HM Treasury

Review of the Securitisation Regulation:

Report and call for evidence response

December 2021

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Executive summary

Securitisation is the process of pooling various exposures to form a financial instrument that can be marketed to investors. This packaging allows lenders (such as banks) to transfer the risks of loans or assets (such as mortgages, auto loans, or consumer loans) to other banks or investors (such as insurance companies or asset managers). These financial instruments are 'tranched', which means that they carry different levels of risk and return to suit the appetite of different investors.

Securitisation activity in the UK is primarily regulated under the Securitisation Regulation (Sec Reg), which has applied since 1 January 2019. The Sec Reg aimed to strengthen the legislative framework for securitisations and revive high-quality securitisation markets after the Global Financial Crisis (GFC). It also created a framework for Simple, Transparent, and Standardised (STS) securitisations, in line with international standards.[1]

HM Treasury is required under Article 46 of the Sec Reg to review the functioning of the Regulation and lay a report on eight specified areas before Parliament by 1 January 2022. This report fulfils that requirement. In preparation, HM Treasury published a call for evidence in June 2021 that sought views on the eight areas specified in the Regulation, as well as on ways the Sec Reg could be improved.

The report finds that, at present, it is challenging to definitively draw conclusions on the effect of the Sec Reg on the functioning of the UK securitisation market. The Sec Reg has only applied in the UK since 2019. During this time, unique external factors, like the Covid-19 pandemic, have disrupted financial markets and made it difficult to assess the effects of the Sec Reg.

Nevertheless, there are signs that the Sec Reg has increased the transparency and robustness of the UK securitisation market, which were key aims of the Regulation. At the same time, there are some indications that the Sec Reg has not boosted securitisation issuance or broadened the investor base as much as it could have.

Overall, HM Treasury continues to support the Sec Reg, in particular noting the importance of preserving confidence in the STS framework. However, there are some areas of the Regulation that may benefit from targeted and appropriate refinement. HM Treasury and the financial services regulators – the Financial

[1] The STS framework is in line with the Basel standard for Simple, Transparent, and Comparable ('STC') securitisation. It is designed to make it easier for investors to understand and assess the risks of a securitisation investment. Certain firms, such as banks and insurance firms, who hold compliant STS securitisations may be able to benefit from preferential capital treatment.

Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) – will continue to monitor the market.

The report outlines specific areas of the Sec Reg that HM Treasury considers may be usefully re-visited to ensure it best delivers for the UK securitisation market. In particular, we note the issues and suggestions related to disclosure requirements raised by respondents to the call for evidence. HM Treasury recognises that work is needed on the disclosure requirements, especially to assess the distinction between different types of securitisations (i.e. whether they are public or private), and to consider whether the disclosure requirements for certain private securitisations are appropriate.

HM Treasury will also consider amending or clarifying some of the jurisdictional scope matters related to the Sec Reg that were raised. This includes scoping out certain unauthorised, non-UK Alternative Investment Fund Managers (AIFMs) from the Regulation's definition of institutional investor and clarifying due diligence requirements for investors when they invest in non-UK securitisations. HM Treasury also agrees with respondents that an STS equivalence framework, under which future equivalence determinations could be made, should be introduced.

Further areas where HM Treasury, working with the regulators, will consider whether changes are appropriate include revisions to risk retention requirements and exploring expanding disclosure templates to require more information about a securitisation's environmental, social, and governance impact.

The report concludes that no changes are currently needed to the Sec Reg relating to Third Party Verifiers (TPVs) or Securitisation Special Purpose Entities (SSPEs), because neither of these elements of the regime raised major concerns.

Finally, the report covers the prudential treatment of securitisation (i.e. capital and liquidity requirements) within regulatory regimes for banks, building societies, and insurance firms. This is not directly in scope of the review because the requirements sit outside the Sec Reg. However, considering the high interest in this topic shown by respondents to the call for evidence, HM Treasury and the PRA will consider certain points related to the prudential treatment of securitisations in due course.

Chapter 1

Introduction

1.1 Securitisation is the process of pooling various exposures to form a financial instrument that can be marketed to investors. The securities are 'tranched', which means that they carry different levels of risks and return to suit the appetite of different investors.

1.2 Securitisation is an important part of well-functioning markets and a useful source of finance for UK businesses. It can aid capital, liquidity, and risk management. Soundly structured securitisation is a useful channel for diversifying funding sources and allows for a broader distribution of financial-sector risk. Securitisation can also help free up lenders' balance sheets to allow for further lending to the real economy. Overall, it can make the financial system more efficient and provide additional investment opportunities.

1.3 The Securitisation Regulation (Sec Reg) has applied since 1 January 2019 as the main piece of legislation governing securitisation in the UK.[1] Article 46 of the Sec Reg requires HM Treasury to review the Regulation's functioning and to lay a report before Parliament by 1 January 2022. This report fulfils that requirement.

1.4 On 24 June 2021, HM Treasury launched a call for evidence seeking views on the functioning of the Sec Reg. This was intended to inform HM Treasury's review and report to Parliament, and to help HM Treasury understand how the Sec Reg can best deliver for the UK financial market and economy. The call for evidence closed on 2 September 2021.

1.5 The call for evidence asked for views on the following areas that HM Treasury must report on:

a) Effects of the Sec Reg – including the introduction of the Simple, Transparent, and Standardised (STS) securitisation framework – on the functioning of the securitisation market, the contribution of securitisation to the real economy (in particular on access to credit for Small and Medium-sized Enterprises (SMEs) and investments), and the interconnectedness between financial institutions and the stability of the financial sector;

b) Risk retention modalities;

c) Disclosures related to private securitisations (including two specific areas);

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[1] For an overview of securitisation, the Sec Reg, and related legislation, see 'Introduction' and 'Securitisation Regulations' on pages 2 to 4 of 'Review of the Securitisation Regulation: Call for evidence', HM Treasury, June 2021.

d) An STS equivalence regime;

e) Environmental, Social, and Governance (ESG) disclosures;

f) The third-party verification regime; and

g) Limited licensed banks.

1.6 The call for evidence also sought views on the definition of institutional investor in the Sec Reg as it relates to certain non-UK Alternative Investment Fund Managers (AIFMs).

1.7 HM Treasury's review presents an opportunity to consider ways in which the Sec Reg could be improved to ensure the regime is as effective as it can be. To this end, HM Treasury set out its overarching aims for the review in the call for evidence:

- To bolster securitisation standards in the UK, in order to enhance investor protection and promote market transparency; and
- To support and develop securitisation markets in the UK, including through the increased issuance of STS securitisations, in order to ultimately increase their contribution to the real economy.

1.8 HM Treasury received 21 responses to the call for evidence from a range of institutions involved in securitisation activities, or with an interest in securitisation, including:

- Industry trade bodies;
- Securitisation manufacturers (originators, sponsors, and Securitisation Special Purpose Entities, or SSPEs);
- Investors;
- Third Party Verifiers (TPVs);
- Securitisation Repositories (SRs);
- Credit rating agencies;
- Academics.

1.9 HM Treasury is grateful to all respondents for their responses to the call for evidence and engagement throughout the process of conducting this review. While every response was considered, HM Treasury exercised discretion to summarise and reflect the most salient points in this report, which is not intended to be a comprehensive report of all the issues raised by respondents.

Next steps for the review

1.10 Responses to the call for evidence have identified priority areas in the Sec Reg, and wider UK regulation for securitisation, which HM Treasury considers could be improved. Following its review, HM Treasury is committed to working with the financial services regulators – the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) – to further examine these areas and, where appropriate, to bring forward reforms. We outline where reforms are being considered in the 'Conclusion' sections of the chapters in this report.

1.11 Alongside this, HM Treasury is also conducting the Future Regulatory Framework (FRF) Review, which was established to consider how the financial services regulatory framework should adapt to be fit for the future, and in particular to reflect the UK's new position outside of the EU. The government published a detailed consultation on the FRF review in November 2021.[2] That consultation sets out proposals for changes to the regulators' statutory objectives and enhanced mechanisms for accountability, scrutiny, and oversight of the regulators by Parliament, HM Treasury, and stakeholders. It also sets out that the independent regulators will be able to determine the direct regulatory requirements that apply to firms.

1.12 HM Treasury will ensure the outcomes of this securitisation review are delivered in line with the outcome of the FRF Review. For example, where responsibility for making firm-facing requirements is delegated to the regulators, the government would set the scope and core elements of the regulatory regime for securitisation. The government may also set out what the FCA and PRA must have regard to when making any reforms and maintaining the regime.

[2] 'Future Regulatory Framework (FRF) Review: Proposals for Reform', HM Treasury, November 2021.

Chapter 2

Overall Effects of the Securitisation Regulation

2.1 The Sec Reg aimed to kickstart high-quality securitisation activity after a decline in general securitisation activity following the Global Financial Crisis (GFC). Central to this ambition was its implementation of robust requirements, consolidation of various sectoral regulations, and introduction of the STS designation. The Sec Reg also aimed to support securitisation as a tool to better distribute financial-sector risk.

2.2 Article 46(2)(a) requires HM Treasury to assess the effects of the Sec Reg, including the introduction of the STS designation, on three areas:

- The functioning of the securitisation market;
- The contribution of securitisation to the real economy, in particular on access to credit for SMEs and investments;
- The interconnectedness between financial institutions and financial stability.

2.3 HM Treasury asked questions on these areas in the call for evidence to gain a better understanding of the impacts of the Sec Reg. For example, HM Treasury asked for comparisons between the UK securitisation market and that of other jurisdictions, as well for comparisons of any relevant financial regulation in the UK and that of other jurisdictions. The call for evidence also asked questions on how the Covid-19 pandemic and the UK's exit from the European Union (EU) have affected the UK securitisation market.

2.4 By its nature, this chapter overlaps with a range of areas that are covered in this report. Where appropriate, there are references to further detail provided in other chapters.

Responses – Market functioning

2.5 16 respondents answered questions on the overall effects of the Sec Reg. Generally, responses were mixed about those effects on market functioning. Both favourable and less favourable views were shared, and respondents didn't unanimously agree on the Sec Reg's impact since its introduction.

2.6 While there were suggestions for reforming the Sec Reg and the associated prudential capital treatment of securitisation positions in the UK, the vast majority of respondents conveyed their general support for the Sec Reg.

2.7 By and large, respondents recognised that the Sec Reg has been in force for less than three years, so it is difficult to draw definitive conclusions on its effects at this stage. External factors that overlapped with the introduction of the Sec Reg, such as the Covid-19 pandemic, have also made it difficult to assess its impact. For both of these reasons, HM Treasury and the regulators welcome further feedback as new evidence becomes available.

The Sec Reg's effects on market functioning

2.8 A range of respondents acknowledged the benefits that the Sec Reg has brought to the functioning of the UK securitisation market, many of which were explicit goals of the Sec Reg. Respondents shared that it has so far:

- Improved the transparency of securitisations;
- Increased the securitisation market's robustness and harmonisation;
- Helped increase liquidity in the securitisation market.

2.9 A number of respondents were less positive about the effects that the Sec Reg has had on market functioning, claiming that it has so far:

- Not returned market size to pre-GFC levels;
- Not managed to sufficiently broaden the investor base of securitisations, especially among insurance companies and insurance funds;
- Increased requirements on market participants.

2.10 Respondents raised a range of reasons to explain the Sec Reg's less positive effects, including:

- Excessive and overly prescriptive requirements, particularly in relation to due diligence and disclosures, compared to other capital market instruments (e.g. covered bonds);
- Higher capital-adjusted costs compared to other, similar capital market instruments and alternative funding mechanisms, such as the Bank of England's (BoE) Term Funding Scheme (TFS);[1]
- Disproportionate levels of securitisation regulation in the UK and other jurisdictions compared to the risk posed by securitisation, given its historical performance since the GFC.

STS securitisation

2.11 The Sec Reg introduced the STS designation for qualifying securitisations with the ambition of reinvigorating the securitisation market by increasing harmonisation, transparency, diversifying the investor base, and increasing investor confidence.

2.12 STS securitisations are designed to make it easier for investors to understand and assess the risks of a securitisation investment by excluding more complex features. Securitisations must comply with specified criteria in the Sec Reg to be designated as STS. Manufacturers are liable for compliance with their STS designation, but in turn institutional investors must check that all STS securitisations

[1] The BoE's TFS and Term Funding Scheme with additional incentives for SMEs (TFSME) offered funding at Bank Rate plus a scheme fee. The TFS ran from September 2016 to February 2018. The TFSME ran from March 2020 to October 2021. Both the TFS and TFSME were designed to provide banks with cheap funding in order to strengthen the transmission of the Monetary Policy Committee's reductions in Bank Rate.

they invest in comply with these requirements. Firms subject to the Capital Requirements Regulation (CRR) and Solvency II who are holding compliant STS securitisations can benefit from preferential capital treatment, provided these STS securitisations meet additional requirements set out in the CRR and Solvency II.

2.13 Most respondents supported the introduction of the STS designation and its stated objective to revive a robust securitisation market. Some respondents were particularly positive about the introduction of the STS designation, arguing that it plays an important part in the efforts to rebuild trust in securitisation by the market and regulators after the GFC. A number of respondents asserted that the STS designation could help prevent a repeat of the crisis.

2.14 Other respondents were more critical about the performance of STS securitisation, and some concluded that the introduction of the designation may not yet have stimulated the market nor attracted new investors to the extent that was originally intended. Respondents also noted that much of the STS designation has been applied to existing transactions issued before the Sec Reg was introduced, rather than newly issued STS securitisations.

2.15 Following a question in the call for evidence on what investors consider when deciding to invest in an STS or non-STS securitisation, respondents provided the following information:

- Capital benefits and liquidity in the secondary market are key considerations, both of which can be better for STS securitisations;
- More sophisticated investors already carry out due diligence and credit checks and don't view the due diligence requirements for STS securitisations as burdensome;
- Some less sophisticated investors, however, were said to prefer to invest resources in carrying out the same due diligence and credit checks for higher-yielding, non-STS transactions instead.

2.16 Respondents also provided views as to why investment in STS securitisations has not revived the wider securitisation market to the extent that was intended:

- Some manufacturers and investors don't think that the benefits derived from STS designation are always proportionate to the cost of complying with STS criteria;
- The investor base for STS securitisations may be constrained by the limited range of transactions and asset classes that can easily qualify as STS under the Sec Reg;
- STS securitisation capital benefits may not always be as attractive in comparison to other fixed income products.

Market performance – A comparison

2.17 To evaluate the performance of the UK securitisation market, HM Treasury asked respondents for views and evidence on a number of comparisons, including how the UK market has performed compared to different jurisdictions and in different time periods. Respondents provided a wide variety of data and charts on the performance of the UK securitisation market.

2.18 In terms of current performance, the latest data from one respondent shows that, in the first half of 2021 (H1 2021), the UK had the highest volume of placed issuance[2] by country of collateral[3] of any European country (see Table 2.A). The same respondent's data shows this was the case in full year 2020 too, and that H1 2021 represents the lowest half-year issuance on record for total securitisation issuance in Europe (including the UK).[4]

Table 2.A: Placed issuance by European country of collateral

Country	Q1 2021	Q2 2021
Belgium	0.3	0.0
France	0.5	1.1
Germany	2.0	3.1
Greece	0.0	0.0
Ireland	1.0	1.7
Italy	0.0	0.5
Netherlands	2.3	2.1
Pan European	7.0	8.4
Portugal	0.0	0.0
Spain	2.0	1.2
Switzerland	0.0	0.2
UK	**14.2**	**4.5**
Other Europe	0.0	1.0
European Total	**29.2**	**23.9**

Figures represent volume in EUR billions

Source: AFME 2021 Q2 Data Report

2.19 Another respondent shared that there has been a higher volume of issuance from UK institutions securitising mortgage loans compared to EU institutions, which more heavily relied on covered bonds for the financing of mortgage loans.

2.20 In terms of global performance, one respondent provided data that depicts how total securitisation issuance in Europe compares to other notable jurisdictions since 2016 (see Chart A). The respondent added that comparisons to the US should exclude the effects of the government-sponsored enterprises, i.e. Fannie Mae and Freddie Mac, and on this basis US issuance varies between three to six times that of

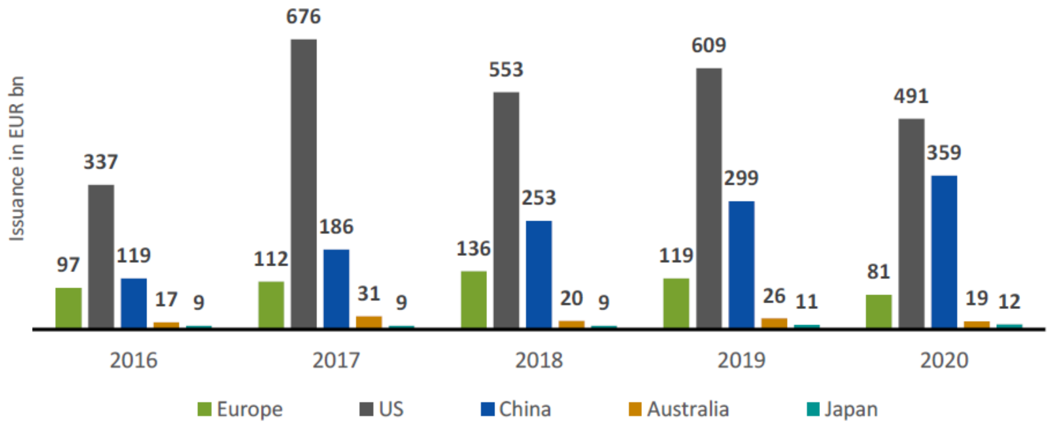
2 Placed issuance is where the securitisation is sold to investors, rather than retained by the originator.

3 Country of collateral refers to the country where the securitisation's collateral is situated e.g. where the collateral of an RMBS is made up of UK properties, then the country of collateral for that securitisation would count as the UK.

4 'Q2 2021 Securitisation Report', AFME, September 2021.

Europe (including the UK).[5] Another respondent underlined the importance of the Australian securitisation market to its financial sector and noted a growing number of productive relationships between Australian issuers and UK and European investors.

Chart A: European (including UK) total issuance by country of collateral compared internationally[6]



2.21 Some respondents also provided evidence comparing the current state of securitisation markets since the GFC, which aimed to show:

- Certain securitisations, in particular Residential Mortgage-Backed Securities (RMBS), auto loan and consumer credit-backed securities, as well as non-ABCP securitisations more generally, have performed strongly since the GFC;
- Securitisation issuance has been constrained for similar reasons to most financial markets, namely low credit demand, the strong capital position of banks, and deep pools of liquidity;
- Using different evaluation metrics (e.g. measuring issuance of UK collateral instead of currency denominated issuance) may indicate that there has been lower issuance volume in the UK securitisation market since the GFC.

EU Exit

2.22 In addition to answers to the call for evidence questions on the Sec Reg's effects on market functioning, respondents also provided specific views on the effects of the UK's departure from the EU and the Covid-19 pandemic on the UK securitisation market. There was no consensus on the impacts of these events.

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5 The respondent provided evidence suggesting that US government-sponsored entities (GSEs) purchase circa 80% of mortgages originated by US banks. The implication is that US GSEs are a significantly large and active investor in the US securitisation market that create demand for a large portion of the US securitisation market (i.e. mortgages), which isn't comparable to the UK, Europe or Australia.

6 'AFME Securitisation Data Report Q2 2021' and 'AFME CMU KPI Report 2021', AFME, 2021. The chart is reproduced with AFME's permission. Note that US agency volumes (i.e. volumes from the government-sponsored entities) and European retained volumes have been excluded from total issuance for the respective regions.

2.23 Regarding the effects of EU Exit, some respondents thought this had been minimal and shared the following points:

- EU Exit hasn't impinged on market functioning, at least partially because UK investors have benefited from the temporary recognition of EU STS securitisations in the UK;[7]
- The effective exercise of transitional powers by the FCA and PRA, known as Temporary Transitional Powers (TTP), limited the transition's immediate impact on market activity;
- UK banks managed their credit portfolios effectively.

2.24 Other respondents thought that EU Exit could be seen to have affected market functioning in the UK – or may do so in the future – because:

- It may have reduced the number of investments in UK securitisations by EU investors;
- It creates the need for dual compliance (i.e. the requirement for market participants operating in the UK and EU to comply with both the UK and the EU Sec Reg);
- The UK securitisation market may suffer if an alternative mechanism to the TTP is not put in place.

Covid-19 pandemic

2.25 Regarding the effects of the Covid-19 pandemic, all respondents acknowledged that the UK securitisation market had been affected by it, reflecting the impact on the wider capital market. Some respondents shared evidence that suggested some securitisations were affected more than others, particularly in terms of credit performance, namely credit card securitisations and Commercial Mortgage-Backed Securities (CMBS), as well as synthetic securitisations.

2.26 A number of respondents stated that they expect the full effects of the Covid-19 pandemic on the UK securitisation market to materialise in the future. In particular, they noted that RMBS, amongst other types of securitisation, could be adversely affected and there could be an increase in non-performing loans, where borrowers are in default due to missing scheduled payments for a specified period.

2.27 Yet, in general, most respondents indicated that they thought the UK securitisation market held up well despite the market tumult caused by the pandemic, and that it has recovered quickly. The following comments were provided:

- Credit performance was robust and credit losses were lower in the UK securitisation market compared to other financial markets;
- There were very few credit downgrades of UK securitisations by ratings agencies, which one respondent opined could at least partly be explained by UK banks being cautious with their lending to UK companies in sectors affected by EU Exit (which subsequently were also the sectors most

[7] See paragraph 5.3 in Chapter 5 for an explanation of the temporary recognition.

adversely affected by the pandemic, e.g. retail, hospitality, and construction).

2.28 Notably, a number of respondents stated that, in their view, government and regulator support had prevented a debt crisis, which would have severely damaged the securitisation market. Some shared specific supporting examples:

- The UK had the highest proportion of mortgages that benefitted from a moratorium[8] compared to any EU country;
- While the eviction moratorium exerted financial pressure on buy-to-let landlords who had to forbear any non-payments, cuts to the rates of Stamp Duty[9] boosted the UK housing market, and thus the RMBS market;
- The BoE's decision to accept securitisations for its enhanced Contingent Term Repo Facility[10] helped stabilise the market.

Responses – Securitisation and the real economy

2.29 A number of respondents described how securitisation can channel more funding to the real economy, remarking that:

- Securitisation can protect SMEs from funding shocks and the procyclical behaviour of bank lending;
- Greater market competition and a larger investor base for securitisations will increase the amount of capital to support real economy lending;
- Securitisation enables banks to safely and proactively manage capital and diversify their funding sources, and it can also reduce banks' reliance on short-term funding.

2.30 Regarding SMEs in particular, a small number of respondents highlighted how the Sec Reg may not have supported SME securitisation. Due diligence requirements and loan-by-loan disclosure requirements, which can be difficult to fulfil for SME loans, were cited as examples.

2.31 However, a larger number of respondents pointed out that other factors beyond the Sec Reg may be impinging on SME securitisation, including:

- Other funding mechanisms that are more economical than SME securitisation, such as covered bonds or the BoE's TFS;
- High transaction costs for SME securitisations, which stem from structuring, arrangement and legal work, plus the appointment of third parties.

2.32 Some respondents claimed that traditional securitisations where the underlying exposures consist of SME loans are a small proportion of the total UK securitisation market and provided reasons why:

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8 The UK government introduced an eviction moratorium in November 2020 that prevented tenants from being evicted from commercial and residential properties for unpaid rent.

9 The UK government cut the rates of Stamp Duty in July 2020 to help buyers whose finances were affected by the Covid-19 pandemic.

10 The BoE launched the [Contingent Term Repo Facility](#) in March 2020.

- SME loans are riskier than residential mortgages or consumer loans which affects their liquidity, means rating agencies look for higher credit enhancement, and sees investors demand higher credit spread compared to other underlying exposures;

- The significant upfront costs and relative complexity involved both in the securitisation process of SME loans and for SMEs involved in issuing securitisations.

2.33 Multiple respondents suggested that SME and mid-large corporate loans are better suited to synthetic securitisations instead, providing the following reasons:

- The higher risk weights of SME loans compared to other underlying exposures, like residential mortgages, make synthetic securitisations more efficient in terms of the costs and benefits of using Significant Risk Transfer (SRT);

- These loans are often revolving in nature, which is better suited to synthetic securitisations;

- Synthetic securitisations enable banks to hedge exposures that are difficult to sell, because the exposures are retained by the issuing banks, unlike with traditional securitisations.

2.34 Other respondents stated that non-bank financial institutions (NBFIs) use securitisations to raise funding. This demonstrates how securitisation can support the real economy, as many NBFIs provide finance for SMEs. One respondent shared that NBFI originators are becoming a larger component of the UK SME financing market, and that they typically seek senior financing from banks by way of private securitisations of SME loans.

2.35 Multiple respondents proposed ideas for how the Sec Reg could change to better support financing to the real economy and close the SME funding gap, which one respondent suggested was estimated to be £15 billion in 2020 and set to increase in 2021:

- Simplify disclosures for SME loans;

- Change requirements around the quality and consistency of historical performance data for SME loans.

2.36 Other respondents provided further ideas for how the wider UK securitisation market could be adapted to increase SME lending:

- Make certain synthetic securitisations STS-eligible where a regulated credit insurer provides protection to SME loans;

- Encourage originators to direct securitisation proceeds towards more SME funding;

- Introduce a government-supported entity into the UK securitisation market, similar to other jurisdictions, like the US and EU.

Responses – Interconnectedness and financial stability

Interconnectedness

2.37 There was a mix of views from the handful of respondents who responded to the call for evidence question on the Sec Reg's effect on interconnectedness between financial institutions. While some thought that the Sec Reg hasn't had a material effect, other respondents were positive about its effects.

2.38 For example, some respondents said that the Sec Reg's disclosure requirements and resulting standardisation of disclosures have increased interconnectedness by facilitating the trade of securitisations and loan portfolios between institutions. Respondents added that this has had the positive effect of improving the liquidity of securitisation positions held by institutions.

2.39 However, some respondents suggested that the Sec Reg may have increased interconnectedness in a negative manner. One respondent claimed that there is a risk that market participants may hold more overlapping portfolios due to the standardisation of securitisation transactions and the Sec Reg's risk retention rules.

2.40 One respondent also suggested that additional macroprudential measures for the securitisation market should be introduced to both the primary credit lending market and secondary securitisation market. The measures could also address interconnectedness arising from securitisation activities and risks related to excessive lending.

Financial stability

2.41 Responses to the call for evidence question on the effects of the Sec Reg on financial stability were also mixed, but there were no strong concerns that it had a negative overall impact on financial stability.

2.42 Some respondents provided positive remarks that the Sec Reg's provisions guarding against risks to financial stability are appropriate, and included the following comments on the benefits of both securitisation and the Sec Reg to financial stability:

- The Sec Reg's risk retention rules incentivise positive alignment between the financial interests of originators and investors;
- The Sec Reg should continue to exclude retail investors so that the market benefits from the participation of institutional investors who have the appropriate governance, methods, and processes to appropriately assess credit risk and comply with regulatory requirements;
- Synthetic securitisation enables the majority of loans to stay on banks' balance sheets and therefore under the purview of bank officials who manage that relationship, while transferring risk from the UK banking system to external investors.

2.43 Other respondents expressed concerns about the effect that the Sec Reg and securitisation more generally have on the stability of the financial sector. Some respondents claimed that:

- The Sec Reg may have reduced the depth and liquidity of the secondary securitisation market (though other respondents shared the opposite view on liquidity – see paragraph 2.8);
- The securitisation market may inadvertently be privileging private securitisations, which could reduce the number of investors.

Conclusion

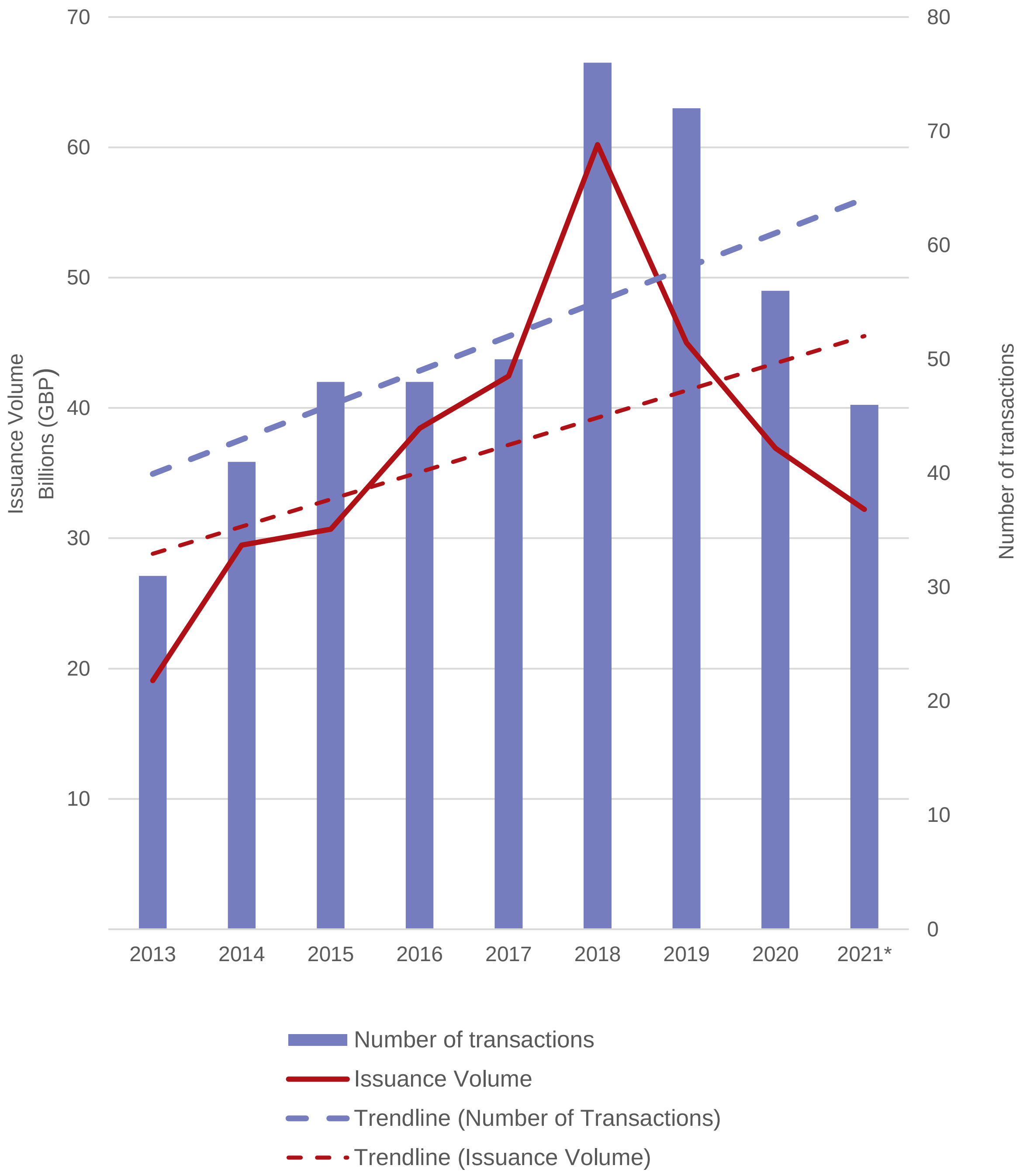
2.44 HM Treasury welcomes responses to the call for evidence and their provision of insight and evidence. They have provided HM Treasury with a better understanding of various perceived effects of the Sec Reg and helped shed light on where industry views diverge and overlap.

2.45 HM Treasury also welcomes views on the positive effects that the Sec Reg has had to date, such as on increasing the transparency and robustness of the UK securitisation market. We also note that, while respondents provided suggestions for reforms and noted the Sec Reg may be unduly prescriptive relative to other pieces of regulation, they were generally supportive of it.

2.46 HM Treasury recognises that the dynamics of the UK securitisation market have changed compared to before the GFC. However, HM Treasury considers that there are significant limitations to evaluating the effect of the Sec Reg by comparing current market performance to pre-GFC performance. Fundamentally, there was a very different regulatory and economic environment across the financial sector pre-GFC, and securitisation structures were generally more complex and lacked transparency at that time. Therefore, the pre-GFC market may not be the right benchmark by which to assess the current market.

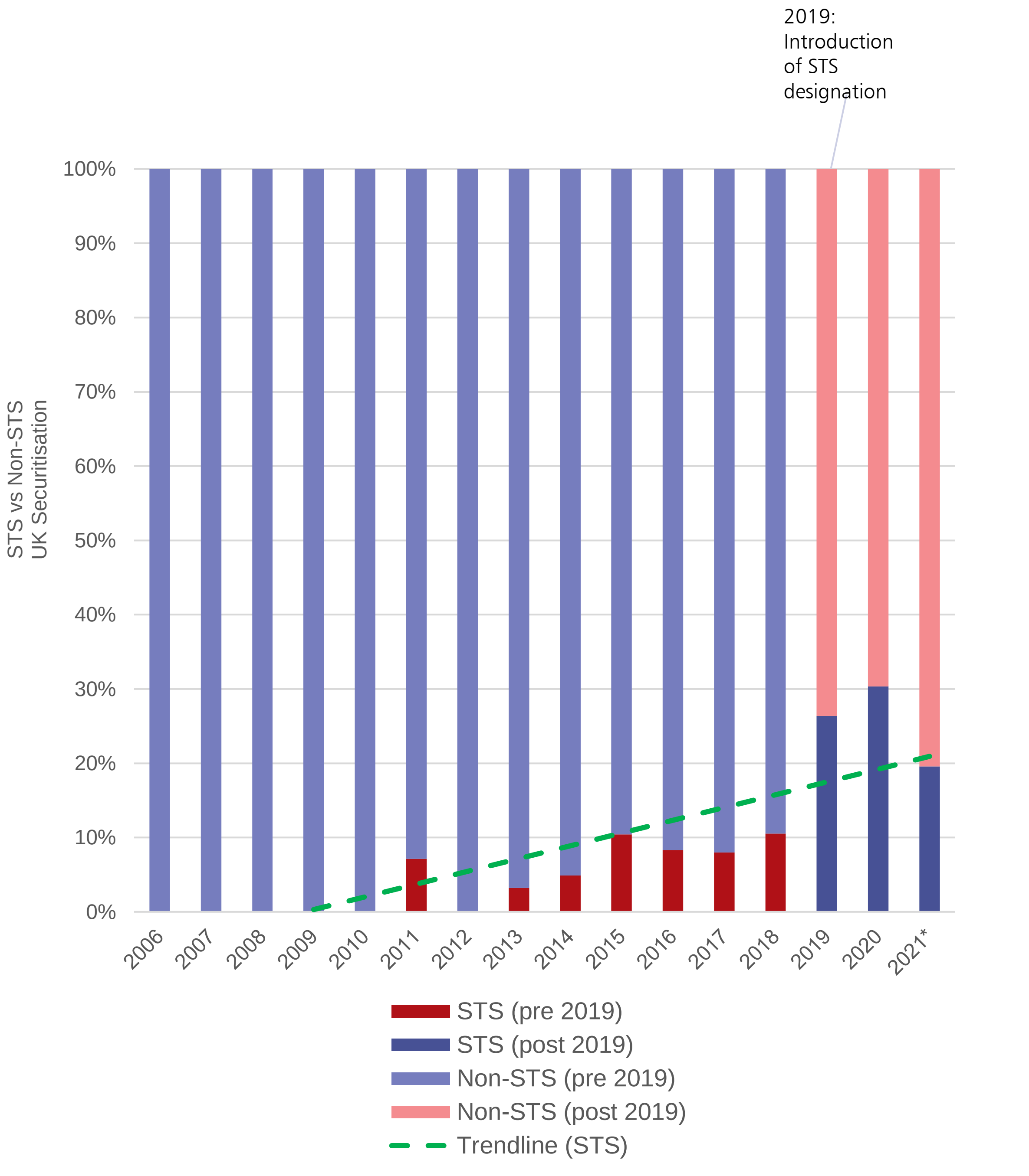
2.47 Although some industry claims were more sceptical, there are important indicators that the UK securitisation market remains in relatively good health. While total UK securitisation issuance may have declined since the introduction of the Sec Reg (see Chart B), the wider context shows that UKs placed issuance remains the largest in Europe (see Chart A), which we consider the most comparable regulatory environment to the UK. Furthermore, the credit performance of the UK securitisation market since the introduction of the Sec Reg has been robust, despite recent events, such as the Covid-19 pandemic.

Chart B: Number and volume of GBP-denominated securitisations



Sources: Dealogic, Bloomberg and internal calculations
**Includes data up to 30/09/2021*

Chart C: Percentage of STS GBP-denominated securitisations vs non-STS[11]



Sources: Dealogic, Bloomberg and internal calculations
**includes data up to 30/09/2021*

[11] Note securitisations could only be designated as STS after the Sec Reg applied from 1 January 2019. This chart shows the percentage of GBP-denominated securitisations issued between 2013-2018 that have received STS designation, but were originated before the Sec Reg took effect.

2.48 Although some industry claims were more sceptical, there are important indicators that the UK securitisation market remains in relatively good health. While total UK securitisation issuance may have declined since the introduction of the Sec Reg (see Chart B), the wider context shows that UKs placed issuance remains the largest in Europe (see Chart A), which we consider the most comparable regulatory environment to the UK. Furthermore, the credit performance of the UK securitisation market since the introduction of the Sec Reg has been robust, despite recent events, such as the Covid-19 pandemic.

2.49 Regarding responses about the STS designation, HM Treasury observes a positive, upward trend of STS securitisation issuance, including in 2021 (see Chart C), and will continue to support the development of a deep and diverse STS securitisation market.

2.50 Overall, HM Treasury agrees with points raised by multiple respondents who acknowledged the difficulties in accurately assessing the effects of the Sec Reg on market functioning due to the unique events of recent years, chiefly EU Exit and the Covid-19 pandemic, and the fact that the Sec Reg is not yet fully implemented.[12]

2.51 Considering responses, market trends, and the time that has passed since the Sec Reg was introduced, HM Treasury assesses that the Sec Reg remains an important element to the functioning regulation of securitisation in the UK. We remain committed to the ongoing and effective implementation of the Sec Reg and welcome industry support and engagement in this endeavour.

2.52 HM Treasury also recognises the contribution that securitisation can make to the real economy, including to SMEs. While we acknowledge the impact of the Sec Reg and the potential impediments to the growth of SME securitisations, we intend to continue looking at ways to support the real economy and the provision of finance to SMEs. Additionally, we expect that any potential changes to the Sec Reg that HM Treasury may undertake will be beneficial to the securitisation market, including for SME securitisations.

2.53 Regarding the effects of the Sec Reg on interconnectedness between financial institutions and the stability of the financial sector, HM Treasury notes that, on the whole, respondents were generally satisfied that the Sec Reg's provisions guard against financial risks that could arise from these two issues. In particular, respondents cited the Sec Reg's requirements around transparency and risk retention as supporting the robustness of the securitisation market.

2.54 Regarding the proposal from one respondent to introduce macroprudential measures or other additional regulatory enhancements for both the primary credit lending market and the securitisation market, HM Treasury does not see the need for these at present. We remain of the view that the provisions in the Sec Reg, and the monitoring and actions of the PRA and Financial Policy Committee (FPC), mean that the UK macroprudential framework is currently sufficient to protect against any adverse effects that securitisation could cause to financial stability. The FPC has mechanisms to help inform policy as needed, including in-depth assessments of particular risks and the power to make recommendations to HM Treasury and other regulators.

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[12] Certain elements of the Sec Reg remain outstanding, including the Technical Standards specifying risk retention requirements and the participation of an authorised Securitisation Repository in the UK.

2.55 HM Treasury and the regulators will continue to monitor the UK securitisation market as it adapts to the Sec Reg over time. Meanwhile, we expect that any potential changes to the Sec Reg undertaken as a result of this review (which are set out in other chapters) will help support the effective functioning of the UK securitisation market.

Chapter 3
Risk retention

3.1 The risk retention requirements in the Sec Reg aim to align the incentives of sell-side parties in a securitisation with those of investors. These requirements are designed to limit the negative incentives that contributed to the GFC. The Sec Reg ensures that the originator, sponsor or original lender of a securitisation must always hold at least 5% of the nominal value of the securitisation in accordance with prescribed methods, or 'modalities'.

3.2 Article 46(2)(b) requires HM Treasury to assess in this report:

> "The differences in the use of the modalities referred to in Article 6(3), based on the data reported pursuant to point (e)(iii) of the first subparagraph of Article 7(1). If the findings show an increase in prudential risks caused by the use of the modalities referred to in points (a), (b), (c) and (e) of Article 6(3), then suitable redress shall be considered"

3.3 In the call for evidence, HM Treasury asked questions on the differences in the use of modalities under Article 6(3) of the Sec Reg to further inform our understanding of how risk retention currently operates, obtain market participants' views on the framework, and understand whether any improvements are needed.

Responses

3.4 11 respondents answered the call for evidence questions on risk retention. Overall, respondents did not have major concerns with the use of different modalities. Indeed, the majority of respondents thought that the risk retention framework as a whole was reasonable, with one respondent noting it provides appropriate optionality for compliance while ensuring alignment of interests.

3.5 Regarding the choice of modalities, respondents suggested there is a fairly even split between the use of modalities that are based on horizontal retention and on vertical retention.[1]

3.6 Respondents shared that the decision as to which modality to use comes down to the ultimate aim of the originator, sponsor or original lender that is securitising:

- For transactions where the primary aim is to raise funding, respondents commented that first loss retention is usually used, as

[1] 'Horizontal' risk retention is where the manufacturer retains no less than 5% of the value of the first-loss tranche (or the first-loss of each underlying exposure) and 'vertical' risk retention is where the manufacturer retains no less than 5% of the value of each tranche (or of each underlying exposure) sold to investors. For the purpose of this comparison, 'vertical' also includes randomly selected exposures.

the risk and return profile makes this tranche the most expensive to fund when placed with a third party;

- For transactions where the primary aim is to achieve capital reduction through SRT, respondents claimed they will often use vertical retention to maximise the volume of capital freed up by the securitisation.

3.7 Regarding the other questions asked in the call for evidence, respondents also suggested:

- Allowing the recognition of overseas risk retention, such as that in the US where there are different risk retention models (e.g. 2.5% risk retention is required for Collateralised Loan Obligations, or CLOs), to ultimately expand cross-border securitisation markets;
- Clarity to be provided on specific technical areas, such as i) the timeline for and final approach to the UK's adoption of the final risk retention Technical Standards and ii) the process for transferring the CLO manager who is retaining risk where investors in a CLO choose to replace the manager;
- Greater flexibility by enabling L-shaped risk retention (i.e. for a portion of risk retention to be first loss and a portion to be vertical), thereby allowing originators, sponsors or original lenders to get the benefits of both vertical retention and first-loss retention in the same securitisation;
- Allowing excess spread to count towards the originator, sponsor, or original lender's 5% risk retention requirement in SRT transactions, given they are required to hold capital against said excess spread.

3.8 In relation to risk retention and the securitisation of non-performing exposures (NPEs), respondents also asked for:

- Eligible servicers to be allowed to fulfil the risk retention requirements, as this would better align incentives in the case of servicers who have responsibility for recovering any lost funds arising from non-payment;
- For securitisations of NPEs, the risk retention to be calculated on the transaction price rather than the nominal price, so as to avoid a situation whereby the originator, sponsor or original lender effectively holds greater than 5% of the economic value of the securitisation by virtue of the baseline for the 5% calculation being the nominal price.

Conclusion

3.9 In terms of the review element under Article 46(2)(b), HM Treasury is of the view that the risk retention framework broadly works as intended. There are no material concerns from HM Treasury, the regulators, or call for evidence respondents about different modalities creating prudential risks. HM Treasury, therefore, does not intend to restrict or adapt the existing modalities at this time.

3.10 Regarding the proposals made by industry, HM Treasury consider there could be merit to a number of them. HM Treasury, and the PRA through their Technical

Standards process, will review specific areas, including: transferring the risk retention manager; allowing eligible servicers to fulfil risk retention requirements in NPE securitisations; and calculation of the risk retention on the transaction price for NPE securitisations. Insofar as it is possible, the PRA intends to prioritise work on the risk retention Technical Standards in 2022.

3.11 HM Treasury can see potential benefits to L-shaped risk retention and including the excess spread as an element of risk retention. However, further work with the regulators is required to ensure that these changes, if implemented, would not negatively impact the alignment of sell side parties' incentives.

3.12 Regarding the recognition of overseas risk retention, HM Treasury notes that the Sec Reg allows for UK investors to invest in overseas securitisations if they are able to verify that the originator, sponsor, or original lender of the securitisation retains 5% of the net economic interest in the securitisation in accordance with Article 6 (as set out in Article 5(1)(d)). HM Treasury does not think there is a need to change the current risk retention requirements in the Sec Reg to support the recognition of overseas risk retention beyond this.

Chapter 4

Disclosures for private securitisations

4.1 Transparency around the underlying exposures and other characteristics of a securitisation is critical to investors', potential investors', and competent authorities' understanding of the risks involved. Disclosure requirements in the Sec Reg aim to ensure appropriate levels of transparency for all securitisations.

4.2 The disclosure requirements for securitisations, set out in Article 7 of the Sec Reg, vary to some extent according to whether a securitisation is 'public' or 'private'. Public securitisations are those where a prospectus has to be drawn up under section 85 FSMA and accompanying FCA rules.

4.3 Private securitisations are those that are not subject to this requirement. Generally, private securitisations will not require a prospectus under section 85 FSMA, because their securities are not admitted to trading on a Regulated Market situated or operating in the UK (and because their securities are also not offered to the public in the UK). Instead, these securities may, for example, be traded on a multilateral trading facility (MTF), or they may be admitted to trading on a trading venue outside of the UK.[1]

4.4 Manufacturers of private securitisations do not need to disclose information by means of a Securitisation Repository (SR), as is required for public securitisations under the Sec Reg. Manufacturers of private securitisations are also not required to fill in the templates on inside information or significant event information contained in Annexes 14 and 15 of the onshored Technical Standards.[2]

4.5 Article 46(2)(c) requires HM Treasury to assess in this report:

> "Whether there has been a disproportionate rise of the number of transactions referred to in the third subparagraph of Article 7(2),[3] since the application of this Regulation and whether market participants structured transactions in a way to circumvent the obligation under Article 7 to make available information through securitisation repositories"

4.6 Article 46(2)(d) requires HM Treasury to also assess in this report:

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1 See section 85 FSMA and accompanying FCA rules for further details on when a prospectus is required to be drawn up.

2 'Onshoring' refers to the legislative approach taken by government to address deficiencies that arose from the withdrawal of the UK from the EU and ensure that financial services regulation continued to operate effectively after EU Exit. The relevant Technical Standards are Commission Delegated Regulation EU (2020/1224) and Commission Implementing Regulation (EU) 2021/1225.

3 This refers to private securitisations that do not require a prospectus under section 85 FSMA and accompanying FCA rules.

> "Whether there is a need to extend disclosure requirements under Article 7 to cover transactions referred to in the third subparagraph of Article 7(2) and investor positions"

4.7 In order to review these points, HM Treasury asked in the call for evidence about manufacturers' considerations for issuing public or private securitisations and investors' views on the usefulness of the current disclosure requirements for private securitisations. It asked whether there would be any benefits to extending disclosure requirements for public securitisations to private securitisations.

4.8 HM Treasury also asked for information on additional matters related to disclosures, such as on certain types of transactions that are classified as private (including bilateral[4] and intragroup[5] transactions), and on manufacturers' considerations for where they list their securitisations.

Responses

4.9 14 respondents provided information related to disclosure requirements. Aside from Chapter 2, which covered the overall effects of the Sec Reg, this chapter saw the most interest in terms of the number of respondents.

Number of, and motivations for, private securitisations

4.10 Related to the number of private transactions and manufacturers' motivations in structuring securitisations (Article 46(2)(c)), 2 respondents' views were that the Sec Reg has resulted in more private securitisations being issued at the expense of public securitisations.

4.11 Respondents also provided a range of considerations for choosing to issue a private instead of a public securitisation, including the following categories:

- Scale of the transaction:
  - Some smaller transactions may not be large enough to be issued publicly;
  - Certain stages of a securitisation (such as warehouse financing prior to issuing a securitisation)[6] are best kept private until the appropriate volume of loans is reached to make public securitisation viable.
- Manufacturer concerns, aims, and considerations:
  - Where there is particularly sensitive data, private securitisation is preferable so that manufacturers can control access to such information;

[4] This refers to arrangements that only involve one institutional investor.

[5] This refers to arrangements where the institutional investor may be the originator or sponsor, or is within the same group or consolidation structure as the originator or sponsor.

[6] Warehousing is a process which enables originators to lend without using their own capital. It involves a line of credit being provided to an originator, which is then used to provide loans, e.g. mortgages, to borrowers. The loans can be securitised in order to repay the original line of credit.

- Private securitisations are more likely to involve sophisticated investors with deeper understanding of manufacturers' business models and risks;
- Public securitisations may only be issued strategically to diversify an originator's funding sources;
- Public securitisations often involve banks serving an agency role for NBFIs and distributing the risk to the market.

- Type of the securitisation and/or the underlying exposures – the following were given as examples of transactions that are often private:
  - Synthetic securitisations;
  - Securitisations of trade receivables;
  - Asset-Backed Commercial Paper (ABCP) programmes.
- Cost and resource:
  - There can be more work and additional costs to issue a public securitisation;
  - If a private investor is prepared to invest faster, more or at a lower price than would be expected if the securitisation were issued publicly, then the manufacturers are likely to issue a private securitisation.

4.12 Considerations for issuing public versus private securitisations are interrelated with listing location. If a securitisation is not admitted to trading on a Regulated Market situated or operating in the UK, this may cause the securitisation to qualify as private under the Sec Reg. Respondents provided a range of considerations for choosing their listing location:

- Historic listing on certain exchanges – some types of securitisations, such as CLOs, have traditionally listed in Ireland and more recently on Euronext's Global Exchange Market in Dublin, and continue to be largely listed there;
- Tax considerations – whether a listing venue classifies as a recognised stock exchange for the purpose of the quoted Eurobond exemption;[7]
- Disclosure requirements of the exchange;
- Liquidity associated with listing on certain exchanges;
- Reputation of the exchange;
- Cost associated with listing on certain exchanges;
- Location of the collateral of the underlying exposures and whether it is in the same jurisdiction as the exchange.

[7] The Quoted Eurobond Exemption exempts UK entities from the requirement to pay UK withholding tax for any interest payable on debt owed to a non-UK entity. To qualify for the exemption, certain criteria need to be met, including for a debt to be listed on a HMRC recognised stock exchange. See 'Recognised stock exchanges', HM Revenue & Customs, December 2020.

Extending public securitisation disclosure requirements to private securitisations

4.13 In terms of whether disclosure requirements for public transactions should be extended to private ones (Article 46(2)(d)), respondents generally did not find the lack of requirement for private securitisations to report to an SR to be a problem. Some noted that investors in private transactions would often prefer to obtain information directly from the manufacturer, rather than receiving this data from an SR.

4.14 One respondent also noted concerns related to the fact that there is a loss of control over the information once it is reported to an SR. For instance, if the SR holds the disclosure information, then they are able to decide who is a potential investor and therefore entitled to it, which may be different to who manufacturers see as potential investors.

4.15 However, some respondents noted that the data quality control offered by an SR provides added value. Additionally, 2 respondents pointed to SRs being beneficial as a single point of access for information: as more data is reported to SRs, data analysis and comparability will be improved, which is critical for future market growth. It was noted a securitisation market with a large proportion of private securitisations and fragmented information that is not reported to SRs could lead to opaqueness.

4.16 Most respondents noted that there was no need to extend the requirement to fill in templates on inside information or significant events information to private securitisations. However, one respondent thought it would be helpful for manufacturers to disclose inside information for private securitisations in the same way as for public securitisations.

Wider issues related to disclosure requirements

4.17 Many respondents noted that issues with disclosure requirements were hindering the market. They agreed that improving disclosure requirements for private securitisations should be a priority.

4.18 Many respondents recommended changing the definition of private securitisation away from the current link to section 85 FSMA prospectus requirements. Suggestions for how public and private securitisations could be defined included:

- Scoping out transactions that are intragroup from any type of disclosure requirements under the Sec Reg, particularly for insurers where much of their use of securitisation is as an internal restructuring tool (however, one respondent thought that intragroup securitisations should not be excluded from the definition of private securitisation, as they can be executed with a view to being potentially sold in the market later and so there is benefit to providing disclosures for them);
- Bilateral transactions should be considered as a separate category and scoped out of disclosure requirements;
- Transactions with a small number of investors who have meaningful contact with sell-side parties should be considered bilateral and also scoped out;

- Larger transactions with multiple investors that are traded on an MTF should be treated like public securitisations for the purposes of the Sec Reg, even where they are not required to make available an approved prospectus under section 85 FSMA;

- Synthetic securitisations should be categorised differently to public transactions for the purpose of disclosure requirements;

- If a securitisation involves an announcement made through formal channels aimed at a wide audience of potential investors, then this should generally be categorised as public securitisation.

4.19 Respondents also generally agreed that disclosure requirements for private securitisations should be amended to make them less stringent. They argued that private securitisations typically involve close manufacturer-investor relationships where they work together to understand the risk before entering into a transaction, and therefore do not need to be bound by prescriptive templates. Respondents further noted that the effort and resource required to disclose, and carry out due diligence on, information for private securitisations can act as barriers to market entry for issuers, investors, and certain underlying exposures.

4.20 Specific suggestions for changes to the disclosure requirements for private securitisations included:

- Fully removing any disclosure requirements for private securitisations;

- Setting principles for the types of disclosures that are required, but removing the need to comply with disclosure templates;

- Providing more flexibility to depart from existing templates if needed, for example extending the number of 'ND' options that can be included in a template;[8]

- Simplifying the templates and requiring them only for regulatory disclosure to competent authorities.

4.21 Several respondents also suggested changes to specific areas of the existing templates and asked for clarification on whether certain guidance applies.

Conclusion

4.22 In terms of the first review element under Article 46(2)(c), HM Treasury notes that the number of private STS securitisations notified to the European Securities and Markets Authority (ESMA) in 2020 exceeded the number of public STS securitisations. Since the end of the EU Exit transition period in January 2021, the number of private STS securitisations notified to the FCA has also exceeded public STS securitisations.

4.23 However, HM Treasury considers that this is in part because, since the end of the EU Exit transition period, all securitisations listed on a trading venue which is not situated or operating in the UK, including in the EU, could have qualified as private

[8] 'ND', or no data, can be entered into fields in FCA templates where there is no data provided (for a variety of reasons, such as the data not being collected, or the field being not applicable). The amount of fields where ND options can be entered are limited by the 'Guidelines on securitisation repository data completeness and consistency thresholds', European Securities and Markets Authority, July 2020.

for the purposes of the Sec Reg (previously they would generally have qualified as public if they were admitted to trading on a Regulated Market in the EU). Data also shows that the majority of UK securitisations were listed in the EU (not UK) even before the implementation of the Sec Reg in January 2019.[9]

4.24 Therefore, considering factors like EU Exit, we cannot conclude that there has been a disproportionate rise in private securitisations purely as a result of the introduction of the Sec Reg, although it cannot be ruled out that it had some effect on the rise in private securitisations. Furthermore, the fact that the disclosure requirements do not differ significantly for private and public securitisations (as both types of securitisations need to fill in most templates) also implies this may not be a major reason for manufacturers to circumvent the requirements. We also note that respondents listed a variety of other matters, beyond disclosure requirements, which are considered when deciding whether to issue a private or public securitisation.

4.25 In terms of the second review element under Article 46(2)(d) on whether to extend disclosure requirements to private securitisations, HM Treasury does not consider that simply extending the public disclosure requirements (i.e. reporting to an SR and filling in two additional templates) to private securitisations would bring about sufficient benefit. Instead, this needs to be considered more holistically in terms of the overarching purpose of disclosure requirements.

4.26 HM Treasury agrees with respondents that the disclosure regime in the Sec Reg can be improved. In particular, HM Treasury considers that distinguishing between public and private securitisations solely on the basis of whether a prospectus is required under section 85 FSMA may not always be appropriate. We also consider that there may be certain specific situations in which more flexibility as to the format and content of disclosures would be beneficial, provided there is still sufficient information disclosed.

4.27 Therefore, HM Treasury intends to work with the regulators to consider where changes to the current framework may be appropriate. This could involve considering both how securitisations are categorised as either public or private and what kinds of disclosure requirements are appropriate for private securitisations. HM Treasury and the regulators will seek to carry out this work while maintaining the Sec Reg's high standards of transparency, which remain crucial to securitisation markets functioning safely and effectively.

4.28 Any changes to the definition of public and private securitisation, and to disclosure requirements, would need to be carefully developed with industry input. HM Treasury and the regulators will consult on any proposals in due course.

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[9] See 'Chart 2.E: Listing of GBP-denominated securitisations by number of deals' on page 12 of 'Review of the Securitisation Regulation: Call for evidence', HM Treasury, June 2021.

Chapter 5
STS Equivalence

5.1 Equivalence is an autonomous mechanism by which one jurisdiction can recognise relevant standards in another jurisdiction as equivalent to their own. It can provide for regulatory relief by removing duplicative requirements on cross-border business or exposures, or directly allowing or easing market access arrangements for cross-border business.

5.2 Article 46(2)(e) requires HM Treasury to assess in this report:

> "Whether in the area of STS securitisations an equivalence regime could be introduced for third-country originators, sponsors and SSPEs, taking into consideration international developments in the area of securitisation, in particular initiatives on simple, transparent and comparable securitisations"

5.3 In order to do so, HM Treasury's call for evidence asked questions about the merits and drawbacks of introducing an STS equivalence regime for third-country securitisations, as well as the considerations and elements that such an equivalence regime could include. It also sought views on the impact on firms of the UK's temporary recognition of EU STS[1] and the lack of recognition of UK STS by the EU at the end of the EU Exit Transition Period.

Responses

5.4 10 respondents provided information relating to an STS equivalence regime. All responses were supportive of the creation of such an equivalence regime by HM Treasury. Reasons for this included:

- In principle, UK investors should be able to receive the same capital treatment for their investment in STS securitisations in the UK or overseas;
- If overseas STS securitisations can be recognised in the UK, this could provide UK investors with better choice, increase liquidity, and reduce concentration risk;
- This is in line with the UK's perceived general approach to equivalence, which favours being open in general, unless there are specific risks of doing so.

5.5 Many of the respondents also confirmed that entering into mutually reciprocal recognition arrangements was a priority, in order to deepen the securitisation market and avoid fragmentation. However, some respondents also

[1] The Sec Reg provides for a transitional period until 31 December 2022 with respect to securitisations which meet the relevant STS criteria and are designated as STS under the EU Sec Reg (such securitisations are referred to in this chapter as 'EU STS'). EU STS are eligible for the same treatment as UK STS.

stated that STS equivalence granted by the UK, even if it were not reciprocated, was preferable to no equivalence at all.

5.6 In relation to the introduction of an STS equivalence regime, respondents also mentioned the following considerations:

- Equivalence should be granted on the basis of principles, including to jurisdictions that have only implemented the Basel-IOSCO STC standards. However, one respondent said that the Basel-IOSCO STC standards alone were not enough, and jurisdictions that are granted equivalence should also have strong and competent regulatory oversight, with the capacity to sanction bad actors;

- Regulatory cooperation between UK regulators and overseas regulators should not be a condition for granting equivalence; while another respondent said that this is an important element;

- If introduced, equivalence determinations under the STS regime should be made for jurisdictions other than just the EU;

- Measures should be taken to mitigate the immediate impact of any potential withdrawal of equivalence, for example via 'grandfathering' (allowing for existing STS securitisations from the jurisdiction where equivalence is withdrawn from to keep their STS recognition in the UK for the life of the transaction), or introducing an adaptation period following withdrawal of equivalence, for instance of 2 years, to allow investors to adjust their portfolios;

- If introducing an STS equivalence regime and granting equivalence under it will take several years, then an interim equivalence regime should be created until it is in place. One respondent suggested this could be done, for example, based on equivalence granted under existing regimes, such as CRR Article 107(4) – in other words, jurisdictions that are deemed equivalent for the purpose of the underlying credit exposures should be deemed equivalent for STS securitisations until an STS equivalence regime is introduced;

- TPVs should play a key role in ensuring equivalence of overseas securitisations, and a new STS equivalence regime should also include mutual recognition of TPVs;

- The requirement in Article 18(2) of the Sec Reg for STS securitisations to be located in the UK should be removed, and instead securitisations from any jurisdiction should be able to become designated as STS in the UK so long as they comply with the criteria set out in the Sec Reg.

5.7 Regarding the impact of temporary recognition of EU STS in the UK as part of the government's approach to EU Exit, and of the lack of reciprocal EU recognition of UK STS, several respondents maintained that they found the former to be helpful. On the latter, several respondents found increased difficulty in placing UK securitisations with European investors, especially banks, which one respondent said resulted in increased cost of funding for some parts of the economy.

Conclusion

5.8 HM Treasury agrees with respondents that an STS equivalence regime is desirable and should be introduced at the appropriate time. The most important feature to preserve in the STS market is confidence in the soundness of the underlying concept, and an equivalence regime could help support this.

5.9 Introducing an STS equivalence regime could help promote the development of robust securitisation frameworks internationally, thereby encouraging STS securitisations as an important element of open, well-regulated, and well-functioning markets globally. HM Treasury is also of the view that this could help provide UK investors with more choice and, if it leads to overseas recognition of UK STS securitisations, it may provide UK securitisation manufacturers with greater demand and greater liquidity for their securitisations.

5.10 HM Treasury will provide further detail on the relevant considerations to granting an STS equivalence determination and on the associated processes, such as withdrawal or adaptation periods. Any new equivalence regime will be consistent with the principles and processes set out in the November 2020 Guidance Document for the UK's Equivalence Framework for Financial Services.[2] In preparation for it, HM Treasury will also consider whether any measures should be put in place before an STS equivalence regime is created.

5.11 In terms of international developments in the area of securitisation, respondents noted there are several jurisdictions which have, or are currently considering, the implementation of the STC standards. An equivalence framework would allow HM Treasury to consider whether any of those jurisdictions could be eligible for an equivalence assessment. HM Treasury and the regulators will continue to consider international developments in the area of securitisation.

5.12 HM Treasury is not minded to remove the requirement for originators and sponsors involved in an STS securitisation to be established in the UK in Article 18(2).[3] Supervision of STS, with the ability for competent authorities to sanction those who don't comply with the relevant requirements, is a crucial element of the Sec Reg's STS framework.

5.13 If a securitisation involving originators or sponsors located outside the UK were allowed to be recognised as STS in the UK, the FCA would not be able to supervise whether the originator or sponsor have correctly designated their securitisation as STS and have complied with the Sec Reg STS framework. It would not be reasonable to expect that other jurisdictions' regulators will supervise compliance of securitisations issued in their jurisdiction with the UK Sec Reg framework. This is why introducing an equivalence regime is considered a better mechanism for achieving the aims of allowing UK investors more choice in STS, including overseas STS. It would provide assurance that STS securitisations in a jurisdiction that has been granted equivalence are indeed equivalent to those in the UK, including because that jurisdiction has an equivalent supervisory and enforcement framework.

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2 'Guidance Document for the UK's Equivalence Framework for Financial Services', HM Treasury, November 2020.

3 This applies to non-ABCP securitisations. For ABCP STS securitisations, Article 18(2) requires only the sponsor to be established in the UK.

Chapter 6

Environmental Disclosure Requirements

6.1 Understanding and mitigating the impact of climate change, biodiversity loss, and other environmental issues both by and on the financial system are crucial to establishing a sustainable economy. Under the Sec Reg and onshored Technical Standards, securitisation manufacturers are required to share certain environmental performance information with investors.

6.2 Currently, Article 22(4) of the Sec Reg requires that, where the underlying exposures of a securitisation are residential mortgage loans or auto loans or leases, the originator and sponsor of an STS securitisation must publish the available information related to the environmental performance of the assets financed by those underlying exposures.

6.3 In addition, the onshored Technical Standards require originators, sponsors and SSPEs to provide, where possible, an Energy Performance Certificate (EPC) and the name of the EPC provider for a securitisation's underlying exposures where the underlying exposures are residential mortgage loans or auto loans or leases. This requirement applies to all securitisations with these underlying exposures – whether STS or non-STS securitisations, public or private.

6.4 Article 46(f) requires HM Treasury to assess in this report:

> "The implementation of the requirements provided for in Article 22(4) and whether they need to be extended to securitisation where the underlying exposures are not residential loans or auto loans or leases, with the view to mainstreaming environmental, social and governance (ESG) disclosure"

6.5 The call for evidence asked questions to better understand the usefulness of the Sec Reg's current environmental performance disclosure requirements, the availability of information to fulfil them, what additional environmental information might be useful and attainable, and what else the Sec Reg could do to support the government's green finance aims.

Responses

6.6 13 respondents answered questions on this topic in the call for evidence. Overall, most respondents acknowledged the growing importance of environmental performance disclosure, both to the securitisation market and to the wider goal of aligning the financial system to a more sustainable future.

6.7 Some respondents were particularly positive about how securitisation itself can support the transition to a sustainable economy, opining that it is a capital-efficient way of investing in ESG securities and one that has a more direct and measurable environmental impact than other green investments.

6.8 The majority of responses, however, were focused on the implementation of the Sec Reg's current environmental disclosure requirements and their reflections on a future green securitisation framework.

Environmental disclosure

6.9 Positively, one 1 respondent shared that the introduction of various ESG disclosure rules and frameworks at a global level has started to have a beneficial effect on financial markets. Other respondents suggested that the availability of environmental information will improve in time.

6.10 Yet, most respondents mentioned issues with the availability and standardisation of environmental performance data, including the information required by the Sec Reg, which affect both securitisation manufacturers and investors. Respondents' comments detailed issues with:

- Limited environmental data for securitisations with legacy loans;
- Limited ESG collateral currently available in the market;
- The time lag between the origination of a securitisation's underlying exposure and when that asset is securitised, which reduces the value of any associated environmental information for investors;
- Non-standardised environmental data, which makes it hard for investors to compare securitisations and for originators to efficiently collect and process environmental data.

6.11 Many respondents shared views on how the Sec Reg's disclosure requirements for environmental data could be expanded:

- Both the detail required and the underlying exposures subject to the environmental disclosure requirements should be expanded;
- Any expansion of the environmental disclosure requirements should be focused on underlying exposures where there is environmental data readily available;
- Any move towards mandatory environmental disclosures for securitisation should not precede a more comprehensive approach to disclosures across the financial system and wider economy;
- There should be a phased approach to any changes to the environmental disclosure requirements.

6.12 Other respondents made further suggestions for adapting or supporting the Sec Reg's environmental disclosure requirements. For example, one respondent asked for an independent data repository of ESG factors to be established.

6.13 On the other hand, multiple respondents said that it was unclear why separate ESG disclosure requirements were required for securitisation when no other capital raising instruments have them. In this context, a significant number of respondents expressed concerns about the Sec Reg imposing further disclosure requirements on manufacturers, sharing that:

- It would be time consuming, costly, and add little value, especially as some market-led initiatives (e.g. ESG questionnaires) are already benefiting market participants;
- More focus should be given to improving the quality and availability of underlying exposures' environmental data at origination, as some securitisation manufacturers may not have been involved in the origination and are therefore less able to collect the relevant environmental data;
- Any changes to the environmental disclosure requirements should be aligned with complementary domestic and international schemes, such as taxonomy development, and should not be introduced until those schemes are established.

Future green securitisation framework

6.14 The call for evidence touched on the possibility that a future green securitisation framework could support the government's green finance aims and outlined reasons why such a framework may be difficult to implement, at least in the immediate future. Respondents were invited to comment on how else the Sec Reg can support the government's green finance aims in the near future. There was a range of views provided.

6.15 Some respondents enthused that a green securitisation framework would be transformative, mobilising private sector financial flows to sustainable investments. One respondent shared that such a framework, alongside a green taxonomy, would help reduce the threat of greenwashing and improve the detail and quality of green securitisation data.

6.16 Looking to the future, respondents provided comments on how a green securitisation framework could best be constructed:

- It should be flexible to account for the diverse pool of underlying exposures and reduce the risk of market fragmentation;
- It should be supported by the FCA and aligned with other international schemes, which would support more informed decision making by investors;
- A green securitisation could be defined by whether its proceeds were used to finance green projects (often referred to as 'the use of proceeds' approach).

6.17 A few respondents suggested mechanisms beyond the Sec Reg that could support government green finance aims, including government financial support and capital relief.

6.18 In contrast, a fair number of respondents thought that establishing a green securitisation framework in the near future would be premature and provided the following comments:

- There are currently too many ongoing and overlapping developments in green finance that would make establishing a coherent and effective green securitisation framework difficult;

- Any new green securitisation policies and/or regulations should take place outside the Sec Reg;
- Market consensus should lead any developments in green securitisation.

Conclusion

6.19 To put the financial sector and the economy on a more sustainable footing, concerted and collective action must be taken by governments, individuals and industries. The government is committed to greening the finance industry[1] and becoming a net zero-aligned financial centre[2] and welcomes the information provided by respondents on environmental disclosures, a potential green securitisation framework, and how the Sec Reg can support the government's green finance aims in the near future.

6.20 HM Treasury recognises the importance of environmental information for securitisation investors, but also acknowledges the current difficulties with the availability and standardisation of such data.

6.21 With a view to striking a balance between helping mainstream ESG disclosures, not overburdening securitisation manufacturers, and providing information that investors would find most useful, HM Treasury and the regulators will consider whether it is appropriate to extend the Sec Reg's environmental information disclosure requirements, as raised in Article 46(2)(f). It is likely that any additional information required by the Sec Reg's disclosure templates would be subject to availability, as is the case for the Regulation's current requirements.

6.22 Any such changes would be subject to consultation with industry. Any changes will also take account of developments in the regulation of green finance disclosure that will soon be implemented (e.g. the Sustainability Disclosure Requirements (SDR)), and they will consider how current and future environmental information disclosure requirements interact to ensure a consistent and proportionate approach.

6.23 Regarding a green securitisation framework, HM Treasury recognises its potential merits. We also acknowledge that developing this would require support and input from industry. Additionally, as stated in the call for evidence, we know that developing any effective green securitisation framework would necessitate considered and coordinated work with related initiatives, such as the UK Green Taxonomy. It would also require close collaboration across government, regulators, and international bodies.

6.24 As a result of this work and the complex nature of such a framework, HM Treasury does not expect to set up a green securitisation framework in the immediate future, especially prior to a broader sustainability disclosure framework being set up in the SDR. Given the evolving dynamic of the securitisation market and wider ESG developments, HM Treasury may consider such a framework in the future.

6.25 Regarding the ask for green securitisations to be given beneficial capital treatment, HM Treasury does not think this is appropriate at present. In lieu of a

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1 See 'Greening Finance roadmap', HM Government, October 2021.

2 See 'Chancellor: UK will be the world's first net zero financial centre', HM Treasury, November 2021.

comprehensive framework for reporting on sustainable economic and financial activities being established in SDR, we think that there are currently more prudent ways to incentivise the financing of green projects.

Chapter 7

Third party verification regime

7.1 TPVs were introduced in the Sec Reg to assess the compliance of a securitisation with the STS criteria. TPVs need to be authorised by the FCA in order to operate in the UK. The use of a TPV by securitisation manufacturers is voluntary but can help provide confidence in a securitisation's compliance with the STS criteria.

7.2 Article 46(2)(g) requires HM Treasury to assess in this report:

> "The appropriateness of the third-party verification regime as provided for in Articles 27 and 28, and whether the authorisation regime for third parties provided for in Article 28 fosters sufficient competition among third parties and whether changes in the supervisory framework need to be introduced in order to ensure financial stability"

7.3 In the call for evidence, HM Treasury sought views on the appropriateness and effectiveness of the third-party verification regime, noting there is currently only one TPV authorised to verify STS compliance in the UK.

Responses

7.4 9 respondents provided views related to TPVs. Respondents largely recognised the additional value provided by TPVs, particularly noting:

- That TPVs help to guard against the risks of non-compliance, fraud and mis-selling, and therefore provide investors in STS securitisations with additional reassurance over the transaction;
- There is better liquidity for STS securitisations verified by a TPV, demonstrating investors' preference for STS securitisations that have been verified by a TPV (one respondent noted some investors won't invest at all in self-certified STS securitisations).

7.5 One respondent noted that self-certification of STS securitisations (rather than using a TPV) is preferable, in order to avoid incurring additional costs. Another respondent noted that STS securitisations that have been certified by a TPV result in better execution, which more than offsets the cost of using a TPV.

7.6 Respondents noted several scenarios where they considered a TPV to be of less value:

- Synthetic transactions (noting these are not eligible for STS designation), because the investor already undertakes significant due diligence;

- Repeat or frequent issuances, where there is an expectation that if the first issuance is verified by a TPV, then the following ones will be of similar quality.

7.7 Respondents held mixed views on the risks of relying on TPVs leading to investors undertaking reduced due diligence. While some respondents noted that this could happen, the majority noted that this was unlikely, given that the liability for STS designation and due diligence continue to sit with manufacturers and investors, respectively.

7.8 Respondents noted the potential benefits of greater competition in the TPV market would likely be improved pricing and preventing dependency on one party, indicating there is demand for greater competition in the market.

7.9 However, respondents also noted constraints that, in their view, limit the viability of new TPVs entering the market at present, including:

- It is not a very profitable business considering the requirement to charge cost-based, non-discriminatory fees, which is further exacerbated by the market being relatively small;
- The requirements that prevent conflicts of interest and structurally separate TPVs from other financial services entities that could be involved in securitisations are difficult to manage and disincentivise new participants;
- The market incumbency of the one existing TPV in the UK and the expected challenges (and cost) of competing to acquire customers;
- The lack of certainty around the extent of any future STS divergence between the UK and the EU;
- Given the small market size, new TPVs may only seek to enter the market if they can access both UK and EU markets and then only if processes are sufficiently similar to generate economies of scale.

7.10 Respondents pointed out there were limited interventions that could increase competition in this context, with the most common recommendation being to grow the STS securitisation market, including through enabling EU TPVs to access the UK STS securitisation market and vice versa.

Conclusion

7.11 HM Treasury welcomes the information provided on the value-add of the TPV regime. Based on responses to the call for evidence and engagement with the regulators, we consider the TPV regime is currently appropriate and changes do not need to be introduced in order to ensure financial stability.

7.12 In terms of the TPV authorisation regime and competition, HM Treasury recognise the challenges associated with creating greater competition in the TPV market raised by respondents. We note that there are no immediate concerns raised as a result of the current lack of competition in the TPV market. However, HM Treasury will continue to monitor whether problems related to a lack of competition arise in the future.

7.13 At present, we expect that any potential changes to the Sec Reg that HM Treasury and the regulators may undertake will be beneficial for the securitisation market, including for STS securitisations. This should support the growth of the securitisation market and, therefore, the potential for increased TPV competition.

7.14 Regarding the proposal for TPVs to assess UK STS securitisations without having a physical presence in the UK, HM Treasury is not minded to take this forward. This would be contrary to the general approach to authorisation which requires a physical presence in the UK and could create issues in terms of the FCA being able to effectively oversee non-UK TPVs.

Chapter 8

The role of Securitisation Special Purpose Entities

8.1 SSPEs play a key role in the securitisation process: they manage the transfer of underlying exposures from the originator, the sale of tranched securities to investors, and the cashflow of the underlying exposures between other sell-side parties and investors. They are subject to a range of regulatory requirements in the Sec Reg and are insolvency remote.[1]

8.2 Article 46(2)(h) requires HM Treasury to assess in the report:

> "Whether there is a need to complement the framework on securitisation set out in this Regulation by establishing a system of limited licensed banks, performing the functions of SSPEs and having the exclusive right to purchase exposures from originators and sell claims backed by the purchased exposures to investors"

8.3 As discussed in the call for evidence, HM Treasury understands that this review clause is focused on whether abolishing SSPEs and replacing them with a smaller number of limited licensed banks (LLBs) could increase the resilience and transparency of securitisations. In addition to seeking views on this point, HM Treasury asked a number of other questions designed to deepen our understanding of the role of SSPEs in securitisation markets.

Responses

8.4 7 respondents answered questions on the role of SSPEs. Respondents unanimously agreed that the current SSPE regime was fit for purpose, with one respondent noting there had not been a single SSPE insolvency in the UK in at least the last three decades. As such, respondents agreed that introducing a system of LLBs would have limited benefit and arguably result in significant negative impacts on the system (such as increased concentration risk from reducing the number of entities), and therefore should not be pursued.

8.5 In relation to disclosures provided by SSPEs and their ability to help investors ascertain a full view of the transaction, most respondents to this section noted that disclosure requirements for manufacturers, including SSPEs, are sufficient. One respondent noted that the requirements are helpful but could do more to ensure investors receive enough past performance data and information on counterparty risk.

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[1] The Sec Reg includes requirements to ensure that even if the originator of the underlying exposures goes into insolvency proceedings, the loans transferred to the SSPE for securitisation are not subject to severe clawback provisions by the liquidator of the originator.

8.6 Respondents noted that a number of minor improvements to the SSPE regime could prove useful, including:

- Providing clarity on the circumstances where originators should fund the SSPE if it faces a cashflow problem;
- Requiring more ESG information to be provided by SSPEs (and other relevant parties);
- Reporting on a consistent basis on counterparty risk across transactions;
- Consolidating the law relating to SSPE insolvency into one place (including any relevant case law) to make the legal regime easier to navigate.

Conclusion

8.7 HM Treasury agrees with respondents that the current system of SSPEs works well and does not see a reason to replace it with a system of LLBs.

8.8 Regarding the suggestion to consolidate the law relating to SSPE insolvency, while we can see there may be potential benefits to providing additional clarity, the relative benefits are unlikely to outweigh the significant resource that would be required to undertake this work, given the lack of SSPE insolvencies. As such, HM Treasury does not intend to take this proposal forward.

8.9 Future work on disclosures described in Chapters 4 and 6, including related to ESG disclosures, will consider the points raised by respondents to these questions on SSPEs. Any other minor issues will be considered, should they become material concerns in the future.

Chapter 9

Alternative Investment Fund Managers

9.1 HM Treasury is not under a legal obligation to review the Sec Reg's definition of institutional investor under Article 46 of the Sec Reg. However, we asked questions in the call for evidence on how market participants have applied the definition to better understand the effects of the current definition and to gather industry views on whether it should, and how best it can, be changed.

9.2 The due diligence requirements, set out in Article 5 of the Sec Reg, apply to institutional investors. The requirements are a key part of the Sec Reg and are designed to help the UK securitisation market benefit from the participation of institutional investors who appropriately evaluate securitisations' risks and make informed investment decisions.

9.3 The Sec Reg's definition of institutional investor includes Alternative Investment Fund Managers (AIFMs), who are defined in Article 2(12)(d):

> "An AIFM (as defined in regulation 4(1) of the Alternative Investment Fund Managers Regulations 2013) which markets or manages AIFs (as defined in regulation 3 of those Regulations) in the United Kingdom"

9.4 AIFMs are legal persons in the business of managing alternative investment funds (AIFs), which can exist for saving or income generating purposes and can include private equity funds, hedge funds, and real estate funds. The Sec Reg regulates securitisation activity carried out by AIFMs.

9.5 The Sec Reg's definition of institutional investor as it relates to AIFMs does not specify the jurisdiction in which the AIFM must be authorised or have its registered office. Therefore, the Sec Reg's current definition means that any unauthorised, non-UK AIFMs managing or marketing an AIF in the UK could be considered in scope of the due diligence requirements.

Responses

9.6 7 respondents answered questions on the Sec Reg's definition of institutional investor as it applies to AIFMs and the effects thereof.

9.7 The vast majority of respondents endorsed HM Treasury's view stated in the call for evidence that the Sec Reg's definition of institutional investor as it applies to AIFMs is problematic and securitisation markets would benefit from it being addressed. Respondents raised the following views:

- The current definition may be harming UK competitiveness, as some non-UK AIFMs may be declining to seek investors in the UK so as not to become subject to the Sec Reg's due diligence requirements (one respondent emphasised that this situation is negatively impacting UK investors who want exposures to non-UK AIFs);

- The current definition may cause difficulties in terms of enforcement and supervision.

9.8 Multiple respondents suggested that the optimal way to address the issue would be to explicitly scope out all unauthorised, non-UK AIFMs. One respondent made clear that their view is that the due diligence requirements for non-UK AIFMs should be the responsibility of the home regulator's supervisory framework and enforcement policy, not that of the UK regulator(s).

9.9 Other respondents argued that small authorised and small registered UK AIFMs should be excluded from the Sec Reg's due diligence requirements.

9.10 One respondent took a different position; they suggested that any changes made to the scope of the Sec Reg's due diligence requirements should ensure all investors face a level playing field and do not suffer a competitive disadvantage because of their legal structure or where they are based.

Conclusion

9.11 HM Treasury welcomes industry support for considering amendments to the Sec Reg's definition of institutional investor to take certain unauthorised, non-UK AIFMs out of scope of the due diligence requirements. This change will be taken forward at the appropriate time.

9.12 As stated in the call for evidence, HM Treasury and the FCA think that requiring all unauthorised, non-UK AIFMs that manage or market AIFs in the UK to comply with due diligence requirements may create extraterritorial problems for the FCA in terms of supervision and enforcement, and it may also disincentivise some of these types of firms from seeking investors in the UK.

9.13 In relation to proposals to scope out small authorised and small registered UK AIFMs from the Sec Reg's due diligence requirements, HM Treasury is not minded to change its definition of institutional investor so as to exclude them. This is appropriate for the following reasons:

- It's reasonable to assume small authorised and small registered UK AIFMs holding securitisation positions are sophisticated entities that can, therefore, comply with the Sec Reg's due diligence requirements;
- We have not received any evidence that demonstrates subjecting small authorised and small registered UK AIFMs to the due diligence requirements disincentivises their participation in the securitisation market.

Chapter 10
Jurisdictional scope

10.1 Article 46 does not explicitly require HM Treasury to consider issues related to the jurisdictional scope of the Sec Reg. However, HM Treasury is aware of concerns around the ambiguity related to the requirements in the Sec Reg.

10.2 In the call for evidence, HM Treasury asked a question about whether any ambiguity around the geographical scope of the Sec Reg requirements has impeded market transactions, and whether clarification in this area could be helpful.

Responses

10.3 10 respondents provided information related to jurisdictional scope (not including those who replied to questions on non-UK AIFMS, covered in Chapter 9 of this report). Many of these respondents raised concerns about jurisdictional scope issues, saying that these issues have caused uncertainty and impeded the securitisation market.

10.4 A key issue was raised by respondents in relation to investment in overseas securitisations by UK investors. Article 5(1)(f) of the Sec Reg requires UK investors to verify that overseas securitisation manufacturers have made available information which is substantially the same as that which they would have made available in accordance with Article 7 (which sets disclosure requirements), including substantially the same frequency and modalities.

10.5 Respondents noted several issues with this requirement:

- It is unclear what 'substantially the same' means, so firms are not sure whether they are complying;
- 'Substantially the same' is too restrictive because other jurisdictions' disclosures are not substantially the same. A conservative interpretation may consider only UK and EU disclosures to be substantially the same, so the effect may be that UK investors cannot invest in securitisations other than those in the EU and UK, which is undesirable;
- There are specific issues in trying to obtain substantially the same disclosures from securitisation manufacturers in other jurisdictions. For example, some jurisdictions have confidentiality regulations that prevent manufacturers from providing disclosures on the underlying exposures. Alternatively, some manufacturers find it difficult to provide the same information as in FCA templates, as these are based on UK definitions that are not used or easily extractable in non-UK and non-EU banking systems.

10.6 Respondents suggested possible solutions to address issues with the requirement in Article 5(1)(f):

- Clarifying what "substantially the same" means (and providing sufficient flexibility to allow investment in securitisations other than those in the UK and EU);
- Changing the due diligence requirements for investors related to disclosure to become more principle-based, specifically replacing Article 5(1)(f) and 5(1)(e)[1] of the Sec Reg with a general obligation to conduct due diligence on disclosures that is proportionate to the risk of the securitisation position, ensuring an investor has sufficient information to adequately assess the transaction and underlying asset pool;
- Establishing an equivalence regime for all securitisations (not just for STS securitisations, as is discussed in Chapter 5) that requires an assessment of another jurisdiction's disclosure and risk retention requirements. If another jurisdiction was deemed to have equivalent disclosure and risk retention, then UK investors could freely invest in securitisations issued there on the same basis as UK securitisations;
- Requiring UK investors to check that the overseas manufacturers have complied with the relevant disclosure rules in their jurisdiction.

10.7 Separately, some respondents also suggested clarifying that the Sec Reg requirements apply just to entities established in the UK.

10.8 Some respondents also noted that EU Exit has caused ambiguity about whether, and how, firms should comply with both the Sec Reg in the UK and the EU Sec Reg in securitisations with cross-border elements. They noted this problem is likely to be exacerbated if there is future significant divergence between the two jurisdictions' frameworks.

Conclusion

10.9 HM Treasury agrees with respondents that Article 5(1)(f) could helpfully be clarified further and wants to support the ability for UK investors to invest in overseas securitisations that meet certain conditions. However, HM Treasury also needs to ensure UK investors have an appropriate amount of information to assess the risk of their securitisation investment.

10.10 Therefore, HM Treasury does not intend to remove the due diligence requirements in favour of a general principle-based approach, as we believe due diligence requirements support the strong disclosure requirements in place under the Sec Reg.

10.11 HM Treasury also agrees with some respondents that it would not be practicable to require UK investors to assess compliance of a securitisation with the disclosure rules of another jurisdiction. Furthermore, if a jurisdiction has minimal disclosure rules, these rules may be of a much lower standard than the UK's disclosure rules under the Sec Reg. Just because a securitisation complies with their

[1] Article 5(1)(e) of the Sec Reg requires investors to verify that securitisation manufacturers established in the UK have made available information in accordance with Article 7.

domestic disclosure requirements may not mean those disclosures provide sufficient transparency for UK investors to properly assess the risk.

10.12 Finally, creating an equivalence regime for all disclosure requirements appears to be a disproportionate tool for a task that can, and routinely is, done by UK investors as part of their normal due diligence prior to investment. UK investors should not be prohibited from investing in securitisations in jurisdictions that don't necessarily have equivalent disclosure requirements in general, so long as the specific securitisations invested in by UK investors have substantially the same disclosures. The creation of an equivalence regime for disclosures could take away some of this flexibility.

10.13 As such, HM Treasury and the regulators will, as a priority, seek to clarify what kind of disclosures are required for securitisations where the manufacturers are established outside the UK. This will aim to balance pragmatism with high disclosure standards like those in the UK, and this will be considered in light of any potential changes to disclosure requirements for securitisations (as outlined in Chapter 4), given the complementary nature of the two workstreams.

10.14 HM Treasury will also monitor the impact of any uncertainty arising from jurisdictional scope issues, including relating to the impact of EU Exit, and consider further steps if any issues are impeding the functioning of the market in the future.

Chapter 11

Capital and liquidity treatment

11.1 Article 46 does not include a requirement for HM Treasury to assess the prudential treatment of securitisations (i.e. their capital and liquidity requirements, which ensure firms hold capital that can absorb losses and liquid assets to survive liquidity stresses, respectively), as those requirements are not contained in the Sec Reg. Instead, prudential requirements are set for banks, building societies, and designated investment firms under the CRR, which implements international standards set by the Basel Committee on Banking Supervision (the Basel framework). Prudential requirements for insurance firms are set in Solvency II.

11.2 However, respondents to the call for evidence provided a substantial number of views regarding the effects of capital and liquidity treatment of securitisations on the market, including proposals for how to amend this treatment. HM Treasury and the regulators have, therefore, considered these comments as part of this report.

Responses

11.3 7 respondents provided views on the capital and liquidity treatment of securitisation. Respondents generally made the point that their decisions as to whether to invest in or issue securitisations cannot be viewed in isolation from the capital and liquidity treatment of those products (including as compared to competing investments or structures).

11.4 Respondents unanimously agreed that less stringent capital and liquidity treatment would support the functioning of securitisation markets. Respondents believed that less stringent treatment could support securitisation in financing for the real economy, including SMEs.

11.5 In relation to the overall functioning of the market, respondents shared that:

- The reforms introduced via the Sec Reg and corresponding changes to prudential treatment introduced via the CRR amending regulation have supported investor confidence in the securitisation framework, but there is still more to be done;
- Securitisation is heavily regulated compared to other capital market instruments;
- High capital requirements for banks and insurers holding securitisation positions are seen as a key impediment to the growth of the UK STS market;
- The current capital and liquidity requirements for banks and insurers holding both STS and non-STS securitisations do not correspond to the actual risks posed by the underlying exposures;

- Changes should be made to help facilitate risk transfer from the banking sector to non-bank investors, including insurance firms.

Capital treatment

11.6 Several respondents called for the extension of the UK STS framework to allow various types of securitisations to be eligible for STS designation, including synthetic securitisations (akin to the EU STS framework), CLOs, and CMBS.

11.7 Several respondents also raised lowering the p-factor used to calibrate the capital requirements against securitised assets for all securitisations (STS and non-STS) calculated under the Securitisation Internal Ratings Based Approach (SEC-IRBA) and the Standardised Approach (SEC-SA).

11.8 2 respondents suggested reviewing Solvency II methodologies, for example reviewing the Matching Adjustment (a mechanism in Solvency II that reduces the technical provisions for insurance liabilities when certain conditions are met) and the Solvency II Standard Formula.

11.9 Multiple respondents raised the significance of the finalised Basel III reforms (often referred to as Basel 3.1) on securitisation. In particular, respondents flagged the potentially high impact of the Output Floor on capital requirements for certain securitisations.

Liquidity treatment

11.10 Multiple respondents raised the issue of adjusting the Liquidity Coverage Ratio (LCR) in relation to securitisation. This included suggestions to:

- Promote STS securitisations from their current eligibility as Level 2B High-Quality Liquid Assets (HQLA) to Level 2A or Level 1;
- Lower the ratings at which STS securitisations are eligible to qualify as HQLA;
- Recalibrate HQLA haircut requirements for STS securitisations;
- Expand the LCR framework to allow for non-STS securitisations to be eligible as Level 2B assets, including CMBS.

Conclusion

11.11 Considering the extensive feedback from industry on the impact of capital and liquidity treatment of securitisation, HM Treasury recognises this is a priority area for respondents.

11.12 The UK remains committed to the full, timely, and consistent adoption of the Basel standards, alongside other major jurisdictions. However, there may be areas where it is appropriate to tailor reforms to the UK. Under the Financial Services Act 2021 (FS Act 2021), the government has delegated the implementation of the CRR Basel standards to the PRA, subject to an enhanced accountability framework. This will require the PRA to consider additional factors, such as the relative international standing of the UK, in its implementation.[1]

11.13 In this context, HM Treasury does not currently see sufficient evidence to support significant changes to the capital treatment of securitisation, which is consistent with the Basel standards. For example, allowing CMBS and CLOs to be STS-eligible would not be justifiable deviations from the Basel standards.

11.14 In relation to calls for the inclusion of synthetic securitisations in the UK STS framework, HM Treasury and the regulators take interest in the extent to which such a measure would benefit real economy lending and UK competitiveness, and we welcome further work by industry to evidence this proposal. However, the expansion of the STS framework to include synthetic securitisations appears to provide insufficient risk reduction relative to the lower capital requirements that STS securitisations are eligible for. As such, HM Treasury and the regulators are not currently minded to pursue these suggestions.

11.15 We note respondents' points on the potential impact of the Basel 3.1 reforms, in particular the Output Floor, on the capital treatment of both STS and non-STS securitisations. This will be examined through the PRA's Basel 3.1 consultation, expected in H2 2022. The evidence related to Basel 3.1 provided to this call for evidence will be considered as part of that consultation.

11.16 Responses related to capital requirements for securitisation for insurance firms will be considered as part of the Solvency II review.[2]

11.17 HM Treasury also acknowledges the responses that raised liquidity treatment as a priority issue, including that some elements of the current liquidity requirements go beyond the Basel standards. Following the FS Act 2021, liquidity rules have been delegated to the PRA.[3] The PRA will consider if there are grounds to re-evaluate the liquidity treatment of securitisations, alongside any other liquidity issues.

[1] The CRR Basel standards are certain standards recommended in a document issued by the BCBS, as defined in Section 4 of the FS Act 2021. Part 9D, Section 144C of the Financial Services and Markets Act 2000 requires the PRA to have regard to relevant Basel standards, UK relative standing, the ability for businesses to provide to finance to the real economy on a sustainable basis, the Net Zero 2050 target, and any other matter specified by HM Treasury, when making rules to implement the CRR Basel standards.

[2] HM Treasury's Solvency II review is ongoing. See details at 'Solvency II Review: Call for Evidence', HM Treasury, July 2021.

[3] See 'Liquidity and funding permissions', Prudential Regulation Authority, July 2021.

Annex A
Glossary

ABCP, or Asset-backed commercial paper (programme or transaction) – as defined in Article 2(7) and 2(8) of the Sec Reg, a programme of securitisations the securities issued by which predominantly take the form of asset-backed commercial paper with an original maturity of one year or less; or a securitisation within an ABCP programme.

AIFM, or Alternative Investment Fund Manager – as defined in regulation 4(1) of the Alternative Investment Fund Managers Regulations 2013, a legal person, the regular business of which is managing one or more alternative investment funds (AIFs) as defined in regulation 3 of the Alternative Investment Fund Managers Regulations 2013.

BCBS, or the Basel Committee on Banking Supervision – a body which sets global prudential standards for internationally active banks (the Basel Framework).

BCBS-IOSCO STC standards – the BCBS and IOSCO criteria for identifying simple, transparent and comparable (STC) securitisations.

CRR, or the Capital Requirements Regulation – Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. Following the UK's withdrawal from the EU, the CRR forms part of retained EU legislation.

CRR amending regulation – Regulation (EU) 2017/2401 which amended and updated the CRR, including methods to calculate risk weights and preferential treatment for STS securitisations meeting certain criteria.

EU Exit transition period – the one-year period from 31 December 2019 following the UK's departure from the European Union during which EU rules on trade, travel, and business continued to apply in the UK.

EU Sec Reg, or the EU Securitisation Regulation – Regulation (EU) 2017/2402 as it applies in the EU.

Excess spread – a form of credit enhancement whereby income received in respect of the securitised exposures net of costs and expenses can be used to absorb portfolio losses before they are allocated to more senior tranches.

HQLA, or High-Quality Liquid Assets – assets of high liquidity and credit quality as referred to in Articles 10-12 of Chapter 2 of the Liquidity Coverage Ratio (CRR) Part of the PRA Rulebook (effective from 1 January 2022). See definition of L1, L2A and L2B assets for those assets that qualify as HQLA.

Institutional investor – an institutional investor as defined in Article 2(12) of the Sec Reg.

IOSCO, or the International Organization of Securities Commissions – a body comprising the world's major securities regulators responsible for setting securities standards.

L1, or Level 1 Assets – assets of extremely high liquidity and credit quality as referred to in Article 10 of Chapter 2 of the Liquidity Coverage Ratio (CRR) Part of the PRA Rulebook (effective from 1 January 2022). Examples of such assets include coins and banknotes, high-quality covered bonds, reserves at central banks and government-issued debt securities (subject to certain conditions as outlined in the Article).

L2A, or Level 2A Assets – assets of high liquidity and credit quality in accordance with Article 11 of Chapter 2 of the Liquidity Coverage Ratio (CRR) Part of the PRA Rulebook (effective from 1 January 2022). Examples include covered bonds and claims on central banks and governments with a high but lower credit quality than those eligible as L1 Assets. They also include certain corporate debt securities.

L2B, or Level 2B Assets – means assets of high liquidity and credit quality in accordance with Article 12 of Chapter 2 of the Liquidity Coverage Ratio (CRR) Part of the PRA Rulebook (effective from 1 January 2022). Examples include certain asset-backed securities, certain corporate debt securities and covered bonds of high but lower credit quality than those eligible as L2A assets, and certain shares.

Liquidity buffer – the amount of L1 assets, L2A and L2B assets that an institution holds in accordance with Chapter 2 of the Liquidity Coverage Ratio (CRR) Part of the PRA Rulebook (effective from 1 January 2022). A minimum of 60% of the liquidity buffer is to be composed of L1 assets, and L2B assets may constitute a maximum of 15% of the liquidity buffer.

LCR, or Liquidity Coverage Ratio – the ratio of a firm's liquidity buffer to its net liquidity outflows assessed over a combined idiosyncratic and market-wide 30 calendar day stress scenario, expressed as a percentage, as per Article 4 of Chapter 2 of the Liquidity Coverage Ratio (CRR) Part of the PRA Rulebook (effective from 1 January 2022).

MTF, or Multilateral Trading Facility – in this report, a multilateral trading facility operated by a UK investment firm or a market operator that brings together multiple third party buying and selling interests in financial instruments in a non-discretionary way.

NPE, or Non-Performing Exposure – an exposure as defined by 1.2 of Chapter 1 of the Non-Performing Exposures Securitisation (CRR) Part of the PRA Rulebook (effective from 1 January 2022).

Original lender – as defined in Article 2(20) of the Sec Reg, an entity which, itself or through related entities, directly or indirectly, concluded the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised.

Originator – as defined in Article 2(3) of the Sec Reg, 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 exposures being securitised; or
(b) purchases a third party's exposures on its own account and then securitises them.

Output Floor – a new policy within Basel 3.1 to ensure that the capital requirements of banks that use internal models do not fall below a percentage of capital requirements derived under standardised approaches.

pfactor – a parameter in the CRR and Basel Framework which is used in the calculation of risk weighted assets of securitisation positions under SEC-IRBA and SEC-SA.

Regulated Market – a multilateral system operated or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments (in the system and in accordance with its nondiscretionary rules) in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules or systems. For the purposes of section 85 FSMA, this must be a regulated market which is a recognised investment exchange under section 285 FSMA, but not an overseas investment exchange within the meaning of section 313(1) FSMA.

Risk retention – the net economic interest in the securitisation which the originator, sponsor, or original lender need to retain on an ongoing basis (as required under Article 6(1) of the Sec Reg).

Securitisation manufacturer – a collective term for the parties involved in issuing a securitisation, including the originator, the SSPE, and the sponsor.

Securitisation position – as defined in Article 2(19) of the Sec Reg, an exposure to a securitisation.

Sec Reg, or the Securitisation Regulation – Regulation (EU) 2017/2402. Following the UK's withdrawal from the EU, the Sec Reg forms part of retained EU legislation.

SR, or Securitisation Repository – as defined in Article 2(23) of the Sec Reg, a legal person that centrally collects and maintains the records of securitisations.

SSPE, or Securitisation Special Purpose Entity, also known as a Special Purpose Vehicle (SPV) – as defined in Article 2(2) of the Sec Reg, a corporation, trust, or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator.

Servicer – as defined in Article (2)(13) of the Sec Reg, an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis.

Solvency II – an EU regime derived from Directive (2009/138/EC) which sets out the regulatory requirements for insurance and reinsurance firms. The regime has been 'onshored' as part of the government's approach for the UK's withdrawal from the EU.

Sponsor – as defined in Article 2(5) of the Sec Reg, a credit institution or investment firm (as further specified in Article 2(5) of the Sec Reg), whether located in the United Kingdom or in a third country, which

(a) is not an originator and
(b) either –
(i) establishes and manages an ABCP programme or other securitisation that purchases exposures from third party entities; or

(ii) establishes an ABCP programme or other securitisation that purchases exposures from third party entities and delegates the day-to-day active portfolio management involved in that securitisation to an entity which is authorised to manage assets belonging to another person in accordance with the law of the country in which the entity is established.

SEC-IRBA, or Securitisation – Internal Ratings Based Approach – a UK formula-based approach for PRA-authorised firms (including banks, building societies and PRA UK designated investment firms) to calculate the risk weight of the securitisation positions held in accordance with CRR articles 254, and 258 to 260.

SEC-SA, or Securitisation – Standardised Approach – a UK formula-based approach for PRA-authorised firms to calculate the risk weight of the securitisation positions held in accordance with CRR article 254, 261 and 262.

STS securitisation – securitisations for which originators, sponsors and SSPEs may use the designation 'STS' or 'simple, transparent and standardised' in accordance with the STS framework contained in Articles 18 to 27 in the Sec Reg.

Synthetic securitisation – defined in Article 2(10) of the Sec Reg as a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator.

TTP, or Temporary Transitional Powers – powers which allow the financial services regulators to delay or phase-in onshoring changes to UK regulatory requirements arising at the end of the EU Exit transition period.

Traditional securitisation, also known as non-ABCP securitisation – as defined in Article 2(9) of the Sec Reg, a securitisation involving the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to an SSPE or through sub-participation by an SSPE, where the securities issued do not represent payment obligations of the originator.

Underlying exposure – in the context of securitisation, generally this refers to the set of obligations an original borrower has to their creditor, including loans, trade receivables and other exposures, which an originator can pool together and have securitised.

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