Follow up from call. Topic: Article 5(1)(e)

From: Shaun Baddeley
To: Roberta De Filippis; Thierry Sessin-Caracci; Eirini Kanoni; Maria Vittoria Cazzola
Cc: Pablo Portugal; Maria Pefkidou; Eoin Burke

Dear ESMA and EBA colleagues,

Many thanks for your time on the call last Monday. Your argument was centered on the fact that it may be challenging to give direction to Competent Authorities in line with AFME's letter dated 9 December 2022, given that prior to release of the Commission's Article 46 Report dated 10 October 2022, the position should have already been clear for EU investors investing in 3rd country securitisations. We said that the reality is in fact very different. Please see at the bottom of the email a selection of letters / comments by the industry over time making this point clear.

Below we set out some pointers to emphasise the fact pattern;

Revisiting the Joint Opinion of the Joint Committee of the ESAs (the "JSA Opinion") and the subsequent Joint Committee report on Article 44 (the "JC Report") that you referred to on the call, we make the following observations:

- In March 2021, the JSA Opinion noted that Article 5(1)(e) *may be* understood to include third country securitisations, and that there is no flexibility for this requirement to be waived or modified for third country securitisations. It then invited the Commission to assess the feasibility of introducing an "equivalence" regime as a solution for introducing more flexibility so that the verification can be presumed to be completed in the case of third country securitisation even if not all EU transparency requirements are fulfilled in every detail.

- In May 2021, the JC Report further observed the lack of clarity on the jurisdictional scope of Art. 5 and the lack of guidance with regard to the implementation of a "proportionate" due diligence and of due diligence obligations at loan level, without however further discussing the feasibility of an "equivalence regime" for transparency requirements in non-EU deals. It just invited the Commission to provide interpretative guidance that should follow proposals made by JSA Opinion, while at the same time also recommending for guidance to address how adequacy and proportionality could be achieved in the context of due diligence and how investors are expected to perform due diligence at loan-level.

- The JSA Opinion was at odds with the recommendations of the High-Level Forum Report on CMU (published in June 2020) which stated that Article 5(1)(e) should not apply to third country transactions, and that a "proportionate" approach should be considered instead. (The High-Level Forum Report recommended to the Commission to "allow an EU-regulated investor in third-country securitisation to determine whether it has received sufficient information to meet the requirements of Article 5…to carry out its due diligence obligation proportionate to the risk profile of such transaction" and to provide a clarification that Article 5(1)(e), which triggers strict compliance with the EU standards of disclosure and reporting, including the use of standardised EU templates, "does not apply to third country originator/sponsor or SSPE… rather such third country originator, sponsor and SSPE must ensure that the EU-regulated investor has received sufficient information" to meet its investor due diligence requirements on a proportionate basis.)

- In July 2021, the Commission published a consultation on the review of the SECR which, among other things, sought feedback on the statements and recommendations of the JSA Opinion and the JC Report in relation to the jurisdictional scope of application, which further reinforced the message to the industry that the state of uncertainty on the legal interpretation continues.

- The Commission report on the functioning of the SECR (published in October 2022) acknowledged that Article 5(1)(e) gives rise to questions of legal interpretation and acknowledged that "submissions of the Joint Committee and the feedback to the consultation clearly indicate that the requirements of Article 5(1)(e) are currently interpreted and applied differently by market participants". It considered the "equivalence" regime, as proposed by the JSA Opinion, and acknowledged that there was little support for setting up such equivalence regime. The Commission concluded that "the legislative intent of the verification obligation under Article 5(1)(e) of the Securitisation Regulation is key to the interpretation of this provision" and that "differentiating the scope of information to be provided, depending on whether the securitisation is issued by EU entities or by entities based in third-countries, is not in line with the legislative intent" and that "it is not appropriate to interpret Article 5(1)(e) in a way that would leave it to the discretion of the institutional investors to decide whether or not they have received materially comparable information".

As you may see, each of these reports provided a different interpretation of Art 5(1)(e) or a different recommendation, and made apparent, **therefore, that reading level 1 text is far from straightforward**. **This continuous ambiguity and lack of clear and consistent guidance from EU authorities around what is expected from EU institutional investors in terms of due diligence in third country deals have created significant uncertainty to the market**. Please refer to a selection of communications below.
Waiting for the release and implementation of the new templates will only increase this chronic uncertainty. As explained in the AFME letter, "third country reporting entities have, since the original date of application of the Securitisation Regulation, been reluctant to provide full Article 7 information, since reporting entities would need to make substantial and costly adjustments to their reporting systems to comply with the Article 7 templates. We expect this reluctance to have only increased now that the templates for private securitisations are expected to be significantly changed (and simplified so as to significantly reduce the scale of the changes and costs required) in the relatively short term."

It is therefore imperative that **forbearance be provided now as a transitional measure until the implementation of the new templates**, so to prevent unintentionally excluding EU institutional investors from investing in third country deals and in order to minimise the cost of implementing the necessary changes.

- U.S. SFA letter of July 2019
- FMLC letter of November 2019
- AFME letter
- Clifford Chance client briefing published in February 2019
- Clifford Chance briefing from January 2021
- further Clifford Chance briefing from June 2021

Please do let us know if any of the above is unclear or if you disagree with the facts as stated.

Kind regards,

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