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Key implications of the European Commission Report on the EU Securitisation Regulation for European CLO managers and investors

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A new European Commission report on the functioning of the EU Securitisation Regulation addresses key uncertainties in existing interpretations of the EU Securitisation Regulation in the European CLO market. Some of the European Commission's suggestions will be welcomed by the CLO market since the report suggests ESMA templates could be simplified in the future and CLOs will continue to be exempt from securitisation repository reporting. Additionally, while certain sustainability reporting may be included in future revisions to the EU Securitisation Regulation, the proposed phased-in approach would seem to mirror the contractual approach already being followed by many in the European CLO market. The European Commission report also provides guidance on the jurisdictional scope of the EU Securitisation Regulation, in particular the application of Article 7 transparency reporting where none of the originator, sponsor or SSPE are located within the EU.

Background

The provisions of the EU Securitisation Regulation¹ apply to securitisations with securities issued on or after 1 January 2019 (including CLOs, CLO warehouses and fund-leverage transactions structured as securitisations). The EU Securitisation Regulation has created a single, harmonised legal framework for participants in securitisation transactions and is supplemented by guidelines and technical standards published by the EBA, ESMA and European Commission. Following Brexit, the EU Securitisation Regulation has also been transposed into U.K. law² and, with some minor differences, largely reflects the EU regime.

Last week, the European Commission published a report³ (the "European Commission Report") which examines key developments in the European securitisation market and addresses several outstanding questions relating to the regulatory framework which will be of particular interest to the European CLO market and European investors in CLO securities. In this Alert, we highlight key positives which can be taken from the European Commission Report, notably: (i) the European Commission recommends revisiting ESMA reporting templates that apply to private transactions in order to address possible technical difficulties and extraneous fields, thereby potentially reducing the reporting burden for CLO managers and issuers seeking to comply with the EU Securitisation Regulation; (ii) the European Commission confirms that currently it is not anticipated that the private securitisation definition will be amended, meaning CLOs will continue to be exempt from posting to public securitisation repositories; and (iii) a possible amendment is suggested to the EU Securitisation Regulation to permit voluntary sustainability reporting in the form of principal adverse impacts ("PAI") disclosures for broadly syndicated assets in the short term and mandatory disclosures in the medium term, which, in the case of voluntary disclosures, would appear to mirror the contractual approach already being followed by many CLO managers in the European market. The European Commission Report also provides interpretative guidance suggesting that EU investors in non-EU CLOs may be required to verify that such CLOs comply with the EU Securitisation

Regulation's transparency and reporting requirements, which could require significant reporting and disclosure changes for non-EU CLOs to ensure they remain eligible for investment by EU-domiciled CLO investors.

Simplified ESMA reporting templates?

Originators, sponsors, or special purpose entities ("SSPEs") of securitisations must make certain information available to allow investors to conduct due diligence prior to investing in those deals.⁴ This obligation includes publishing quarterly disclosure reports for performance both of the deal and its underlying exposures. In each case, reporting is conducted using the current ESMA templates which continue to largely replicate the form of templates adopted on 23 September 2020 under the regulatory technical standards and implementing technical standards⁵ (and superseding the transitional reporting templates used prior to then). The templates for asset-level reporting are particularly extensive, leading the European CLO market to the view that such extensive and strict reporting is in most cases disproportionate to what is necessary to help investors in European CLOs determine whether such investments are appropriate, noting particularly that in structures with a large number of exposures (such as credit card receivables, auto loans and possibly CLOs), loan-by-loan reporting may not be proportionate to the impact which a single loan can have on a transaction. Some market participants also note that this reporting is highly burdensome (from both a time and cost perspective) for CLO managers and issuers to comply with.

Such views have been reflected in the opinions elicited during the European Commission's consultation, with respondents indicating that the reporting is excessive, leading investors to rely instead on their own due diligence, and that certain fields in the templates are problematic or difficult to complete.

The European Commission Report helpfully concludes that any reporting that is not used by investors should be avoided since the cost of compliance does not bring about benefits for investors. In view of this, the European Commission invites ESMA to review their reporting templates to address these shortfalls, including removing possible unnecessary fields, addressing technical issues in completing certain data fields and better aligning data fields with investors' due-diligence needs to avoid investors conducting their own separate due diligence and supporting the general aim of the legislation, being to ensure investors have all necessary information available to them to make an informed investment decision. Given the longstanding opinion in the European CLO market that similar such changes should be made, these views are welcomed. We note that, assuming these changes are executed, this could be a key aspect by which the EU and U.K. Securitisation Regulations would diverge if the FCA templates (the U.K. equivalent of the ESMA templates) do not mirror any changes made to the ESMA templates.

Continuing exemption for private securitisation reporting to securitisation repositories?

On a related transparency and disclosure theme, the European supervisory authorities previously issued a joint opinion to the European Commission⁶ (the "Joint Committee Report"), which, among other things, suggested that the European Commission should consider expanding the definition of "private securitisations". The EU Securitisation Regulation currently exempts private securitisations from needing to report information to securitisation repositories, and almost all European CLOs qualify as private securitisations by virtue of being listed on the unregulated Global Exchange Market of the Irish Stock Exchange. Accordingly, there has been some concern following the Joint Committee Report that this exemption could be revised to bring CLOs within the scope of public securitisation reporting, thereby requiring publication of information to public securitisation repositories.

The European Commission Report helpfully concludes that it would not be appropriate to amend the definition of private securitisations, noting that the current definition is clear-cut and works well

within the market. Furthermore, the European Commission does not view the lack of securitisation repository reporting for private securitisations to be an obstacle to supervision by regulators, although the European Commission Report leaves the door ajar for revisiting this position. This will be another piece of welcome news for the European CLO market since it means CLOs will continue to be exempt from the additional burden of posting to public securitisation repositories, at least for the time being. This also remains true for CLO warehouses and fund-leverage transactions.

Forthcoming sustainability reporting obligations?

Sustainability reporting continues to be a topic of focus in the broader securitisation market, and the European CLO market is no exception. While the EU Securitisation Regulation currently includes only limited provisions regarding sustainability disclosures, which do not apply to non-STS securitisations, the European CLO market has, since at least the inception of the EU Securitisation Regulation, voluntarily advanced ESG-related investment criteria and sustainability disclosures. One key hurdle in further advancements is often noted to be the availability of information on the underlying obligations and standardisation of ESG-related disclosures.

The European Commission is given a mandate to report on creating a specific sustainable securitisation framework on the basis of a report produced by the EBA.⁷ The EBA published its report on 2 March 2022,⁸ recommending, among other things, that the EU Green Bond Standard ("EU GBS") be clarified with respect to its application to securitisations to ensure a level playing field for asset classes and that the EU Securitisation Regulation be amended to extend voluntary PAI reporting to non-STS securitisations in the short term and mandatory reporting in the medium term.

The European Commission Report generally supports the EBA's view and recognises the need to further develop PAI disclosures, indeed going so far as to recommend that the forthcoming RTS should be as wide as possible in this regard. We understand that to mean that the EBA's recommendation for PAI reporting will initially be voluntary for non-STS securitisations, and it is a likely outcome that it will be extended in the medium term to be mandatory for all securitisations subject to the EU Securitisation Regulation. When viewed through the lens of the current European CLO market, the European CLO market would appear already to be making steps in this direction of travel, placing the market in good stead to respond to these potential upcoming regulatory changes.

In respect of the EU GBS, the European Commission Report also confirms that there is no current impetus to create a dedicated framework for green securitisations, particularly since there are very few green assets available to securitise. However, the European Commission Report notes that, in line with the EBA's recommendation, it is supportive of ongoing negotiation in respect of the EU GBS to make it more appropriate for securitisations, and the Paul Hastings team remains actively involved in discussions in this regard.

Non-EU CLOs required to comply with EU transparency and disclosure requirements?

The Joint Committee Report previously discussed certain difficulties over the EU Securitisation Regulation's jurisdictional scope. The European Commission Report now offers guidance on certain matters raised in the Joint Committee Report, and the conclusions drawn will be particularly relevant for EU investors in non-European securitisations, including U.S. CLOs.

The EU Securitisation Regulation requires investors to confirm, before investing in a securitisation, that the information required under Article 7 of the EU Securitisation Regulation has, where applicable, been made available following the frequency and modality set out in Article 7.⁹ The existing ambiguity has surrounded situations where all of the originator, original lender, sponsor and SSPE are located outside of the EU (as is often the case in a U.S. CLO). In such situations, given the absence of existing guidance and turning on the use of "where applicable" in Article 5(1)(e),¹⁰ the

CLO market (and the securitisation market more generally) had reached the view that European investors in non-EU CLOs should not need to verify compliance with the strict Article 7 reporting requirements to enable them to invest in those CLOs; the consequence is that, absent special circumstances (such as the originator being located in the EU), many such CLOs have not so far provided information using existing ESMA templates (and will instead have satisfied themselves with the industry-standard reporting to which such CLOs invariably adhere).

The European Commission Report suggests that, in its view, this was not the legislative intent of Article 5(1)(e), since EU-domiciled investors will need the information required under Article 7 to ensure that those investors can satisfy themselves of their "buy-side" obligations under Article 5(1)(e). Notwithstanding this conclusion, the European Commission acknowledges that such interpretation may *de facto* exclude EU investors from non-EU CLOs on the basis that non-EU "sell-side" entities may not wish to provide the information according to the procedures set out in Article 7 and that the (above noted) request to revisit the reporting templates may reduce the competitive disadvantage if the required information is easier for non-EU "sell-side" entities to provide.

In light of the European Commission Report, we anticipate EU-domiciled investors in non-EU CLOs will revisit how they approach requests for compliance with Article 7 reporting, and we expect the market to start complying with Article 7 reporting over the coming weeks and months.

EU-domiciled investors may also need to assess their situation in respect of existing positions in non-European CLOs that have not insisted on full Article 7 reporting given the European Commission Report is equivocal on how the guidance may impact these existing positions.

As the European Commission Report consists of interpretative guidance (as opposed to formal amendment of the EU Securitisation Regulation), there is no explicit "grandfathering" offered. Notwithstanding this, there are good arguments to be made that EU-domiciled institutional investors who invested in non-EU CLOs prior to the publication of the European Commission Report should not be required to dispose of such holdings or be subject to punitive regulatory capital treatment (as applicable) and neither should they be subject to potential sanctions by competent authorities. Firstly, EU institutional investors are required to conduct their Article 5 due diligence at the time of investment¹¹. Given the prevailing market position and lack of interpretative guidance prior to the publication of the European Commission Report, it seems doubtful that such an investor could reasonably be viewed as having breached its verification obligations at the time of investment. Secondly, EU institutional investors holding non-EU CLOs should still be able to comply with their ongoing due diligence requirements¹² notwithstanding the European Commission Report. Thirdly, as a policy matter, the European Commission's intention over the medium term is clearly to create a simpler reporting regime for all private securitisations (see "*Simplified ESMA reporting templates?*") and it would be perverse if any kind of enforcement were attempted in the interim period between now and the introduction of simplified reporting templates for holdings previously acquired. For these reasons, it does not seem appropriate that EU institutional investors' existing non-EU CLO positions should be deemed to be non-compliant positions. In addition, it should be noted that the EU Securitisation Regulation sets a standard of negligence or intentional infringement¹³ for the imposition of sanctions by competent authorities. Where an EU institutional investor has followed market practice at the time of its investment in a non-EU CLO position, it may be difficult for a competent authority to form the view that such actions constituted negligence when considered in that context.

Notwithstanding the position for existing holdings of this type of non-EU CLO, securities issued by such CLOs may be off-limits for affected EU investors to acquire in the secondary market to the extent rectification measures are not taken (i.e. if these non-EU CLOs do not start providing full Article 7 reporting).

Given the potential impact of the European Commission Report on EU-domiciled investors in non-EU CLOs, such investors should consider taking detailed advice on a case-by-case basis. Although this may seem like an additional burden which may not be welcome, it is encouraging that the European Commission Report proposes amendments to simplify such transparency reporting (including by amending the ESMA templates), which will hopefully make it easier for non-EU CLOs to provide such information to EU investors in the future.

As ever, we remain committed to helping our clients navigate this changing regulatory landscape. Please get in touch with your Paul Hastings contacts if you wish to discuss any aspect of this Alert further.



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¹ Regulation (EU) 2017/2402, as amended by Regulation (EU) 2021/557 and as further amended, varied or substituted from time to time.

² Regulation (EU) 2017/2402 as it forms part of domestic UK law by virtue of the European Union (Withdrawal) Act 2018 (as amended by the European Union (Withdrawal Agreement) Act 2020), as amended by the Securitisation (Amendment) (EU Exit) Regulations 2019 of the United Kingdom and as further amended, varied or substituted from time to time.

³ "Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation". Full report available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022DC0517>. The Commission was required to publish such report pursuant to Article 46 of the EU Securitisation Regulation.

⁴ Article 7(1) of the EU Securitisation Regulation.

⁵ Regulation (EU) 2020/1224 of 16 October 2019 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards specifying the information and the details of a securitisation to be made available by the originator, sponsor and SSPE.

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⁶ "ESA's opinion to the European Commission on the jurisdictional scope of application of the Securitisation Regulation, JC 2021 16". Full report available at: https://www.esma.europa.eu/sites/default/files/library/jc_2021_16_-_esas_opinion_on_jurisdictional_scope_of_application_of_the_securitisation_regulation_003.pdf.

⁷ Article 45a and Article 46 of the EU Securitisation Regulation.

⁸ Available at: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2022/1027593/EBAR%20report%20on%20sustainable%20securitisation.pdf.

⁹ Article 5(1)(e) of the EU Securitisation Regulation.

¹⁰ Similar uncertainty has not surrounded the UK Securitisation Regulation which, when transposed into UK law, made it clear under Article 5(1)(f) that if the originator, sponsor or SSPE is located outside the UK, it must still make available information which is substantially the same as that which would need to be made available as if it was in the UK (and following the same timings/modalities as if it was established in the UK).

¹¹ Article 5(1) of the EU Securitisation Regulation.

¹² Article 5(4) of the EU Securitisation Regulation.

¹³ Article 32 of the EU Securitisation Regulation.