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CAUTIOUS DAWN FOR EUROPE'S NEW STS SECURITISATION REGIME

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With the noble intention of promoting greater issuance and encouraging investment in a more robust market for asset backed securities, Europe's new regime of simple, transparent and standardised ("**STS**") securitisations has had something of a tentative start since the European Union's regulations were ushered in at the beginning of 2019.

Uncertainty on a number of fronts, in particular regarding certain technical aspects of complying with the new criteria has to some extent compounded the difficulties in meeting the complex and onerous certification and reporting requirements required to gain the STS seal of approval.

The more beneficial capital treatment for banks, funds and other investors such as insurance companies, some of whom are currently priced out of the securitisation sector in Europe, should improve pricing levels and funding costs. However, meeting the complex criteria required for STS qualification is burdensome. For example, there is an ongoing obligation to notify regulators if at any time a deal fails to meet the STS standards and it remains unclear from a practical perspective how and by whom that obligation will be discharged. With the tough criminal sanctions that can potentially be imposed where deals have been incorrectly certified to be STS, it is perhaps of little surprise that predictions of a slow and cautious approach on the part of originators using STS have materialised.

Logistical Compliance Challenge

Applicable to RMBS and other types of ABS issuance, but not CMBS, CLOs, sub-prime MBS or synthetic deals, overall there are a number of characteristics or elements, ranging in complexity, which must be satisfied to achieve STS status. These characteristics are classified under simplicity, transparency and standardisation.

Included in the 'Simple' STS factors are; prescribed perfection triggers on asset quality deterioration, contractually binding obligations on underlying exposures alongside representations that the underlying assets are unencumbered, in line with predetermined and unambiguous eligibility criteria. Among the multitude of other 'Transparency' requirements, STS is particularly concerned with the uniformity of the underlying assets and the issuer's ability to demonstrate how these assets have performed on a historical basis. This means originators will need to report and attest to numerous data fields on details such as; outstanding balance, interest rate, borrower income information and employment status on a loan-by-loan basis, as part of the historical static and dynamic performance data

going back for up to five years. Other factors include regular asset performance reports for investors, the provision of a liability cash flow model and external, independent verification of underlying exposures. 'Standardised' conditions include; the satisfaction of risk retention requirements, the hedging of currency and interest rate risk, and clear provisions for counterparty replacement and conflict resolution. In terms of understanding exactly who is required to make the relevant disclosures and attestations to seek STS classification, the EU regulations state that responsibility lies with the originator and the issuer. Although designated third parties who have been authorised by ESMA may undertake these tasks on behalf of an entity, it is clear that the originator and issuer will be fully liable for any failings or statements that prove to be incorrect.

It has to be said that collecting and verifying such huge volumes of data for each transaction presents a logistical challenge for originators and issuers seeking to obtain the STS certification. Significant investment in technology and personnel may be required to overcome this issue. Furthermore, the templates that are needed have not yet been implemented, this may be less of an obstacle for major banks with their greater resources but it has a significant impact on the non-traditional banks and the fintech lending space. It will be interesting to see how attitudes to the new regime develop over time for such participants that rely on the securitisation market for funding. There is, of course, no legal requirement to bring every transaction into STS compliance, so for most institutions it will be a cost/benefit analysis to consider the expenditure against the theoretically tighter pricing that STS would achieve.

Limited Take-Up

An examination of the additional burdens involved in bringing an STS compliant securitisation to the public market underlines the hesitancy evident among issuers at present, albeit in a quiet primary market. Media reports in mid-March pointed to a €719.9 million auto lease deal marketing from Volkswagen

as the first European ABS expected to receive STS notification. ESMA, however, is required to maintain and publish a list of transactions that fulfil the STS criteria and by mid-April there were three entries, denoting two private transactions and the €1.1 billion Storm 2019-1 Dutch RMBS from Obvion. Information from third party agencies offering STS certification services meanwhile, generally indicates low demand at the present time.

The greatest prevailing uncertainty lies in the fact that although the new regulations have been in place since the beginning of January there is insufficient detail on the technical standards which are yet to be finalised by ESMA. Until some clarity is achieved in that area, it will be difficult for market practice to develop. However a number of deals in the pipeline have included certain STS language in their documentation, notwithstanding some heavy caveats, pointing to the future application of these standards. For deals originating from UK assets, Brexit introduces an additional layer of uncertainty in complying with the EU regulations. As with most areas of the financial markets, the expectation remains that at least initially, the UK government will mirror the relevant European legislation.

From a high level perspective, the efforts of EU regulators to instil greater confidence and transparency in the securitisation market through this reform should be applauded in that investors can be assured that an individual deal is required to meet a certain set of pre-determined standards in order to receive the STS-mark of approval. While European securitised debt issues performed far better in terms of actual defaults than their counterparts across the Atlantic during the financial crisis, which arguably was caused primarily by problems in the US sub-prime mortgage sector, there remains, however misplaced, a degree of public mistrust in the structured finance market across Europe. The STS regulations may go some way to addressing these misconceptions, resulting in a stronger and more liquid market in the future, however at this stage, the perhaps unintended consequences of this legislation are that it has translated into somewhat greater

difficulty in completing deals, with more burden and responsibility for originators and a few degrees more caution on the part of investors.

About the Authors

Sam Ellis

Sam has extensive financial services experience across structured finance, alternative investment funds, capital markets and investment banking. As a Senior Vice President, Sam leads the Maples Group's UK corporate and fiduciary services business in London. He is also an experienced independent director, having served on the boards of a wide range of alternative investment vehicles, including hedge funds, private equity funds and structured finance vehicles across a variety of jurisdictions and strategies since 2011 and brings deep financial services expertise and knowledge from various strategies, regions and structures. Sam previously worked in corporate finance and investment banking at Macquarie Capital in London and in Melbourne. During his time at Macquarie, Sam worked on equity capital markets and merger and acquisition transactions across a variety of sectors and regions, including working with Macquarie's investment funds. Prior to that, he worked in the antitrust, competition and trade group at Freshfields Bruckhaus Deringer in Brussels, focusing on EU merger clearances and antitrust cases.

Jennifer Jones

Jennifer has over 20 years' experience in structured finance, securitisation and capital markets structures. Jennifer has acted as corporate services provider and security trustee on these structures. Jennifer joined the Maples Group in 2017. Previously

Jennifer worked at Capita Asset Solutions in 2016 as a Senior Client Manager. Prior to this, she worked at SFM Europe as a Senior Transaction Manager for nearly five years and was responsible for negotiating and managing a wide range of structured finance transactions from incorporation through to the winding up of the SPV. Before joining SFM Europe, she worked in Allen & Overy LLP's securitisation department for four years as a Transaction Executive. Jennifer has a wide range of experience, having worked with challenger banks, leading UK high street banks and building societies, private equity houses and global investment banks along with many small and mid-sized UK originators on a variety of structures ranging from warehouse structures, ABS, RMBS and CMBS, covered bond programmes and bespoke structures.

Charles Leahy

Charles has over 15 years' securitisation experience, having worked in treasury capital markets, trust and agency and corporate services. Charles previously worked at Law Debenture as a Senior Transaction Manager, where he was responsible for negotiating new structured finance transactions and restructurings and acting as an SPV director. Charles also spent six years working at The Bank of New York Mellon, London as a Senior Relationship Manager in Corporate Trust. Charles' securitisation experience started at St. George Bank, Sydney in capital markets, group treasury. At the time, St. George was the largest Australian balance sheet RMBS issuer. Charles has worked with UK high street banks, private equity firms and hedge funds, as well as small to midsized UK originators. His product experience includes ABS, MBS, warehouses, whole-of-business securitisations, LPNs, DPRs and cat bonds.