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# **The New STS Regime**

## **An overview and some food for thought**

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Presentation

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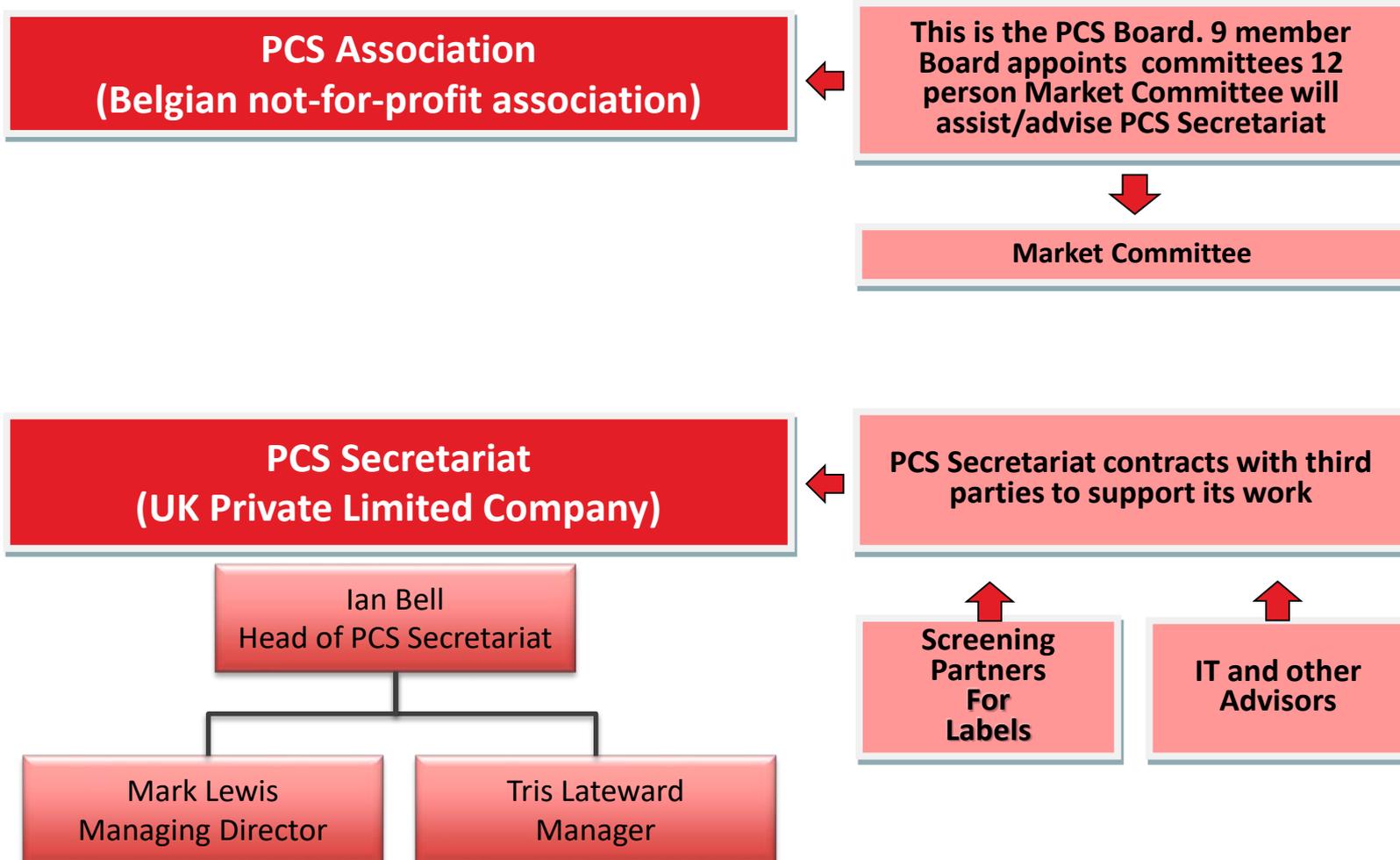
July 2018

- Introduction
- Who is speaking to you?
- The STS Regime – Short Summary
  - The Long and Winding Road
  - Where did it lead?
  - Where is it going?
  - And what do I get for my trouble?
  - Sorry to bring this up, but...what about Brexit
- The STS Regime
  - The great criteria kaleidoscope
  - ABCP – a dual approach
  - The vexed question of interpretations
  - The obligations of market participants
  - Third Party Certification Agents
  - The sanctions and how to avoid them
- PCS can help in making the transition
  - Transition issues
  - PCS STS Reports

- PCS is a **not-for-profit** initiative. Since 2012, it has provided labels for securitisations meeting high standards of simplicity, transparency and quality
- The purpose of the PCS Initiative includes:
  - Helping revitalise the European securitisation market
  - Supporting the growth of the European real economy
  - Fostering the development of best market practices for the European securitisation market with agreed standards of quality, transparency, simplicity and standardisation
  - Improving market confidence for all participants including investors, issuers and regulators

# PCS Corporate Structure

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July 2018



- Allen & Overy
- Allianz
- Amundi
- APG
- AXA
- Baker & McKenzie
- Banca Sella Holding S.p.A.
- Barclays
- BBVA
- Bishopsfield Capital Partners
- Bloomberg
- BNP Paribas
- BNY Mellon
- Clifford Chance
- Credit Suisse
- Deutsche Bank
- European Banking Federation
- Freshfields Bruckhaus Deringer
- Hogan Lovells International LLP
- HSBC
- HSBC Global Asset Management
- ING
- ING Asset Management B.V.
- Intesa San Paolo
- Linklaters
- Lloyds Banking Group
- Mayer Brown
- Moody's Analytics UK Ltd
- Nationwide Building Society
- NIBC Bank
- Obvion
- Rabobank
- Robeco
- Royal Bank of Scotland
- Santander
- Securitisation Services S.p.A.
- Societe Generale
- Swiss Re
- TwentyFour Asset Management
- UBS
- UniCredit
- Weil, Gotshal & Manges

A number of other institutions and associations are “Permanent Observers” of the PCS Association:

- Association for Financial Markets in Europe (AFME)
- Dutch Securitisation Association (DSA)
- European Bank for Reconstruction and Development (EBRD)
- European Banking Authority (EBA)
- European Central Bank (ECB)
- European Fund and Asset Management Association (EFAMA)
- European Financial Services Round Table (EFR)
- European Investment Bank (EIB)
- European Investment Fund (EIF)
- European Securities and Markets Authority (ESMA)
- Insurance Europe
- Irish Debt Securities Association (IDSA)
- KfW
- True Sale International (TSI)

- The PCS initiative commenced operations in November, 2012 with a two-fold strategy. First, to operate and maintain the PCS Label for securitisations and second, to pursue outreach activities with regulators and policy makers
- PCS has concluded 193 PCS Labelled transactions to date with a total transaction value of Euro 265 billion
- PCS has maintained an active outreach programme and has been a material participant in regulatory and policy discussions about the securitisation market since 2012 and more recently, about STS in particular

## A long and winding road

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- 2010 / 2012 – Market stakeholders plead to save securitisation
- 2014 – The European Commission, supported by the ECB, tasks the EBA to define “high quality” securitisation. The EBA publishes its proposals
- 2015 – First draft proposal from the Commission for a new regime – it’s to be called STS
- 2015 – Beating all speed records, at the end of the year the European Council amends and approves Commission proposal
- 2016/2017 – The European Parliament reflects, reflects more, then goes on a gentle meander down the by-ways of retention before returning to the main road
- December 2017 – Two new Regulations are passed: the STS Regulation and the CRR Regulation

# The STS Regime

## Where did it lead?

- **STS Regulation:**

REGULATION (EU) 2017/2402 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

- **CRR Regulation:**

REGULATION (EU) 2017/2401 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

# The STS Regime

## Where did it lead?

### Key Elements of the STS Regulation

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- A Regulation in two parts – and it is important not to confuse them
- The elements that apply to all securitisations:
  - Retention
  - Disclosure
  - Data Repositories
  - Ban on re-securitisations
  - Sanctions
- The elements that apply to STS:
  - Definition of STS (including for ABCP transactions and programs)
  - Certification requirements
  - Regulated Third Party Certification Agents (3PCAs)
  - STS specific sanctions

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# The STS Regime

## Where is it going?

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- Date of entry into force of the STS Regulation: 1<sup>st</sup> January 2019
- Date of entry into force of the CRR Regulation: 1<sup>st</sup> January 2019
- Grace period for pre-01/01/19 deals in CRR: 1<sup>st</sup> January 2020
- What about pre-01/01/19 deals in STS?
  - Grandfathering is available
  - But deals need to meet ALL the STS criteria
  - Some criteria need be met on issuance, others can be “fixed” prior to application

# The STS Regime

## So we just wait? Well, not quite...

There is a lot of secondary legislation and rules we still need to see

- 18 July 2018

Act	Authority	Article
Rules on retention (RTS)	EBA	6.7
Homogeneity (RTS)	EBA	20.14
Homogeneity for ABCP (RTS)	EBA	24.21
STS certification information requirements	ESMA	27.6
STS certification template	ESMA	27.7
Third party agents' information for authorisation	ESMA	28.4

- 18 October 2018

Act	Authority	Article
Guidelines and recommendations on STS criteria	EBA	19.2
Guidelines and recommendations on STS criteria ABCP	EBA	23.3

## So we just wait? Well, not quite...

There is a lot of secondary legislation and rules we still need to see

- 18th January 2019

Act	Authority	Article
Information to be provided by originators	ESMA	7.3
Template for information submission	ESMA	7.4
a) Verification procedures applied by repositories; b) Rules for application for repository authorisation	ESMA	10.7
Application forms for repository authorization	ESMA	10.8
a) Data and information to be provided under Art.7 a) Operational standards for repositories b) What data which public authorities are allowed c) The terms under which authorities access data	ESMA	17.2
Data template for originators/sponsors	ESMA	17.3
Obligations of NCAs to cooperate on enforcement ESMA 36.8	ESMA	36.8

## What do I get for my troubles?

- CRR capital requirement reduction for EU bank investors for STS deals that also meet some additional requirements
- Money Market Funds higher allowances
- BUT, anticipated are:
  - Introduction of STS in the LCR Rules (Commission consultation)
  - Changes to the Solvency II capital requirements for insurance company investors
- And possible changes to central bank collateral rules???

However, please note that risk transfer securitisations currently can NEVER be STS. This has a serious impact for these types of transaction

## We have to talk about Brexit

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- The STS Regime is basically not available outside of the EU
- But the STS Regulation is...a Regulation
- The STS Regulation is already UK law
- Most likely (if that adverb can be applied to any Brexit related matter) the STS Regulation will be swept up in the UK's exit legislation
- There will be a UK STS regime, probably hermetically sealed and separated from the EU STS regime
- Until changed by HMG or Parliament, the STS regime will operate in full on this side of the Channel
- The timing of all this is also potentially dependent on the nature of the transition period

## If you are already lost...

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All the key information is somewhere on the net but to assist PCS has put it all up on its website, including some handy cheat-sheets:

- STS Regulation:  
<http://pcsmarket.org/wp-content/uploads/2018/02/STS-Regulation.pdf>
- CRR Regulation:  
<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2401&from=EN>
- STS Contents Page (like the one you don't get):  
<http://pcsmarket.org/draft/wp-content/uploads/2017/12/Detailed-Contents-Page.pdf>
- STS Summary Contents Page (like the one you need):  
<http://pcsmarket.org/draft/wp-content/uploads/2017/12/High-Level-Contents-Page.pdf>
- STS Criteria (broken down into useful bit sized questions):  
[http://pcsmarket.org/wp-content/uploads/bsk-pdf-manager/STS\\_Criteria\\_28.pdf](http://pcsmarket.org/wp-content/uploads/bsk-pdf-manager/STS_Criteria_28.pdf)
- Secondary legislation timetable:  
<http://pcsmarket.org/draft/wp-content/uploads/2017/12/RTS-and-Delegated-Acts-Timetable1.pdf>
- Secondary legislation by regulatory authority:  
<http://pcsmarket.org/draft/wp-content/uploads/2017/12/STS-RTS-and-Delegated-Acts.pdf>

## The great criteria kaleidoscope

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- To be STS a transaction (not ABCP) needs to meet ALL the STS criteria
- We have identified over one hundred separate point that need be met

## ABCP – dual approach

- The STS regime for ABCP breaks down into two parts:
  - program level criteria – to be met if one wishes the entire ABCP program to be STS
  - transaction level criteria – to be met if one wishes only one or more transactions contained in the ABCP program to be STS
- The program level criteria are difficult and problematic. Early indications is that this may be too onerous and few ABCP sponsors will seek to obtain the STS status for their program
- The benefit of obtaining STS for individual transactions within an ABCP program is the reduction of capital requirements under the CRR for the sponsor, whose liquidity commitment is treated as a securitisation

## The vexed issue of interpretation

- Many STS criteria are not entirely straightforward
- We agree with the EBA's published approach – the “traffic light” analysis
  - No issue criteria
  - “**Green**” criteria – fairly straightforward but could benefit from clarification
  - “**Yellow**” criteria – extremely difficult to interpret without regulatory guidance
  - “**Red**” criteria – literally impossible to determine without additional guidance
- Key document will be EBA's guidelines and recommendations to be out in October (and the Homogeneity RTS – due July)

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## The vexed issue of interpretation - Reds

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- Art 20.8: homogeneity (RTS issue)
- Art 20.10: originator expertise and similar nature of assets
- ***Art 20.11: credit impaired borrowers and “best of knowledge”***
- Art 20.13: dependence on sale of assets (“predominantly”)
- Art 21.8: servicer expertise and similar nature of assets
- Art 21.8: “well documented and adequate”

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# The STS Regime

## Market Participants Obligations

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July 2018

- Issuers
  - STS is not an objective and passive status
  - You must (and need not) apply for it
  - Issuers must certify the STS nature of their issuance
  - Issuers must transmit the certification to ESMA
  - No secret STS – all deals go on the ESMA website
  
- Investors
  - Only if you are regulated by reference to STS do you have legal obligations
  - That can include asset managers under the delegation power
  - Investors can rely “appropriately” but not “mechanically” on the issuer certification



## Third Party Certification Agents

- A new creature in the capital market bestiary
- 3PCAs are regulated at the national level but with passporting rights across the European Union
- Post-Brexit, UK 3PCAs can be regulated in the UK, but likely without passporting rights
- 3PCAs verify and certify the issuer's own STS certification
- They are engaged by the issuers
- There are restrictions on who can be a 3PCA e.g. cannot provide advisory, audit or equivalent services to the Originator, Sponsor or SSPE in the transaction or be a rating agent
- They will prove to be a key part of the STS market infrastructure for issuers to mitigate liability, investors to substantially lighten due diligence and regulators as an early warning system

## Issuer sanctions and how to avoid them

- The STS sanctions for issuers that “mis-certify” are savage
  - Fines of up to 10% of world-wide turn-over
  - Personal fines of up to Euro 5,000,000
  - Possible criminal sanction
- But all is not bleak – issuers are only liable for:
  - Deliberate mis-certification
  - Negligent mis-certification
- And regulated third party certification agents are available
  - The law explicitly prohibits the issuer from transferring liability
  - But the issuer’s obligation is not to be “negligent”
  - The use of an independent and regulated entity to confirm the issuer’s analysis is extremely strong evidence of no-negligent

**BEWARE: the issuer can avoid sanctions but the deal loses its STS status**

## How PCS can help to transition

- During 2018, PCS will do its best to assist market participants and regulators to transition to the new regime
- To do this, amongst other things, PCS will provide to those who apply for one an STS Report for existing and new transaction in both the public and private placement market
- The report will examine a transaction and analyse it against all the STS criteria to determine whether, in PCS' opinion, it meets the STS criteria and, if not, why not
- As an addendum PCS will also, if requested, provide a CRR report looking at the additional CRR criteria and a Grandfathering Report examining the transaction against the grandfathering rules
- As new rules come online (eg LCR and Solvency II), PCS will seek to provide additional reports to cover these areas

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# The STS Regime

## PCS STS Report

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- Currently, without the EBA guidelines and recommendations, any analysis of the possible STS status of a transaction will depend on a high level of interpretation of the STS criteria
- PCS has published its interpretations, based on its knowledge and common sense. But there can be no guarantee that the final regulatory interpretations of the STS criteria will exactly match those of PCS
- An STS Report is therefore not a binary/pass-fail document but a more consultative document helping identify areas issuers or investors will wish to focus

## PCS STS Report – Value for issuers?

- Identify criteria that absolutely fail the STS test
- Identify the areas of uncertainty; what distribution of possible outcomes exist in the regulators future interpretations of the criteria and the cost/benefit analysis of taking a view
- Identify the probable disclosure requirements that STS will drive through the ESMA certification process and the due diligence requirements to demonstrate compliance (and therefore absence of negligence) in certifying STS
- For internal structuring, legal and compliance teams, get the benefit of PCS' deep knowledge of not only the rules but the history and rationale behind the rules

Some potential issues (especially, but not only, around IT) may take many months to “fix” and so we recommend that this work not be done too late in 2108

## PCS STS Report – Value for issuers?

- Identify any fundamental business issues early to allow business to adjust
- Identify any IT and data capture changes that will be required to ensure compliance with the STS rules
- As PCS will continue to engage with regulators throughout 2018, STS Reports can bring to the surface unidentified problems for given issuers or asset classes that PCS can then relay (anonymously) to regulators so inform their own drafting of the secondary legislation
- If issuers wish to seek third party certification, the STS Report process will be a forerunner of the certification process that PCS will hope to run after the STS regime's entry into force

## PCS STS Report – Value for investors?

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- Identify the types of deal that will definitely not be STS or not be grandfathered which are in their books or which they traditionally look to buying
- For asset-managers, getting a sense of the steps that they may be required to take on behalf of their investors under the delegation powers

- The PCS website contains information regarding STS and the STS Reports
- The PCS website is at [www.pcsmarket.org](http://www.pcsmarket.org)

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# Contacts at the PCS Secretariat

The New STS Regime  
July 2018

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Ian Bell, Head of PCS Secretariat

Tel: +44 (0) 20 3440 3721

Mob: +44 (0) 7500 558 040

E: [ian.bell@pcsmarket.org](mailto:ian.bell@pcsmarket.org)

Mark Lewis, Head of PCS Operations

Tel: +44 (0) 20 3440 3722

Mob: +44 (0) 7500 448 833

E: [mark.lewis@pcsmarket.org](mailto:mark.lewis@pcsmarket.org)

Tris Lateward, Director of PCS Operations

Tel: +44 (0) 20 3440 3723

Mob: +44 (0) 7780 333 895

E: [tris.lateward@pcsmarket.org](mailto:tris.lateward@pcsmarket.org)

[info@pcsmarket.org](mailto:info@pcsmarket.org) (for general enquiries)

[admin@pcsmarket.org](mailto:admin@pcsmarket.org) (for the label applications)

[www.pcsmarket.org/contact-us](http://www.pcsmarket.org/contact-us)

