the parties and are the terms consistent with a sale as opposed to a secured loan?

(ii) Does the originator have the right to repurchase the receivables sold? In a true sale the originator is not entitled to have the assets returned to him if he returns the purchase price to the buyer (this principle will not be offended by customary clean-up call provisions in securitisations).

(iii) Does the purchaser have to account for any profit made on a disposition by it of the receivables? In a true sale, if the purchaser sold the assets to a third party for a profit, there is no duty to account to the seller for the profit.

(iv) Is the seller required to compensate the purchaser if it ultimately realises the acquired receivables for an amount less than the amount paid? In a true sale, if the purchaser sells the assets to a third party for a loss, there is no right to recover this loss from the seller.

The above factors should only be treated as rules of thumb. The English courts will allow transactions that display some or all of the above characteristics to be treated as sales if they otherwise are more consistent with sales than loans with the grant of security. If the 'sale' to the SPV is found not be a sale, but rather a secured loan, then it may be void for lack of registration with the registrar of companies (if the seller of the assets in question is a UK company, which is usually the case).

19. Are there data protection or confidentiality measures protecting obligors in a securitisation?

The handling and processing of information on living, identifiable individuals (personal data) is regulated by Regulation (EU) 2016/679 as incorporated into UK domestic law in the Data Protection Act 2018. UK data protection law aims primarily to give control to individuals over their personal data and contains provisions and requirements related to the processing of personal data of individuals who are located in the UK and applies to any enterprise – regardless of its location and the data subjects' citizenship or residence – that is processing the personal information of data subjects inside the EEA. Controllers and processors of personal data must put in place appropriate technical and organizational measures to implement the data protection principles. No personal data may be processed unless this processing is done under one of six lawful bases specified by the regulation (consent, contract, public task, vital interest, legitimate interest or legal requirement).

Thought and care is therefore required in relation to securitisations: securitisation arrangements can result in entities other than the originator having access to or control over personal data, in particular third party, back-up and replacement servicers. Originators typically ensure that the terms on which they contract with customers are appropriate to enable this to occur lawfully and that customers receive sufficient privacy information (although there is a tension between the expectation under data protection law that individuals are informed and securitisation structures which operate on the basis that individual debtors would not typically know that their debts have been securitised).

Analysis of which parties in a securitisation may constitute data controllers and which (if any) may constitute data processors is important, given the requirements under UK data protection law applicable to each. Such requirements include, depending on the characterisation of a party, registration obligations or requirements for mandatory provisions in contractual documentation. An ongoing debate exists as to whether an issuer SPV, which owns receivables but would never in practice receive personal data relating to the same, should be regarded as a data controller.

Mechanisms to ensure that personal data is adequately protected, but that a securitisation is sufficiently robust to survive the insolvency and resulting disruption of a servicer's operations, vary and include mechanisms that provide, for example, that originators are required to transfer data to replacement or back-up servicers only upon the occurrence of limited, serious trigger events (rather than on an ongoing basis). In some securitisations, information is shared in encrypted form only, with a data trustee appointed to hold the encryption key.

The data protection framework in the UK is based on that which exists in the EU, although the UK framework differs in a number of technical respects from the EU framework.

Data controllers (which may include the originator, the SPV, the servicer and any back-up servicer) must register with the Information Commissioner's Office.

20. Is the conduct of credit rating agencies regulated?

Credit rating agencies (CRAs) in the UK are regulated under the retained law version of the CRA Regulation (EU) 1060/2009 (the UK CRA Regulation). In particular, the UK CRA Regulation requires CRAs based in the UK to be registered with the FCA, which is also responsible for the ongoing supervision of these CRAs and specifies the circumstances in which financial institutions can use credit ratings for regulatory purposes.

UK financial institutions can only use for regulatory purposes, those credit ratings that have been issued by FCA registered CRAs. Where the credit rating is issued in a third country outside of the UK, the UK CRA Regulation, by way of exception, permits the credit rating to be endorsed by a registered CRA or certified by the FCA.

The UK CRA Regulation imposes specific requirements on registered credit rating agencies, including relating to their independence and avoidance of conflicts of interest, their methodologies and disclosures. The UK CRA Regulation also imposes obligations on securitisation issuers, including: (i) appointing at least two CRAs to rate any securitisation bond it is having rated; and (ii) to consider appointing at least one CRA with less than a 10 per cent total market share and if it decides not to, to document such determination.

21. Are there taxation considerations in your jurisdiction for originators, securitisation SPVs and investors?

<u>In relation to originators, the key taxation considerations include:</u>

Corporation tax

In respect of a traditional securitisation (where ownership of the underlying assets is transferred from the originator to an SPV), the corporation tax treatment of the asset transfer will depend on the nature of the underlying assets and the transfer may give rise to a corporation tax charge for the originator on any gain resulting from the disposal. The current rate of UK corporation tax is 25 per cent.

In respect of a synthetic securitisation (where ownership of the underlying assets remains with the originator), the corporation tax treatment will depend on the nature of the financial instrument used to transfer the risk to the SPV. Where, for example, the risk transfer is achieved by use of a credit derivative, the originator would expect to be taxed in accordance with the normal rules for derivatives.

VAT

Generally speaking, the securitisation, be it a traditional or synthetic securitisation, should not give rise to a VAT cost for the originator, although the exact VAT consequences can be complex.

Stamp taxes

Other than in the case of certain interests in real estate and certain equity-like securities, there are no stamp taxes or other transfer taxes in the UK on the disposal of assets to an SPV or the entry into of guarantees or credit derivatives.

<u>In relation to securitisation SPVs, the key taxation considerations include:</u>

Most traditional (true sale) securitisations to UK resident SPVs will be structured to fall under the Taxation of Securitisation Companies Regulations 2006. The regulations allow securitisation companies to be subject to corporation tax simply on the cash profit retained within the company after the payment of its disbursements under the transaction waterfall. Broadly, in order to fall within this tax regime, the securitisation SPV must qualify as a securitisation company. Generally, a securitisation company:

(i) is an SPV that issues notes (valued at least GBP 5 million at the date of issue) wholly or mainly to independent investors and holds financial assets as security for those notes (a note-issuing company); or

(ii) is an SPV that is funded by a note-issuing company or intermediate borrowing company, and holds financial assets as security for the capital market arrangement entered into by a note issuing company (an asset-holding company); or

(iii) is an intermediate borrowing vehicle that is funded by a note-issuing company or another intermediate borrowing company and is a party to creditor relationships with an asset-holding company or another intermediate borrowing company (an intermediate borrowing company); or

(iv) is an SPV that acquires or holds financial assets for the purpose of transferring them to an asset-holding company or note-issuing company (or itself becoming the same) (a warehouse company); and

(v) satisfies the 'payments condition' at all times (i.e., that all amounts received flow through to investors within 18 months of the end of the accounting period, other than the SPV's retained profit in the waterfall, and any amounts reasonably required to cover losses or expenses and support creditworthiness);

(vi) does not have an unallowable purpose, being a purpose not amongst the business or other commercial purposes of the securitisation company (for example, a main purpose of avoiding UK tax); and

(vii) as a rule, is not involved in any business activities other than those that are incidental to its role as an SPV in the securitisation.

In circumstances where the necessary connection to the UK is present, certain types of receivables, particularly receivables arising from loans, royalties and real estate rentals, are subject to UK withholding tax unless an exemption applies. Generally, where the receivables are sold to a UK resident SPV, an exemption should apply to the underlying receivable so that no UK withholding tax is due from the underlying obligor. It is therefore usual for loan portfolios to be securitised through a UK tax resident SPV; trade finance and other trading payments are more frequently securitised through SPVs resident for tax purposes in other jurisdictions.

<u>In relation to investors, the key taxation considerations include:</u>

Withholding tax

Interest paid on securitisation notes issued by an SPV in the UK will be subject to UK withholding tax at the basic rate of income tax (currently 20 per cent) unless an exemption applies.

An exemption that is often used, particularly where notes are intended to be widely distributed, is the 'quoted Eurobond' exemption that applies where the notes are listed on a 'recognised stock exchange' or admitted to trading on a 'multilateral trading facility' operated by a 'regulated recognised stock exchange', being a recognised stock exchange that is regulated in the UK, EEA or Gibraltar. Many exchanges qualify as 'recognised stock exchanges', including the London Stock Exchange, Euronext Dublin, the Luxembourg Stock Exchange and the International Stock Exchange of the Channel Islands.

Where notes are privately placed with investors resident in jurisdictions which are party to a double tax treaty with the UK that includes a 'non-discrimination' article, the 'qualifying private placement' exemption from UK withholding tax may be used – provided the other relevant conditions for applicability of the exemption are also met. Alternatively, relief may be obtained by virtue of a double tax treaty (utilising, where appropriate, HM Revenue & Customs' Double Taxation Treaty Passport Scheme).

Stamp taxes

Notes that fall within the loan capital exemption from UK stamp duty and stamp duty reserve tax are exempt from such duties and securitisation notes are usually structured to qualify as such.

Generally, transfers of securities issued by note-issuing companies are also exempt from UK stamp duty and stamp duty reserve tax due to the Finance Act 2022.

22. To what extent does the legal and regulatory framework for securitisations in your jurisdiction allow for global or cross-border transactions?

The UK securitisation market is highly international in nature. Typically, the transaction parties establishing the securitisation and the investors are established in a range of different jurisdictions. UK transactions are often structured to attract global investors, including by way of compliance with US requirements as to, amongst other things, risk retention (and the Dodd-Frank Act).

The Retained EU Law (Revocation and Reform) Act 2023 has repealed certain EU laws and significantly alters the framework for retained EU law under the EU (Withdrawal) Act 2018. As the UK takes its own regulatory path, it is likely that legislators and Regulators will tread a careful path between removing existing barriers (i.e., allowing UK investors to invest easily in US securitisations) without creating new barriers (i.e., allowing UK investors to continue to invest easily in EU securitisations).

The current position is that there are fewer barriers to UK investors investing in non-UK securitisations than there are to EU investors investing in UK securitisations. For an explanation of why this is the case, see also our answers to:

(i) "3. What legislation governs securitisation in your jurisdiction? Which types of transactions fall within the scope of this legislation?" as to the interrelationship between the EU and UK;

(ii) "7. Does your jurisdiction have a concept of "simple, transparent and comparable" securitisations" as to the possible introduction of an STS equivalence regime;

(iii) "9. What are the disclosure requirements for public securitisations? How do these compare to the disclosure requirements to private securitisations? Are there reporting templates that are required to be used?" and

(iv) "11. Do investors have regulatory obligations to conduct due diligence before investing?" as to the requirements for UK investors to verify certain attributes (including disclosure) in respect of non-UK securitisations.

23. To what extent has the securitisation market in your jurisdiction transitioned from IBORs to near risk-free interest rates?

The UK securitisation market has, we believe, fully transitioned from IBORs to near risk-free interest rates in GBP and USD (although some legacy issuances and tranches in certain other currencies may continue to reference IBORs). There is now an active and established market for GBP-denominated securitisations on the basis of a compounded daily SONIA rate and, primarily from US investors, USD-denominated tranches on the basis of a compounded daily SOFR rate.

24. How is the legal and regulatory framework for securitisations changing in your jurisdiction? How could it be improved?

Both UK regulators and EU regulators are consulting on changes to their respective regulatory regimes. There is, however, currently a single European securitisation market. If EU and UK regulatory requirements diverge, that is likely to increase the burden on market participants to dually comply with both EU and UK requirements. This will increase friction in the market and – should divergence occur to a significant extent – market fragmentation could result. A risk is that this may occur as an unintended consequence of efforts of both EU and UK investors to streamline requirements and vitalise the markets, if those efforts occur independently. Minimising regulatory divergence is key to the efficient functioning of the European securitisation market.

See questions 3, 8 and 10, and the information below, for more details.

Developments in the Law

A. Securitisation Regulations 2024

The Securitisation Regulations 2024 were made into law as a statutory instrument on 29 January 2024. Although not yet in full effect, the new regulations will provide a framework for the replacement of the current UK Securitisation Regulation with a regulatory framework that involves far greater rule rulemaking for the Regulators than under the current framework.

The Securitisation Regulations 2024, in addition to setting out the framework for that future regulatory approach contains a limited set of provisions, including a framework for a potential future regime to recognise equivalent non-UK STS securitisations.

As to the actual substance of the rules to be implemented under the Securitisation Regulations 2024, both the PRA and FCA's 2023 consultations are relevant. These are summarised below, with further details in our responses to the other questions throughout this guide.

B. Financial Conduct Authority

In Consultation Paper 23/17, the FCA proposed new rules (for the FCA Handbook) to replace provisions from the UK Securitisation Regulation in relation to:

(i) the due diligence requirements for different types of institutional investors;

(ii) clarifications to the risk retention provisions for non-performing securitisations;

(iii) an exception to complying with on-going risk retention obligations in the event of insolvency of the retainer;

(iv) an exception to the rule against ‘cherry picking’ of assets by originators;

(v) refining the “sole purpose” test;

(vi) the risk retention requirements in re-securitisations;

(vii) re-securitisation restrictions;

(viii) STS securitisations;

(ix) UK sellers of a securitisation position, securitisation repositories and third-party verifiers; and

(x) extending the scope of the cash collateralisation exemption for a synthetic/contingent form of securitisation (although note that cross border challenges will arise on such transactions needing to satisfy both the EU and UK risk retention regimes).

The consultation paper also discussed private and public securitisations, offering an insight into possible future changes. The FCA plans to consult on changes to the reporting regime for private securitisations in a second consultation in 2024.

C. Prudential Regulation Authority

In Consultation Paper 15/23, the PRA set out their proposed rules to replace the requirements on PRA-authorised persons as well as the related Risk Retention Technical Standards and Disclosure Standards. Specific adjustments proposed related to clarifying that the managing party and not the delegating party would be subject to due diligence requirements and also the timelines for manufacturers making available certain information as well as changes to the risk retention requirements (including in relation to NPEs). Further, the rules explained the circumstances in which the PRA envisaged using a new power under Financial Services and Markets Act 2023 for disapplying or modifying proposed rules on the use of re-securitisations. The distinction between public and private securitisations and associated transparency requirements were also addressed. Like the FCA, the PRA may consult on these issues in a future consultation.

In, Discussion Paper 3/23, published on 31 October 2023 by the PRA, the regulator considered key issues for discussions relating to the capital requirements for securitisation transactions. The PRA is also consulting in relation to:

(i) the calibration of the Pillar 1 framework for determining capital requirements for securitisation exposures and their interaction with the Basel 3.1 output floor;

(ii) the alignment of the hierarchy for determining capital requirements for securitisation exposures with relevant Basel standards;

(iii) the scope of the framework for STS securitisations; and

(iv) the use of credit risk mitigation in synthetic significant risk transfer securitisations.

Discussion Paper 3/23 is relevant to:

(i) PRA-authorised CRR organisations involved in securitisations;

(ii) qualifying parent undertakings, including financial holding companies and mixed financial holding companies, credit institutions, investment organisations and financial institutions that are subsidiaries of these organisations; and

(iii) companies providing credit risk mitigation for external credit assessments.

Finally, the PRA, on 5 December 2023, issued Policy Statement 15/23 (which built on feedback from Consultation Papers 5/22, 16/22, 4/23 and 14/23) on the scope, criteria, liquidity and disclosure requirements under the strong and simple framework. The PRA intends to consult on simplifications to Pillar 2 and buffer requirements for Small Domestic Deposit Takers in the second quarter of 2024.

Depending on feedback, the second quarter of 2024 is expected to be the implementation date for the changes resulting from the Regulators’ 2023 consultations – i.e. the FCA’s Consultation Paper 23/17 and PRA’s Consultation Paper 15/23. Both the FCA and PRA note that the need to avoid disruption when replacing the obligations under the UK Securitisation Regulation.

In addition to the securitisation-specific regulatory framework, large parts of the English common law and statutory framework relating to companies, financial services, contract, tort, trusts, insolvency, property and negotiable instruments are relevant to (and underpin the operation of) UK securitisations.

Key improvements

Leading industry bodies have emphasised, in the context of the Regulators’ review of the UK regulatory framework, the importance of:

(i) ensuring compatibility with the EU regulatory framework;

(ii) ensuring compatibility as between the FCA and PRA rules, once introduced;

(iii) revisiting jurisdictional restrictions, (e.g. considering implementing an equivalence regime with the EU STS framework;

(iv) providing clear supervisory guidance; and

(v) providing adequate grandfathering and transitional runways as rules change.

There are, potentially, some elements of securitisations that are typically achieved contractually in the UK, but could be achieved legislatively, as is done in some other jurisdictions, such as:

(i) the insolvency remoteness of securitisation SPVs;

(ii) rules as to the enforcement of security that are tailored to securitisations and expressly seek to maximise value recovery in that context while clearly giving full effect to transaction waterfalls; and

(iii) providing for clear separation between different transactions issued by the same SPV issuer or, even, the clear separation between different silos of assets held by the same SPV issuer (for example, similar to the compartments in a French *Fonds commun de titrisation*) supporting different transactions.

More broadly, global investors seek to invest in UK securitisations in order to obtain exposure to UK securitised assets. Steps taken that improve the performance of such assets will make such assets and their securitisations more attractive to investors globally. Regulatory reforms that encourage UK investors, such as pension funds, to deploy capital towards UK securitisations may result in deeper UK markets and enhance, through securitisations, the funding of the UK real economy.

25. Are there any filings or formalities to be satisfied in your jurisdiction in order to constitute a true sale of receivables?

No filings or formalities are required in England and Wales to ensure that an assignment of receivables constitutes a true sale.

Contributors

Guy O'Keefe
Partner
guy.okeefe@slaughterandmay.com

Oliver Wicker
Partner
oliver.wicker@slaughterandmay.com

Richard Jones
Partner
richard.jones@slaughterandmay.com

David Thomas
Senior Associate
david.thomas@slaughterandmay.com

Kate Patane
PSL
kate.patane@slaughterandmay.com