UK Securitisation: New framework takes effect from 1 November 2024

19 September 2024

With the publication this month of the Commencement Order revoking the existing regulatory regime for UK securitisation, we now have confirmation that the new UK securitisation framework will apply from 1 November 2024. Whilst the substance of the rules remains unchanged in most respects, there are some important points of difference for market participants to be aware of and a new regulatory framework in which the rules will continue to evolve. In this briefing note, we explore some key aspects of the new regime and look ahead to expected future developments.

The new rules

Publication of the Commencement Order[1] revokes the existing, EU-derived Securitisation Regulation in the UK and replaces it with a new UK regulatory framework for securitisation. This is being done as part of the UK Government's "Smarter Regulatory Framework" for financial services which aims to replace EU-derived financial services legislation with new, UK-tailored requirements, the bulk of which will sit in the rulebooks of the UK regulators the Financial Conduct Authority ("FCA") and Prudential Regulation Authority ("PRA")[2].

From 1 November 2024, the UK securitisation regulatory regime will be comprised of the following:

- The Securitisation Regulations 2024[3] which contain overarching provisions and powers for the FCA and PRA to make rules for securitisation;
- The Securitisation (Amendment) Regulations 2024[4] which principally contain due diligence provisions for occupational pension schemes (together, the "new UK Securitisation Regulations"); and
- UK regulators' rules set out in a new FCA "SECN" Rulebook[5] (the "FCA Rules") and a new securitisation Part of the PRA Rulebook, plus an accompanying PRA Supervisory Statement[6] (the "PRA Rules") (together, the "regulators' rules").

[1] S.I. 2024 No. 891

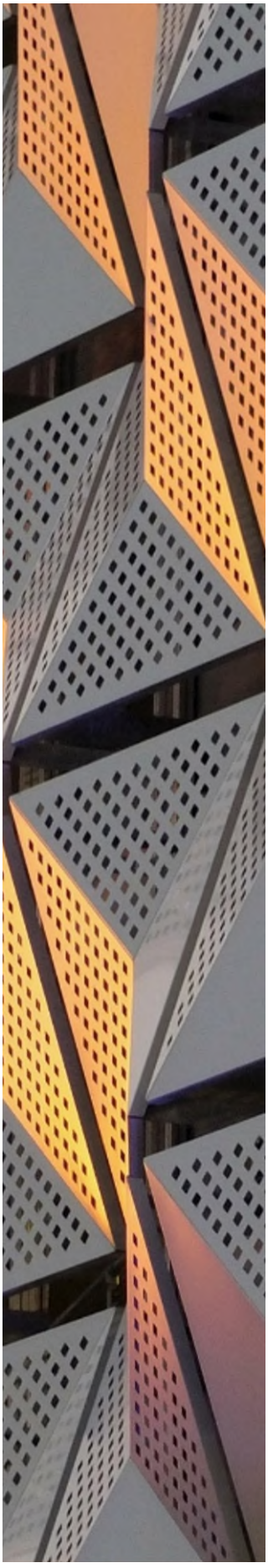
[2] Underpinned by legislative provisions contained in the Financial Services and Markets Act 2023 ("**FSMA 2023**").

[3] S.I. 2024 No. 102

[4] S.I. 2024 No. 705

[5] Set out in FCA Policy Statement 24/4

[6] Set out in PRA Policy Statement 7/24



Scope of application

The FCA and PRA Rules

The FCA Rules apply to:

- FCA-regulated entities acting as institutional investors or "manufacturers" (i.e. originators, original lenders, sponsors or securitisation special purpose entities ("SSPEs")) in a securitisation transaction;
- Entities applying to become Third Party Verifiers;
- Securitisation Repositories as well as those applying to become such.

The FCA is also empowered to set rules under the new "Designated Activities Regime" ("DAR") established by FSMA 2023, which, in this context, will be applicable to UK manufacturers of securitisations, and sellers of securitisation positions to retail clients in the UK. This effectively extends the regulatory "perimeter" to encompass entities not ordinarily subject to the scope of FCA regulation. SSPEs, who will not typically be FCA-regulated entities themselves, would be brought within scope of the FCA Rules as manufacturers under the DAR.

Although the role of "manufacturer" is a new concept in the context of the regulation of securitisation, this in and of itself does not create substantive changes to the nature of the regulatory obligations imposed on transaction parties. Rather, it extends the scope of those obligations to certain sell-side entities acting as securitisation transaction parties, regardless of their authorisation status.

The PRA Rules apply to:

- PRA-authorised entities (broadly including banks, investment firms, insurance/re-insurance undertakings, building societies, credit unions, friendly societies, as well as certain qualifying parent undertakings) acting as institutional investors, originators, sponsors, original lenders or SSPEs in a securitisation transaction.

Importantly, there will be no single set of regulators' rules applicable to all transaction parties. Both sets of regulators' rules may be applicable in any particular transaction (and for dual-regulated entities, both sets of regulators' rules may be applicable to a particular transaction party), and the (UK) regulated status of each transaction participant will need to be carefully assessed to determine which rules are applicable.

While the new Securitisation Regulations require the regulators to "have regard" to the overall consistency of the regulatory framework for securitisation (and the regulators' rules are broadly consistent as at the time of writing), there is scope for divergence going forward.

In addition, the regulators may grant both waivers and derogations from their respective rules. It will be interesting to see if and how this ability shapes the UK securitisation regulatory regime in future (e.g. resecuritisations may be permitted using these powers).

Geographical application

The new UK securitisation regulatory regime is helpfully more specific as to its geographical scope, applying only to entities established in the UK. In particular, the definition of "institutional investor" (and related due diligence obligations) will apply only to AIFMs authorised in the UK, which market or manage an AIF in the UK.

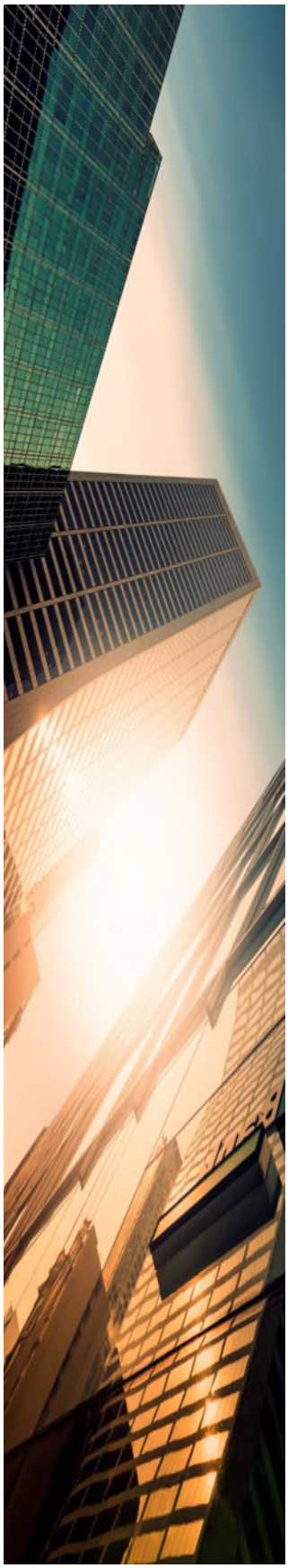
Note that the immediate application (i.e. from 1 November 2024) of the change to the rule around delegation of due diligence and regulatory responsibility (see below) may impact UK AIFMs who have delegation arrangements in place with non-UK authorised entities.

Some substantive changes

While the majority of the new securitisation regulatory regime – for now – remains close to the familiar EU framework from which the existing UK regime was derived, the re-shaping of the UK regime gives rise to some key points and substantive changes of which market participants should be aware. These include:

Diligence requirements

A new, principles-based, approach to investor due diligence will apply, which requires the investor to verify that it has received "sufficient information" to enable it to independently assess the risks of holding the securitisation position, with a commitment from the sell-side entities to make further information available on an ongoing basis. Importantly, this no longer requires the receipt of information in templated formats. While this is potentially helpful for UK investors reviewing disclosure in non-UK transactions, UK manufacturers are still required to provide templated disclosures under the equivalent of the familiar "Article 7" requirements (at least for now, with an anticipated future consultation to cover transparency requirements – see below).



Due diligence may be delegated by an institutional investor to a non-institutional investor, but *unless* the delegate is an FCA/PRA-regulated entity, then the delegating institutional investor retains responsibility for compliance with the due diligence rules. Grandfathering does not apply to this rule so it will impact all such delegation arrangements from 1 November 2024. UK institutional investors should be aware of this change and prepare for required changes to delegation arrangements if necessary.

Risk retention

Whilst some moves have been made to align the UK risk retention position with that under the EU regime, this is one area in which there remains some substantive divergence. By way of example, the UK regime will feature fewer bright lines around determining whether a retainer has been established for the "sole purpose" of securitising exposures.

In addition, while the UK rules have been aligned with certain aspects of the EU Securitisation Regulation[7] that were finalised *after* the UK onshored the EU Securitisation Regulation (for example, the UK has moved towards the flexibility allowed by the EU for securitisations of non-performing exposures ("NPEs"), by allowing the non-refundable purchase price discount to be used to calculate the size of the retained interest), there are some remaining points of difference. Servicers are not permitted to act as retainer in securitisations of NPEs under the UK regime, while they are in the EU, and a retention holder will no longer have the option under the UK regime to transfer the retained interest where it cannot continue as retention holder for legal reasons beyond its control[8].

These are all examples of areas in which closer attention should be paid to language and provisions in new transaction documentation while transaction parties become familiar with the revised scope of some of the UK requirements but which, given the limited uptake of these options on transactions to date, may be of limited practical concern for those structuring and managing transactions.

Transparency and diligence – original commitment to invest

Recognising, helpfully, that the concept of "pricing" is not well aligned with the process for execution of most private transactions (or secondary market trades), the UK regime's disclosure and due diligence requirements will allow the obligations on sell-side parties (to make various disclosures), and on investors (to verify that those matters have

[7] See Commission Delegated Regulation (EU) 2023/2175 and Regulation (EU) 2021/557.

[8] The circumstances in which the retained interest may be transferred are limited to insolvency of the retainer, or where the retainer is no longer included in the scope of supervision on a consolidated basis.

been disclosed), to be met "*before pricing or original commitment to invest*". The intention appears to be that this should be interpreted purposively, i.e., to refer to a definitive commitment to invest and not, for example, upon the signing of a commitment letter early on in a transaction where the commitment to invest is likely to be subject to, amongst other things, agreed documentation.

On private transactions, "pricing" has typically been interpreted to take place on signing the transaction documents (as at that point the terms of the debt are fixed) and we would interpret "original commitment to invest" in the same way, although it is not entirely free of doubt.

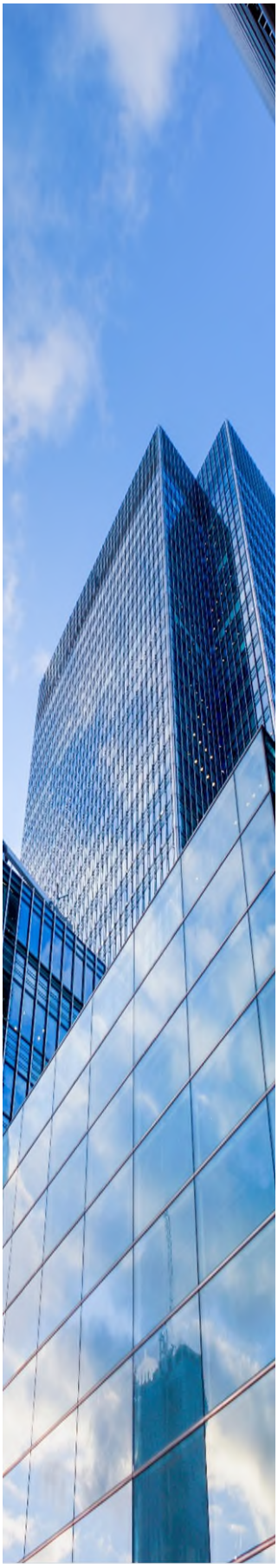
In addition, the UK regime will distinguish between primary and secondary market investors, removing the concept of receiving information "before pricing" for secondary market investors and allowing them instead to verify that they have the relevant information (updated where necessary) before the time at which they commit to invest.

Grandfathering

The new UK regulatory regime applies to securitisations "*the securities of which are issued; and (in the case of securitisations which do not involve the issuance of securities) securitisations the initial or new securitisations positions of which are created*", on or after 1 November 2024, with the existing regime continuing to apply (in most respects) to securitisations entered into on or after 1 January 2019 but before 1 November 2024.

This largely preserves the existing regulatory treatment for transactions entered into since the EU-derived Securitisation Regulation took effect in the UK on 1 January 2019 (providing no amendments or new issuances are made which would take the transaction outside of the grandfathering provisions).

The analysis as to the application of grandfathering provisions that will be required for new transactions and for amendments/new issuances from 1 November 2024 onwards will be similar to that undertaken pre-January 2019. Despite this, the consequences are comparatively benign this time; the new regime represents, if anything, a slight improvement on the existing one, for example, in terms of clarity of jurisdictional scope and flexibility of investor diligence obligations. Note, however, that an existing transaction cannot choose to "opt-in" to the new framework (absent a new issuance or amendment). It will also be important to monitor more substantive changes to the regime over time, as the relevant grandfathering position is likely to require careful examination as additional changes are introduced in due course.



Mechanical changes

Since the bulk of the substantive provisions will be contained in the regulators' rules, there will need to be both a close review of, and updated references made to, UK securitisation legislation and regulators' rules in new transaction documentation for deals where the UK regime is applicable or relevant.

Perhaps one of the most significant changes in connection with the new regime relates not to the substance of the rules but to the way in which they are likely to develop over time. With the majority of firm-facing provisions now set out in regulators' rules and not primary legislation, there is more scope for those rules to change and adapt on a regular basis going forward, perhaps with greater expediency than parliamentary processes typically allow. In theory, the new UK regime will provide regulators with the opportunity to act quickly in response to market changes and the wider regulatory landscape although, as we discuss below, care will need to be taken and the frequent cross-border nature of securitisation transactions borne in mind.

Similarly, for amendments to, and new issuances from, existing transactions – which could take a transaction outside the scope of grandfathering – a case-by-case review of any required amendments to transaction documents, including, by way of example, risk retention memoranda, and a close review and update of relevant legislative provisions, may be necessary.

Going forward

The UK regulators have committed to reviewing the transparency requirements for securitisation transactions and are planning a later consultation paper (in "Q4 2024 or Q1 2025") which is expected to propose further changes, including to the distinction between public and private securitisations, and a possible lighter-touch transparency regime for private deals. This may track closely similar developments expected at EU-level[9], which would be helpful to market participants in what continues to operate in many respects as an EU-UK wide market. Although there will be benefits of additional flexibility and clarity for UK entities, divergence between the rules may mean that transactions wishing to attract investors across both the EU and the UK will need to adopt a "highest common denominator" approach to compliance. The UK regulators have, to date, appeared to be sensitive to the potential time and costs associated with compliance with divergent regulatory regimes in a cross-border context but, on the other hand, have not given any indication that the UK intends to adopt a rule-taker approach when it comes to the regulation of securitisations; UK and EU entities alike will need to keep a watching brief on future developments.

[9] See ESMA's Consultation Paper of December 2023 on securitisation disclosure templates: https://www.esma.europa.eu/document/consultation-paper-securitisation-disclosure-templates.

The new UK securitisation regulatory framework is now set to evolve and adapt (including in relation to the new third-country "equivalence" regime for Simple, Transparent and Standardised securitisations, which is a UK-specific innovation not currently reciprocated in the EU[10]). We look forward to working with our clients to ensure their transactions are compliant with the new UK regulatory regime as of 1 November 2024 and beyond.

Please do not hesitate to contact your usual Simmons & Simmons securitisation contact for further information.

If you would like to discuss any of the issues raised in this article please contact one of the lawyers listed further below.

This article should not be construed as legal advice. Readers are advised to speak to their legal counsel before taking action in relation to any of the matters described above.

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[10] As at the time of writing, no permanent equivalence determination has yet been awarded to any jurisdiction.