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# NAVIGATING THE IMPLICATIONS OF RECENT INTERNATIONAL REGULATORY DEVELOPMENTS FOR DOMESTIC AND CROSS-BORDER SECURITISATION OFFERINGS

## ASF EVENING SERIES

24 FEBRUARY 2015



# INTRODUCTIONS

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## **Panellists**

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## **Moderator**

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## DISCUSSION TOPICS

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- Divergent EU and US risk retention requirements.
- Loan level reporting requirements under EU CRA3 and US Regulation AB II, and central bank collateral eligibility standards.
- Implications of the Volcker Rule for non-US financial institutions engaged in structured finance activities.
- Bank capital and liquidity requirements, including revisions to the Basel securitisation framework.
- 'High quality'/'simple, transparent and comparable' securitisation.



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# RISK RETENTION REQUIREMENTS



# RISK RETENTION REQUIREMENTS

## KEY TAKEAWAYS

- US and EU risk retention requirements diverge – 'Highest-common-denominator' problem:
  - Need to comply with risk retention rules of multiple jurisdictions in global offerings.
- High quality Australian assets may not be exempt from the US risk retention rules – SEC interpretive relief likely required.
- Changes to the EU risk retention rules: Synthetic risk retention not permitted for non-banks.

# EU v US RISK RETENTION REQUIREMENTS

	EU risk retention requirements	US risk retention requirements
<b>Approach</b>	Indirect approach: EU prudentially-regulated credit institutions, investment firms, consolidated entities, AIFMs and insurance companies obligated to comply with risk retention requirements.	Direct approach: Sponsor (i.e., entity that organises/initiates securitisation via transfer of assets) obligated to comply with risk retention requirements.
<b>Application</b>	'Securitisation' (i.e., a transaction or scheme whereby credit risk associated with an exposure/pool of exposures is tranching) – does not need to involve an issue of securities.	'Securitisation transaction' involving the offer and sale of asset-backed securities by an issuing entity.
<b>Retainer</b>	One of originator, sponsor or original lender.	Sponsor, but can allocate proportionate share to originator (originating at least 20% of pool) in certain cases. If multiple sponsors, each sponsor responsible for ensuring that at least one complies.
<b>Retention level</b>	5% of nominal value (i.e., of the initial outstanding principal amount of the asset-backed securities issued <b>or</b> of the securitised assets).	5% of fair value for first-loss retention. 5% of nominal value for vertical slice retention.
<b>Holding period</b>	Life of transaction.	Minimum holding period of at least 5 years for residential/commercial mortgage securitisations and 2 years for all other securitisations. Asset class-specific sunset provisions.
<b>Exemptions</b>	Very limited.	Qualified residential mortgages exemption. Asset class-specific risk retention alternatives. Limited exception for certain foreign securitisations.

# EU v US FORMS OF RISK RETENTION

	EU risk retention requirements	US risk retention requirements
<b>Vertical slice</b>	Yes.	Yes.
<b>First-loss of securities sold to investors</b>	Yes.	Yes.
<b>Representative sample from pool of assets</b>	Yes.	No*.
<b>Seller's interest</b>	Yes - revolving securitisations only.	No.
<b>First-loss interest in respect of securities sold to investors</b>	Yes.	Yes.
<b>First-loss interest in respect of each of the securitised assets</b>	Yes**.	No.
<b>Eligible horizontal reserve account</b>	No.	Yes.
<b>Combination 'L-shaped' retention</b>	No.	Yes.

\* Reflected in the 2011 proposals but removed in the 2013 re-proposal and not reflected in the final rules.

\*\* New under Regulatory Technical Standards implementing the EU Capital Requirements Regulation.



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# LOAN-LEVEL REPORTING REQUIREMENTS UNDER EU CRA3 AND US REGULATION AB II AND CENTRAL BANK COLLATERAL ELIGIBILITY STANDARDS





# LOAN-LEVEL REPORTING

## KEY TAKEAWAYS

- Multiplicity of data reporting requirements.
- Asset-based disclosure requirements under US Regulation AB II strictly apply only in SEC registered deals.
- Over time, we would expect some of the asset-based disclosure requirements under US Regulation AB II to become market standard for Rule 144A offerings.

# IMPLICATIONS OF US REGULATION AB II FOR RULE 144A OFFERINGS



<b>Disclosure and liability framework for Rule 144A offerings</b>	
<b>Disclosure</b>	No specific disclosure requirements. However, Rule 144A offering memorandum is generally drafted to meet SEC standards for a registered offering, subject to generally accepted deviations.
<b>Liability considerations</b>	Liability under the anti-fraud provisions of the US federal securities laws for material misstatements or omissions in connection with the purchase or sale of securities.
<b>Defences</b>	No 'due diligence' defence as such under Rule 10b-5 (and the issuer is strictly liable). However, other participants in the offering (including directors and officers of the issuer) who have performed a 'reasonable investigation' that would establish a due diligence defence under Section 12(a)(2) may be able to rebut the existence of intentional or reckless conduct, as is required under Rule 10b-5.
<b>Negative assurance</b>	Due diligence, comparable to that appropriate in an SEC registered offering, undertaken. 10b-5 negative assurance provided by US counsel.

<b>Implications of US Regulation AB and Regulation AB II for Rule 144A offering practice</b>	
<b>Regulation AB disclosure</b>	Rule 144A offerings generally approximate US Regulation AB-compliant disclosure with respect to transaction structure, sponsor, originator, servicer, origination and servicing programs, static pool information, pool assets, non-US legal and regulatory aspects, significant obligors, significant derivatives counterparties, significant enhancement providers and affiliations/related transactions.
<b>Regulation AB II disclosure</b>	Asset-level disclosure (in Rule 144A offering memorandum and periodic investor reporting) addressing key metrics required under US Regulation AB II likely to become market standard for Rule 144A offerings.



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# VOLCKER RULE

IMPLICATIONS FOR NON-US FINANCIAL INSTITUTIONS  
ENGAGED IN STRUCTURED FINANCE ACTIVITIES

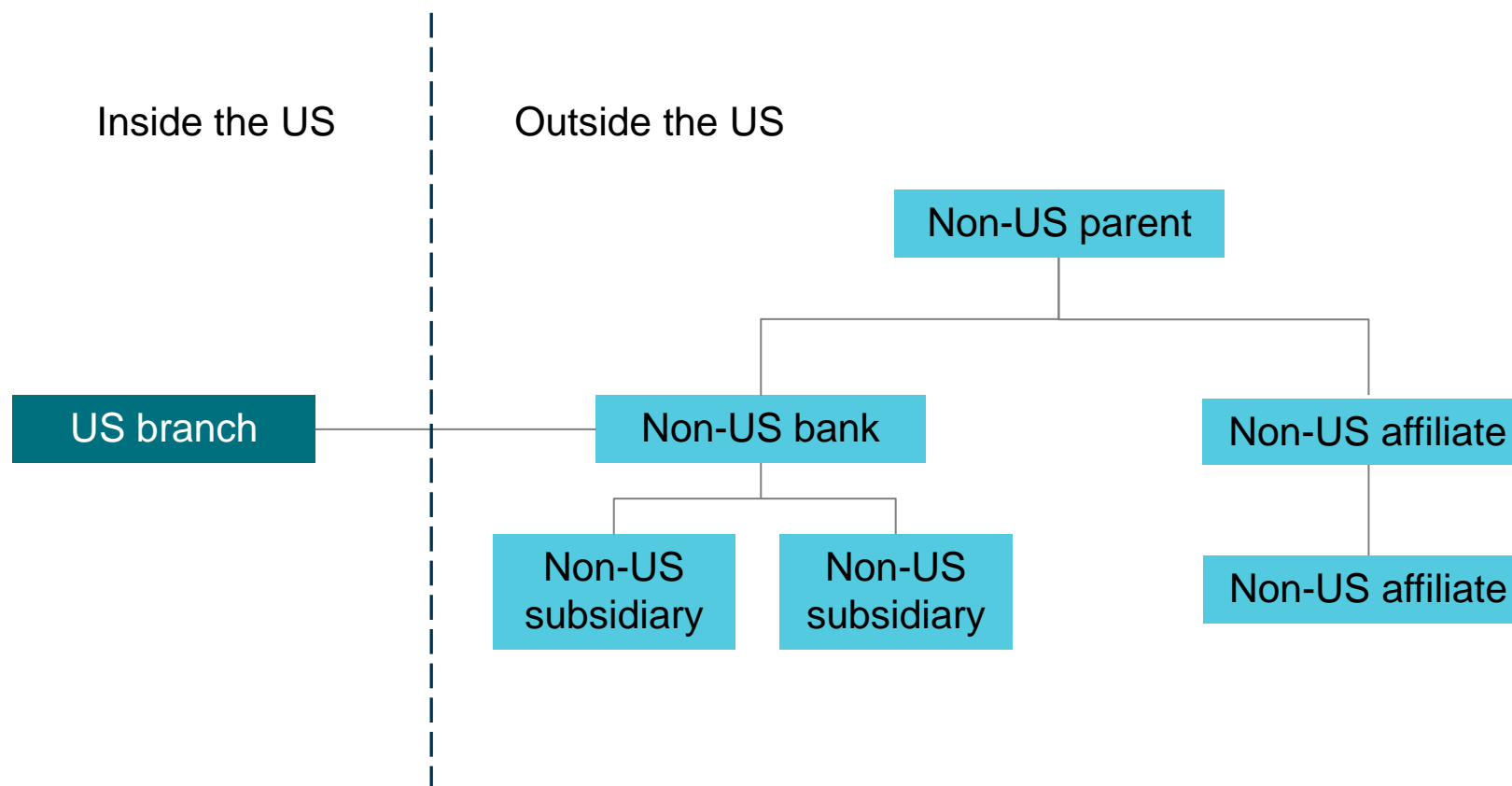


# VOLCKER RULE

## KEY TAKEAWAYS

- Volcker Rule has sweeping extraterritorial scope.
- Volcker issues need to be managed – up front at transaction structuring stage:
  - Involve counsel early.
  - Rely on a US Investment Company Act exemption other than Section 3(c)(1) or Section 3(c)(7).
- Good faith efforts required during 'conformance period'.

# ARE AUSTRALIAN SECURITISATION ISSUERS SUBJECT TO THE VOLCKER RULE?



# IS THE PROPOSED TRANSACTION OR ACTIVITY RESTRICTED BY THE VOLCKER RULE?

Does it involve a 'banking entity'?



Does it involve a 'covered fund'?



Does the proposed activity involve such banking entity investing in, sponsoring, or accepting exposure to the credit risk of, such covered fund?



Does an exception apply?



Could the exception be disallowed based on high risk, material conflict of interest, or threat to financial stability?



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# BANK CAPITAL AND LIQUIDITY





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# 'HIGH QUALITY' AND 'SIMPLE, TRANSPARENT AND COMPARABLE' SECURITISATION







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QUESTIONS?





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-  Associated office
-  Group

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