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European Securitisation Regulation: What's Next For CLOs?

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The European Securitisation Regulation[1] became applicable from 1st January 2019. It has a number of goals, including consolidating and recasting existing European regulations, establishing a framework for Simple, Transparent and Standardised securitisation and introducing new transparency and disclosure requirements. This Q&A addresses the application of the new transparency and disclosure requirements for managed CLOs, following adoption of the reporting templates by the European Commission on 16th October 2019.

What are the Securitisation Regulation disclosure and transparency requirements and what is their objective?

Article 7 of the Securitisation Regulation addresses disclosure and transparency; it is just one small piece of the European Securitisation Regulation. Its goal is to enhance transparency for investors including through the imposition of stricter transparency requirements for originators, sponsors and securitisation special purpose entities (SSPEs).

Disclosures and reporting required under Article 7 need to be made available to the relevant EU regulators and national competent authorities. These also need to be available not only to current investors but, on request, to potential investors to enable them to make informed decisions.

Information to be disclosed on private securitisations (which includes most managed CLOs) includes the following:

- all transaction documents essential to the understanding of the deal (in draft form pre-pricing and in final form on closing);
- a transaction summary (pre-pricing in draft form and on closing in final form) describing the key characteristics of the deal (which can be incorporated into the prospectus if the deal is listed);
- quarterly template-based loan-level and investor reporting;
- disclosure (without delay) of significant events and/or inside information if the deal is within the scope of the EU Market Abuse Regulation (MAR) regime. Private securitisations are not required to use a template for such disclosure.[2]

What is the regulatory timetable following the publication of the finalised technical standards prescribing the new reporting templates?

The European Securities and Markets Authority (ESMA), as the body tasked with drafting the regulatory technical standards (RTS) prescribing the applicable templates and other operational requirements for the disclosures required to be made under Article 7 of the Securitisation Regulation, published updated templates in January 2019. On 16th October, the European Commission adopted the templates with no significant changes. The templates will now progress to the European Council and Parliament for scrutiny, which could take up to three months. The final templates will be published in the Official Journal of the European Union and will come into effect on the 20th day following publication, which is currently expected to be early in the first quarter of 2020.

[1] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

[2] Note that MAR/inside information and significant event disclosures are also relevant for private securitisations, although MAR/inside information disclosures will be relevant only if the CLO is on a MAR trading venue that is in-scope.

What are the implications of the new disclosure and transparency requirements for CLO issuers, sponsors and originators?

The new reports have a prescribed form and template for all securitisations with the underlying exposure template specific to the asset class. The rationale for this decision is that a standardised approach will aid comparison regardless of issuer as data fields provided for every CLO will now be identical. Consequently, the Regulation will impact issuers, sponsors and originators as well as administrators.

The new templates for loan-level disclosure and investor reporting relate to all CLOs within the scope of the Regulation, and must be used from the relevant date of application of Article 7 technical standards. They represent a significant shift from existing post-closing reporting practices and are more onerous.

What is the level of readiness in the CLO industry?

Managers, administrators and legal firms have been working together to prepare for the new disclosure requirements. In particular there have been detailed discussions about data fields for Annex 4 (underlying exposures – corporate), which is the most onerous in terms of data requirements, and Annex 12 (underlying exposures – investor reports). General consensus has been reached on both Annexes but a few points from each remain in discussion. Subject to certain remaining challenges described below, the CLO market looks fairly well prepared for reporting utilising the published templates and in its understanding of the processes involved.

What are the greatest challenges associated with the new reporting requirements?

The main challenge is the data requirements and how they can be fulfilled. This is still a work in progress for both managers and administrators (the latter hold most of the required data but not necessarily in a format that makes completing mandatory templates straightforward). Careful analysis has been required in order to identify the availability of the required data/information and, in cases where it was difficult to provide or obtain the required data/information, consideration of whether the relevant field in the reporting template provided for any flexibility with regard to the use of "no data" options. Interpretation of the requirements of certain fields in the applicable templates was another challenge necessitating referral to the ESMA Q&As for any additional guidance and to engage with industry associations in order to seek further clarifications from ESMA.

More generally, the Regulation requires new data points that must be captured upfront and also greater detail on assets. As a typical CLO will have more than 100 assets and as most information is reported at the asset level, dealing with the volume of data will be challenging.

What practical steps should managers take in the coming months?

The most important thing is to be engaged with industry and regulatory developments and be aware of the requirements and their timing: there is a need to keep on top of new information as it is published, such as ESMA's Q&A publications. Once the detail of the templates is finalised, managers need to ascertain how they will generate data for reporting purposes. The responsibility for these tasks rests with a number of different individuals depending on the manager involved. However, operations oversight, compliance and legal teams should work together to ensure the manager can fulfil the requirements of the Securitisation Regulation.

Does Brexit have any implications for Article 7 of the European Securitisation Regulation?

CLO issuers are mainly based in the Netherlands or Ireland and Brexit will therefore have no implications in terms of the transparency and disclosure requirements applicable to the issuer. It is also expected that corresponding transparency and disclosure requirements will be implemented in the UK. Although the requirements are expected to be broadly similar, CLO issuers and investors will need to keep abreast of developments and understand their implications.

Do CLO issuers and managers need to concern themselves with new requirements associated with making reporting available via an authorised securitisation repository (SR)?

SRs play a central role in enhancing the transparency of securitisation markets and thus of the financial system. Under the Securitisation Regulation, ESMA has direct responsibilities regarding the registration and supervision of SRs. The Securitisation Regulation requires the uploading of documents and reports to a website that has met qualification criteria regarding data protection, backup and other concerns in order to become an authorised repository. While a CLO is a public transaction,

they are deemed to be private securitisations for the purposes of Article 7 as, post-January 2019, they have been typically listed on the Global Exchange Market (GEM) of Euronext Dublin and are not in scope of the Prospective Directive. Therefore, they are not required to report via an authorised repository. Our understanding is that all CLO issues this year have been deemed private for these purposes and we currently anticipate that all future CLOs will be private as well.

What support will CLO managers and others need to ensure compliance with the Securitisation Regulation?

For CLOs, the main ongoing requirements are to complete two templates (Annex 4 and Annex 12) on a quarterly basis and make them available to competent authorities, investors and potential investors (the expected method will be to post them on a website). Ad hoc disclosures (without delay) are also required of information relating to MAR/inside information and/or significant events (Annex 14). Securitisations defined as private are not required to use a template for these MAR/inside information and/or significant events disclosures. They will likely need an administrator to help them complete the templates and host them in order to make them available to authorities, investors and potential investors. The process of producing a template is a combined effort. An administrator can generate data points from its own records. However, additional input is required from managers, who also need to review and approve the completed templates.

The regulatory obligation to publish the required disclosures under Article 7 attaches directly to the relevant EU originator, sponsor and SSPE. ESMA Q&As helpfully confirm that delegation to other agents to facilitate compliance is possible, but the relevant EU originator, sponsor and SSPE will remain responsible for compliance as a matter of law.

An administrator managing this process should aim to ensure that the information and data they request from managers are as specific as possible. Ideally, it should be structured as a clearly laid-out, standardised template to facilitate rapid completion and optimum accuracy and efficiency. It is also important to put validation checks in place that address the relevant criteria and ensure the templates are in the right format. The details of some of these qualitative and structural checks still need to be resolved and an effective administrator will keep their clients informed as progress is made. Similarly, there is some uncertainty over the timing of quarterly reports, which are meant to align with payment date reports. When this uncertainty is resolved, administrators will be able to assist managers in adjusting the timing of their reports.

What characteristics should managers seek in an administrator to assist them with the European Securitisation Regulation?

Ultimately, it is about credibility in the marketplace and a thorough understanding of the underlying data requirements. As the number one administrator in EMEA[3], BNY Mellon is at the forefront of engagement with all market participants and has been working closely with managers, legal firms and other administrators analysing, debating and seeking consensus on the data points across the published reporting templates, as well as applying the additional requirements to meet the interim reporting requirements. There is a high level of familiarity with the Regulation. For those managers eager to know more about the specifics and technical requirements associated with the reporting and transparency requirements under the Securitisation Regulation, BNY Mellon can share information about matters such as validation checks or format conversion to XML.

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[3] Source Asset Backed Alert, October 2019.

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Further details of the Securitisation Regulation can be found at the ESMA website:
https://www.esma.europa.eu/policy-activities/securitisation

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