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COMMENTARY

# EU Disclosure Requirements for Structured Finance Instruments

The European Commission has adopted a final regulation that sets out wide-ranging disclosure requirements for structured finance instruments ("SFIs") in circumstances where the issuer, originator or sponsor is established in the European Union ("EU").

Although the disclosure requirements apply only to structured finance instruments issued on or after 1 January 2017, or outstanding on that date, the disclosure requirements will apply to a broad range of transactions, including unrated and—after a phase-in period—private and bilateral structured finance instruments.

## Background

On 30 September 2014, the European Commission adopted three Regulatory Technical Standards to implement provisions of the EU Regulation on Credit Rating Agencies ("CRA3").[1]

These Regulatory Technical Standards establish:

- Disclosure requirements for issuers, originators and sponsors of structured finance instruments,
- Reporting requirements in relation to the European Rating Platform, and
- Reporting requirements on fees charged by credit rating agencies.

This *Commentary* looks at the first set of Regulatory Technical Standards which apply to the disclosure of information relating to structured finance instruments (the "RTS").

The stated aim of the RTS is to improve the ability of investors to make an informed assessment of the creditworthiness of SFIs, thereby reducing investors' dependence on credit ratings and reinforcing competition between credit rating agencies.

The RTS specify:

- The information that the issuer, originator and sponsor of an SFI established in the European Union must jointly disclose on a website (the "SFIs website") to be set up by the European Securities and Markets Authority ("ESMA");
- The frequency with which this information is to be updated; and
- The presentation of this information by means of standardised disclosure templates.

## Meaning of "Structured Finance Instrument"

The RTS apply to financial instruments or other assets resulting from a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched (i.e., divided into contractually established segments of credit risk with different risks of credit loss), having both of the following characteristics: (i) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and (ii) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

This definition incorporates the definition of "securitisation" in the Capital Requirements Regulation ("CRR")[2] and accordingly introduces the same uncertainties as to whether or not certain types of transactions are "securitisations"—for instance, certain types of portfolio acquisition financings, secured corporate and single-asset commercial mortgage-backed securities ("CMBS") financings.

Recital 2 to the RTS states, "an exposure that creates a direct payment obligation for a transaction or scheme used to finance or operate physical assets should not be considered an exposure to a securitisation, even if the transaction or scheme has payment obligations of different seniority". This recital repeats recital 50 of the CRR, which is generally taken to refer to asset and project finance transactions, rather than as being a general exclusion for real estate finance transactions.

The scope of the RTS is not limited to the issuance of SFIs that qualify as "securities" but also includes "other instruments and assets resulting from a securitisation transaction or scheme, such as money-market instruments, including asset-backed commercial paper programmes". Loans that form part of a securitisation transaction are also in scope.

Despite the arguments of many industry respondents to ESMA's consultation on the draft RTS, both unrated transactions and private and bilateral transactions are within the scope of the RTS, as well as transactions not offered to the public or admitted to trading on a regulated market.

However, in relation to private and bilateral transactions, a phase-in approach applies—the disclosure obligations will apply only once ESMA has proposed to the European Commission an amendment to the RTS which specifies those private and bilateral SFIs to which the standardised disclosure templates apply and also sets out new disclosure templates and reporting obligations suitable to the particular nature of the remaining types of private and bilateral SFIs. This will follow a public consultation.

## Jurisdictional Scope

The RTS apply to all SFIs where one of the issuer,[3] originator[4] or sponsor[5] is established in the European Union. For this purpose, "established" means "has its statutory seat". This means that many transactions not generally considered to be European structured finance transactions will be caught by the disclosure rules because one of the issuer, originator or sponsor is incorporated in the European Union.

## Responsibility for Reporting

The obligation to comply with the disclosure requirements of the RTS is a joint responsibility of the issuer, originator, and sponsor of the SFI. However these parties may designate one or multiple reporting entities to publish the required information on the SFIs website or may outsource this task to a third party. The identity of any designated reporting entity is required to be notified to ESMA without delay.

The designation of a reporting entity does not relieve the issuer, originator and sponsor from their responsibility for complying with the RTS. When complying with the RTS, issuers, originators and sponsors are required to comply with national and EU legislation on confidentiality of information and the processing of personal data.

One concern for banks and other originators which carry out portfolio sales is that the definition of "originator"[6] includes both the entity which created the asset and also an entity that purchases the asset onto its balance sheet and then securitises it. Where a loan portfolio has been sold and subsequently securitised, it is not clear whether the disclosure requirements apply only to the second originator and cease to apply to the first originator. However, this would seem to be the preferable interpretation, particularly since the original lender may not be aware of the subsequent securitisation.

## Applicable Asset Classes

The information requirements under the RTS apply to SFIs backed by the following underlying asset classes:

- Residential mortgages;
- Commercial mortgages;
- SME loans;
- Auto loans;
- Consumer loans;
- Credit card loans; and
- Leases to individuals and/or businesses.

In the case of SFIs backed by other asset classes, a "phase-in approach" applies, and further disclosure requirements will be issued by ESMA. The asset classes to which the phase-in approach applies include:

- Trade receivables;
- Store cards;
- Corporate loans or leases;
- Asset-backed commercial paper;
- SFIs where the underlying assets comprise other SFIs (i.e., resecuritisations); and
- SFIs where the underlying assets are heterogeneous.

## Information to be Reported

The reporting entity is required to provide the following information to the SFIs website:

- Loan-level information using standardized disclosure templates set out in the RTS
- The following documents, where applicable to a SFI, including a detailed description of the payments waterfall:
  - The final offering document or prospectus, together with the closing transaction documents including any public documents referenced in the prospectus, or which govern the workings of the transaction but excluding legal opinions;
  - The asset sale agreement or other applicable transfer document;
  - The servicing, administration and cash management agreement;
  - The trust deed, security deed, agency agreement, account bank agreement, guaranteed investment contract, incorporated terms memorandum or master framework agreement;
  - Any relevant intercreditor agreements, swap documents, subordinated loan agreements, startup loan documents and liquidity facility agreements; and
  - Any other underlying documents that are essential for the understanding of the transaction.
- If a prospectus has not been drawn up, a transaction summary or overview of the main features of the SFI, including:
  - Deal structure;
  - Asset characteristics, cash flows, credit enhancement and liquidity support features;
  - Noteholder voting rights and the relationship between noteholders and other secured creditors;
  - A list of all triggers and events that could have a material impact on the performance of the SFIs; and
  - Structure diagrams containing an overview of the transaction, the cash flows and the ownership structure.
- Investor reports containing specified information.

Although legal opinions are not required to be provided, there is no carve-out for commercially sensitive information such as subscription/dealer agreements or for information that is subject to confidentiality restrictions. Unlike the equivalent disclosure requirements under Article 409 of the CRR, there is no ability for parties to make a determination of what is "materially relevant data" for the purposes of the disclosure requirements.

## Templates for Loan-Level Information

The RTS include standardised templates for loan-level information in relation to the initial asset classes covered by the RTS. In relation to SFIs with underlying assets which are subject to the phase-in approach, the applicable disclosure templates are intended to be developed and provided as soon as technically possible.

Although market participants had argued that the provision of loan-level data was not appropriate for highly granular, revolving asset classes with high pool turnover, such as credit card and trade-finance receivables, no exception has been

made for these asset classes. The RTS do, however, state that ESMA has noted these concerns in relation to SFIs backed by credit card loans and intends to monitor developments.

## Frequency of Reporting

The specified loan-level information and investor reports have to be made available on a quarterly basis, no later than one month following the interest payment date on the SFI. The information specified above has to be made available without delay after the issuance of an SFI.

In addition, where the market abuse regime applies to an SFI, any disclosure of information under that regime also has to be published without delay on the SFIs website by the reporting entity. Where the market abuse regime does not apply, the reporting entity is required to disclose without delay on the SFIs website any significant change or event relating to: (i) a breach of the obligations in the transaction documents; (ii) structural features that can materially affect the performance of the SFI; and (iii) the risk characteristics of the SFI and of the underlying assets.

## Reporting Procedures

The reporting entity is required to submit data files in accordance with the reporting system of the SFIs website and the technical instructions to be provided by ESMA on its website by 1 July 2016. Files sent to the SFIs website must be stored by the reporting entity for at least five years.

Where the reporting entity or the issuer, originator or sponsor identifies factual errors in the data provided to the SFIs website, it is required to correct the relevant data without undue delay.

## Date of Application of the RTS

The RTS come into force on the 20th day after publication in the *Official Journal of the European Union* but apply only with effect from 1 January 2017. The RTS are directly applicable in all EU member states.

In relation to SFIs issued between the date of entry into force of the RTS and the date of their application, the issuer, originator and sponsor are required to comply only with the reporting requirements in relation to the SFIs which are still outstanding at the date of application of the RTS.

## Conclusion

Although market participants will welcome the fact that the RTS apply only to SFIs issued or outstanding on or after 1 January 2017, the scope of the disclosure obligations is less welcome, particularly the inclusion of unrated, private and bilateral SFIs. The RTS will unquestionably increase transparency in the securitisation market but at the expense of significant administrative burdens for market participants.

## Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.


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## Endnotes

1 The EU Regulation on Credit Rating Agencies (Regulation (EC) No 1060/2009), in force since 2010, was amended in May 2011 and further amended with effect from 20 June 2013 ((IP/13/555).

2 Capital Requirements Regulation (EU) No 575/2013, Article 4(61).

3 "Issuer" is defined to mean "a legal entity which issues or proposes to issue securities."

4 "Originator" is defined in CRA3 by reference to Article 4(41) of Directive 2006/48/EC, now replaced by the CRR, which defines "originator" as: "an entity which: (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or (b) purchases a third party's exposures onto its balance sheet and then securitises them."

5 "Sponsor" is defined in CRA3 by reference to Article 4(42) of Directive 2006/48/EC. The CRR defines it as follows: "an institution other than an originator credit institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities". "Institution" is defined as "a credit institution or an investment firm," each as defined in the CRR.

6 *See* endnote 4 above.