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Putting It All Together: A Brief Guide to the UK's New Securitisation Framework

The new securitisation framework will combine three sets of overlapping rules, in an effort to repeal and replace retained EU law in the UK.

The missing piece of the puzzle to the UK's new securitisation framework became clear on 7 August 2023 when the FCA published consultation paper CP23/17 containing the FCA's proposed draft UK securitisation rules (Draft FCA Rules). The Draft FCA Rules complement the draft rules published by the Prudential Regulation Authority (PRA) on 27 July 2023 (Draft PRA Rules), and together they will sit under the Securitisation Regulations 2023, a near-final draft statutory instrument (the Final Draft SI) to be enacted under the Financial Services and Markets Act 2023 (FSMA 2023). Once enacted in final form, the three sets of rules (the Draft Rules) will together replace the existing UK Securitisation Regulation (UK Sec Reg) as part of the wider post-Brexit programme to repeal and replace retained EU law in the UK.

A previously unified regulation will be split between three sets of overlapping rules, with some duplication and differing application depending on who is being regulated. This Client Alert connects the various proposed drafts, identifies how each set of obligations will apply, and highlights what is changing from the current UK Sec Reg regime — and what is not. A table at the end sets out at a glance which instruments apply to each type of securitisation participant.

Headline Points

Below is a summary of the main points:

- The Draft FCA Rules will, when read together with the Draft PRA Rules and Final Draft SI, comprise an entirely new securitisation framework in the UK.

- The FCA clarified that it will regulate not only authorised firms involved in securitisation, but also unauthorised entities acting as original lender, originator, or securitisation special purpose entity (SSPE) of a securitisation.

- The Draft Rules remove ambiguity regarding their geographic scope of application to sell-side parties — they will apply to UK-established originators, sponsors, original lenders, and SSPEs only.

- The PRA and FCA will impose separate (albeit identical) sets of reporting templates, which are consistent with existing UK Sec Reg reporting templates. While we do not anticipate this causing any material disruptions, sell-side parties will need to identify the correct templates that apply to them.

- Investors exposed to UK and non-UK securitisations would not require PRA or FCA reporting templates from sell-side parties, provided that they have at least the information required under the rules sufficient to assess the legal structure and risks involved, along with a commitment to receive ongoing disclosure.

- The Draft Rules will clarify that certain types of investment managers appointed to invest on behalf of institutional investors would be solely responsible for complying with due diligence obligations.

- Risk retention requirements will be amended to facilitate securitisations of non-performing exposures (NPEs) and to allow the transfer of risk upon the insolvency of the retainer.

- In contrast to the EU position, the “sole purpose test” applying to originators for risk retention purposes would not take into account whether income from the securitised exposures represents a retaining entity’s “sole or predominant source of revenue”. Instead, the test would focus on the fact that an originator retaining the risk should not rely on income from securitised exposures or retained securities in meeting its payment obligations, and it would still need:

  - a strategy consistent with a broader business model;

  - substance from assets, capital, and income;

  - sufficiently experienced management; and

  - appropriate governance.

  The provisions are stated to be “considerations”, implying a principles-based approach. Overall, we do not anticipate these differences would have a negative impact on current market structures.

- The FCA proposes amendments to the simple, transparent, and standardised (STS) “homogeneity” criteria so that loans to corporates would be treated as homogeneous with loans to individuals if the underwriting and servicing procedures are similar.

- The FCA has not opted to include synthetic securitisations into the STS framework, or to make major changes to the transparency rules or definitions of private and public securitisations — at least for now.

Which Requirements Apply?

The Final Draft SI

HM Treasury (HMT), the PRA, and FCA aimed to keep the new framework coherent and broadly in line with the existing UK Sec Reg’s requirements, except for a few targeted changes to add clarity and improve the efficiency of the securitisation market. While the Draft Rules involve some duplication and vary in format, they align in substance. The Final Draft SI establishes the regulatory perimeter and sets out the enabling provisions empowering the FCA and PRA to enact rules for the firms they regulate. In addition, the Draft SI will impose direct obligations of its own.

The Final Draft SI will bring into the new “Designated Activity Regime” established under FSMA 2023 all activities relating to the “manufacturing” of securitisations (i.e., acting as originator, sponsor, original lender, or SSPE) and to the selling of securitisation positions to retail investors. By including these activities in the Designated Activity Regime, the Draft SI will grant jurisdiction to the FCA over unauthorised persons as well as authorised persons.

The Draft Rules remove ambiguity regarding their geographic scope of application to sell-side parties — they will apply to UK-established originators, sponsors, original lenders, and SSPEs only. The Draft SI clarifies further that “UK-established” means constituted under the laws of the UK with either a registered or head office in the UK.

The Draft SI will also make some targeted adjustments to the regulatory perimeter with respect to buy-side due diligence obligations when investing in a securitisation. First, the Draft SI will limit the scope of due diligence obligations under the Draft Rules in respect of alternative investment fund managers (AIFMs), so that they will only apply to UK-authorised AIFMs and small, registered UK AIFMs. Currently, the UK Sec Reg definition of institutional investor does not specify the jurisdiction in which the AIFM must be authorised – the Draft SI will amend this. Second, the Draft SI will impose a separate set of due diligence requirements on trustees or managers of occupational pension schemes investing in securitisations. These additional due diligence requirements will sit alongside separate due diligence provisions in the draft PRA and FCA rules that apply to other institutional investors. The separate provisions are necessary because occupational pensions schemes fall under the remit of the Pensions Regulator instead of the PRA and FCA.

The Draft SI will impose a direct obligation on all originators and sponsors to ensure that the SSPE is not established in a jurisdiction listed as high-risk or uncooperative by the Financial Action Task Force, or a jurisdiction that has not signed an agreement with the UK (or a multilateral agreement to which the UK is a signatory) to ensure compliance with standards set by the Organisation for Economic Cooperation and Development (OECD) in the Model Tax Convention on Income and on Capital and the OECD Model Agreement on the Exchange of Information on Tax Matters. It will also oblige all institutional investors not to invest in securitisations employing SSPEs established in such jurisdictions. This adjustment marks a departure from the UK Sec Reg, which prohibits the “establishment” of SSPEs in such jurisdictions, without imposing an express duty on either sell- or buy-side parties.

Draft PRA Rules

The PRA’s consultation paper CP15/23 includes a draft Securitisation Rules Instrument to form part of the PRA Rulebook along with draft reporting templates, draft amendments to Supervisory Statement SS10/18 on the general securitisation requirements and capital framework, and a draft statement of policy regarding permissions for resecuritisations.

The PRA’s proposals would largely preserve current requirements when retained EU law is transferred to the PRA Rulebook. The Draft PRA Rules will apply to PRA-authorised firms, primarily in the areas of:

- due diligence as institutional investors in securitisations, including monitoring, stress-testing, and risk management;
- risk retention;
- asset selection for the underlying asset pool; and
- credit granting requirements in relation to the underlying asset pool, or verification of credit granting if a PRA-authorised originator purchases assets to be securitised.

The term “PRA-authorised persons” includes firms regulated under the UK Capital Requirements Regulation (CRR), insurance and reinsurance undertakings regulated under the UK Solvency II framework (Solvency II), “non-CRR firms” such as credit unions and building societies, and “non-Solvency II firms” such as insurers and friendly societies not regulated under Solvency II that are authorised to provide insurance contracts. The definition includes PRA-authorised credit institutions, investment firms, qualifying parent undertakings such as financial holding companies and mixed financial holding companies, and financial institutions that are subsidiaries of these firms. However, the Draft PRA Rules will not apply to non-UK firms with branches in the UK.

Draft FCA Rules

The FCA's consultation paper CP23/17 represents the first of two anticipated FCA consultations, and sets out the FCA's proposed rules to replace the firm-facing provisions from the UK Sec Reg, which are being transferred into the FCA Handbook. The FCA's consultation paper contains the proposed legal instrument and all related technical standards and their annexes. A second consultation, to be published at a later stage, will review the reporting regime, reconsider the definitions of public and private securitisations, and introduce environmental, social, and governance (ESG) reporting. No timeframe has been given for the second consultation.

The Draft FCA Rules will apply to:

- FCA-authorised sell-side firms (that are not PRA-authorised firms) in relation to risk retention requirements, transparency obligations, resecuritisation restrictions, and credit granting standards;
- unauthorised entities acting as an original lender, originator, or SSPE of a securitisation as part of the new Designated Activity Regime;
- institutional investors (that are not PRA-authorised firms or occupational pension schemes) in respect of due diligence and monitoring requirements;
- firms other than PRA-authorised firms in respect of the ban on resecuritisations;
- individuals holding offices or positions who are responsible for taking management decisions at relevant firms involved in securitisation markets;
- third-party verifiers of STS securitisations; and
- securitisation repositories.

Draft FCA Rules relating to due diligence, risk retention, asset selection, and credit granting requirements do not apply to firms with a PRA authorisation. However, other firm-facing requirements in the draft FCA Rules, such as requirements relating to STS securitisations, apply to FCA and PRA firms alike.

Changes and Implications for Firms

Due Diligence

The Draft Rules will adopt a more principles-based and proportionate approach for institutional investors verifying disclosure by UK and overseas sell-side parties. The Draft Rules will replace Articles 5(1)(e) and 5(1)(f) of the UK Sec Reg with a single approach, requiring that institutional investors verify that:

- sell-side parties have provided sufficient information to enable them to independently assess the risk of holding the securitisation position;
- they have received at least the information listed in the rules (e.g., offering and marketing materials, information on the transaction documents and legal structure, and STS eligibility/notifications); and

- they have a commitment from sell-side parties to continually provide further information (e.g., individual asset data, investor reports, and material information/significant change reports).

In a departure from the UK Sec Reg, the Draft Rules place more reliance on the substance of the information, rather than prescribing the format in which investors must receive the information. However, sell-side parties would still be required to provide prescribed reporting templates. Investors in both UK and overseas securitisations would not need to require information in a prescribed format, provided that they have sufficient information to adequately assess the risks involved.

The Draft Rules also clarify when investors must be provided with underlying documentation, offering documentation/transaction summaries and STS notifications (initial drafts must be provided before pricing, and final documents must be provided no later than 15 days after the transaction closes).

If an institutional investor has delegated investment management decisions to a managing party, the Draft Rules clarify that only the managing party and not the delegating party would be subject to due diligence requirements. This rule applies if the managing party exposes the delegating party to a securitisation position, provided that the managing party is also an institutional investor (other than an occupational pension scheme).

Risk Retention

New provisions relating to risk retention for securitisations of NPEs appear in the Draft Rules, taking into account the non-refundable purchase price discount, which typically applies in securitisations of NPEs. As a result, retention for NPE securitisations would be measured at 5% of the net value of the defaulted portfolio on the date of the securitisation, as opposed to the face amount of the exposures. This would bring the UK rules broadly in line with the EU's securitisation framework.

Also in line with the EU's rules, the Draft Rules will allow for a transfer of the retained risk if the retainer is insolvent or if a mixed financial holding company, UK parent institution, or financial holding company retains risk on a consolidated basis and the retainer is no longer included in the scope of supervision on a consolidated basis. The Draft Rules will leave out more expansive language found in the EU version, which includes situations in which the retainer is, for legal reasons beyond its control, unable to continue retaining risk. This catch-all language was added to the EU rules to accommodate situations where an NPE servicer is acting as retainer of risk, but its appointment as servicer has been terminated. This situation would not arise in the UK, since NPE servicers will not be permitted to retain risk under the Draft Rules. However, the European Banking Authority (EBA) has said that under the EU rules, risk could be transferred in other situations so long as the change of retainer was not based on a voluntary decision.

Under the UK Sec Reg, the "rule against cherry picking" means that originators cannot select assets for securitisation such that the SSPE bears higher losses on those assets than on comparable assets retained on the originator's balance sheet (as measured over a period of up to four years). However, the current regime provides little guidance on what "comparable" assets are. For added clarity, the Draft Rules will take into account whether eligibility criteria of the assets are comparable at the time of selection, the factors used to determine expected performance of the assets, and forecasts that the assets held on balance sheet would not perform significantly better over time.

The Draft Rules will also clarify that the rule against cherry picking would not be breached if originators or sponsors securitise higher-risk assets (e.g., NPEs) compared to assets remaining on balance sheet, provided that the higher risk profiles are clearly communicated to investors. The Draft Rules will also deem this rule not to have been breached when no "comparable assets" are left on the originator's balance sheet, provided this has been communicated to investors.

If originators or sponsors fulfil risk retention requirements on a synthetic basis, e.g., through the use of guarantees or credit default swaps, the retained interest must be fully collateralised in cash and segregated as if it were client money. Currently, only credit institutions are exempt from this obligation. Under the Draft PRA Rules, all PRA-authorised CRR and Solvency II firms would also be exempt from this requirement (in addition to credit institutions).

Under the Draft Rules, as under the UK Sec Reg, entities established for the sole purpose of securitising exposures are ineligible to act as retainer of risk. When testing whether an entity has been established for the sole purpose of securitising exposures, the PRA and FCA have adopted the same language proposed by the EBA in 2018. In contrast to the EU position set out in technical standards adopted this year under the EU Securitisation Regulation, the "sole purpose test" applying to originators for risk retention purposes would not take into account whether income from the securitised exposures represents a retaining entity's "sole or predominant source of revenue". The test would instead focus on the fact that an originator should not rely on income from securitised exposures or retained securities in meeting its payment obligations.

An originator acting as risk retainer would still need a strategy consistent with a broader business model; substance from assets, capital, and income; sufficiently experienced management; and appropriate governance. The provisions are also stated to be "considerations", which implies a principles-based approach. We do not anticipate these differences would have any negative impact on current market structures.

Transparency

The Draft PRA Rules and Draft FCA Rules each contain their own separate set of reporting templates. As currently drafted, the templates are identical to each other. They do not present a significant departure from the reporting templates currently under the UK Sec Reg and from the transparency requirements more generally (aside from some stylistic and formatting changes). The proposals should therefore not involve significant system changes for sell-side parties.

For public securitisations, securitisation repositories would be subject to new operational standards under the Draft FCA Rules, and would be tasked with verifying accuracy and completeness of reports uploaded to them. Securitisation repositories would give a completeness score for submitted reports based on the aggregate "No Data Option" fields submitted. However, unlike in the EU, they would not be required to reject data reports based on certain aggregate completeness thresholds. Rather, they would be obliged to reject reports due to non-compliance with the data templates, or if the use of "No Data Options" prevent the data submission from being sufficiently representative of the underlying exposures in the securitisation. No detail is given, however, as to what "sufficiently representative" entails.

Resecuritisations

The ban on resecuritisations in the Draft Rules mirrors that in the UK Sec Reg, and both regulators intend to permit them on a case-by-case basis in limited circumstances such as where a financial institution is in distress, or to preserve the interests of investors.

The PRA intends to use its powers under section 138BA of the Financial Services and Markets Act 2000 (FSMA 2000), which is not yet in force, to grant permission to include securitisation positions in the underlying asset pool in limited circumstances. These circumstances are broadly similar to those in which the PRA could currently grant permission under the existing UK Sec Reg. Its approach to permitting resecuritisations is set out in its draft Statement of Policy, which is appended to the consultation paper.

According to its consultation paper, the FCA intends to adopt the same approach as the PRA, and use its powers under Section 138A of FSMA 2000 to waive the ban under the same, limited circumstances. However, a detailed approach is not set out in the Draft FCA Rules or elsewhere. Both the PRA and FCA would generally require that the 5% net economic risk would need to be retained at both transaction levels for resecuritisations.

STS Framework

As part of the "simplicity" requirements for STS eligibility, the UK Sec Reg requires that a securitisation be backed by a pool of underlying assets that are homogeneous in terms of asset type. The FCA proposes amendments to the STS "homogeneity" criteria, similar to what the EBA proposed in its in draft technical standards that were published earlier this year: Loans to certain corporates would be treated as homogeneous with loans to individuals if the relevant underwriting approaches and servicing procedures are similar. To avoid limiting the use of the STS label, the Draft FCA Rules also clarify the condition for homogeneity by allowing loans to be serviced either by the SSPE or the originator.

While these incremental changes may provide some additional flexibility, the FCA still has not opted to follow the EU in including synthetic securitisations in the UK STS framework. This reflects HMT's position in its 2021 review of the UK Sec Reg, which concluded that expanding the STS framework to include synthetic securitisations would in HMT's view provide insufficient risk reduction relative to the lower capital requirements for which STS securitisations are eligible.

Next Steps

Aside from some targeted changes outlined above, the Draft Rules will be broadly similar in substance to the existing UK Sec Reg. We do not anticipate any material disruptions if the Draft Rules are adopted in their current form. However, market participants should be familiar with which rules and reporting templates will apply to them.

While the PRA and FCA's consultation papers seek views from market participants in respect of the distinction between public and private securitisations and associated transparency requirements, such feedback would form part of a later review of the transparency requirements as they are not changing under the current consultations. However, the FCA has indicated that it will consider at a later stage developing more proportionate reporting requirements for private securitisations whilst expanding the definition of public securitisations to encompass all securitisations that are publicly distributed to investors. ESG disclosure may also feature in the next round of consultations.

The period for both consultations ends on 30 October 2023.

Roadmap of Draft UK Securitisation Rules — Which Rules Apply?

	PRA-authorised firms	**FCA solo-authorised firms and small, registered AIFMs**	**Unauthorised firms**	**Trustees and managers of occupational pension schemes**	**Securitisation repositories / third-party STS verifiers (as relevant)**
Retail sales of securitisations	FCA Rules	FCA Rules	FCA Rules	FCA Rules	
Requirements for SSPEs	Final Draft SI	Final Draft SI	Final Draft SI	Final Draft SI	

	PRA-authorised firms	FCA solo-authorised firms and small, registered AIFMs	Unauthorised firms	Trustees and managers of occupational pension schemes	Securitisation repositories / third-party STS verifiers (as relevant)
Due diligence	PRA Rules	FCA Rules	FCA Rules	Final Draft SI	
Risk retention	PRA Rules	FCA Rules	FCA Rules	FCA Rules	
Transparency	PRA Rules	FCA Rules	FCA Rules	FCA Rules	FCA Rules
Resecuritisation restrictions	PRA Rules PRA Policy Statement on Permissions for Re-securitisations	FCA Rules	FCA Rules	FCA Rules	
Criteria for credit granting	PRA Rules	FCA Rules	FCA Rules	FCA Rules	
Registration and supervision of securitisation repositories					FCA Rules
Use of the STS designation	FCA Rules	FCA Rules	FCA Rules	FCA Rules	FCA Rules
STS eligibility	FCA Rules	FCA Rules	FCA Rules	FCA Rules	FCA Rules
STS notification and registration	FCA Rules	FCA Rules	FCA Rules	FCA Rules	FCA Rules

	PRA-authorised firms	FCA solo-authorised firms and small, registered AIFMs	Unauthorised firms	Trustees and managers of occupational pension schemes	Securitisation repositories / third-party STS verifiers (as relevant)
Enforcement and remedial measures	PRA Rules or FCA Rules, depending on context	FCA Rules	FCA Rules	Arrangements to be imposed by the Pensions Regulator	FCA Rules

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