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Securitisation Regulation Update: New Regulatory Technical Standards on homogeneity

The Commission Delegated Regulation (2019/1851) (the "**Delegated Regulation**"), which provides the regulatory technical standards ("**RTS**") for STS securitisations, was published in the Official Journal of the European Union on 6 November 2019. The Delegated Regulation entered into force on 26 November 2019 and provides further detail on the requirement for homogeneity under the RTS for Simple, Transparent and Standardised ("**STS**") securitisations. STS securitisations are a concept created under the Securitisation Regulation (Regulation 2017/2402) (the "**Securitisation Regulation**") which entered into force on 1 January 2019.

The Securitisation Regulation provides the framework to designate certain short-term asset-backed commercial paper ("**ABCP**") securitisations and term securitisations as an STS. STS securitisation investors can benefit from favourable regulatory capital treatment if the conditions in the Capital Requirements Regulation (Regulation 575/2013) have been met.

Articles 20(8) and 24(15) of the Securitisation Regulation provide that the underlying exposures of ABCP securitisations should be, among other things, homogenous in terms of asset type taking into account the specific characteristics relating to the cash flows of the asset type. In order to qualify, an asset pool being considered for an STS must navigate a three stage test.

First, the assets comprising the pool must be taken from one (and only one) of the following STS eligible asset classes, namely:

- Residential mortgage loans;
- Commercial mortgage loans;

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- Consumer loans;
- Corporate loans;
- Auto loans and leases;
- Credit card receivables;
- Trade receivables; or
- What is considered by the originator or sponsor in the deal to be a single discrete asset class (as long as the assets are all in the same jurisdiction).

Second, the assets in the pool must meet requisite underwriting and servicing standards to the extent that they are:

- "…*underwritten in accordance with standards that apply similar approaches for assessing associated credit risk*…" (In other words, either the same or substantially similar credit underwriting criteria were or are applied to the origination of all assets in the pool); and
- "…*serviced in accordance with similar procedures for monitoring, collecting and administering cash receivables on the asset side of the* [securitisation special purpose entity (ABS issuer)]…" (i.e., the policies and procedures for servicing the asset pool in the issuer are substantially similar to those applied by all originators of the assets).

Third, one or more "homogeneity factors" must be present in the pool. Prior to publication of the RTS, it was unclear what would give a particular pool of assets sufficient homogeneity. This is now clarified under Article 2 of the Delegated Regulation.

The homogeneity factors vary depending upon which eligible asset class they are applied to. For example, for the first asset class of residential mortgage loans, one or more of the following homogeneity factors must be present:

- The pool consists entirely of loans secured by either: (i) a first ranking mortgage; (ii) a second ranking mortgage; or (iii) a first and second ranking mortgage, over the respective residential property; or
- All of the residential properties mortgaged to secure loans in the pool are either: (i) owner occupied; or (ii) buy-to-let; or
- All of the residential properties mortgaged to secure loans in the pool are situated in the same jurisdiction.

There are analogous homogeneity factors based on ranking of security, property type (office, retail, industrial etc.) and location for STS commercial mortgage backed securities deals. Whereas the homogeneity factors for corporate loans require that all of the loans are either to SMEs or exclusively larger businesses, or alternatively consist entirely of borrowers located in one jurisdiction or are secured over property in just one jurisdiction. For auto loans and credit card receivables, the car owners or cardholders must either all be in the same country or all of the same type, ranging from individuals to financial institutions. There are no homogeneity factors for consumer finance and trade receivables deals, which seemingly pass the third stage of the test automatically.

The Delegated Regulation requires that only one of the homogeneity factors need be present in relation to RMBS, CMBS, auto loan and consumer deals. This can be seen as a retreat from earlier proposals which provided that all or most factors would need to be present. While this might more easily facilitate some international transactions, multinational STS transactions involving smaller economies or multi-originator STS deals in smaller economies may be more difficult to achieve.

More broadly, the Delegated Regulation has provided market participants with some necessary clarity on how to obtain the STS designation. Nonetheless, ESMA statistics show that since the introduction of the Securitisation Regulation, over 100 STS designations have been created without detailed guidance on homogeneity. The most popular asset classes under which the designation has been obtained are residential mortgages and auto loans.

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