

In Practice

Authors Jeremiah Wagner and Christopher Sullivan

NPE servicers prepare to retain risk under EU Securitisation Regulation

In this In Practice article the authors suggest practical steps for servicers to consider before acting as retainer of risk in traditional securitisations of non-performing exposures (NPEs).

Recent changes to the Securitisation Regulation allow eligible servicers in the EU to retain the 5% net economic interest in traditional securitisations of non-performing exposures (NPEs). The European Banking Authority (EBA) has proposed draft regulatory technical standards (draft RTS), which if adopted will provide further detail on how servicers can determine their eligibility to act as retainer of risk.

EXPANSION OF RISK RETENTION ELIGIBILITY

In-scope EU originators, sponsors or original lenders are required to retain a 5% material net economic interest in a securitisation until its final maturity, pursuant to Regulation (EU) 2017/2402 (the Securitisation Regulation). The Securitisation Regulation was amended by Regulation (EU) 2021/557 (the Capital Markets Recovery Package, or CMRP) as part of the EU's efforts to buoy the financial markets during the COVID-19 crisis. The CMRP was intended to achieve this aim in part by facilitating the securitisation of NPEs by EU banks.

Historically, certain servicers could act as retainer of risk only if they fell within the definition of "originator" by virtue of being in the same corporate group as an EU-established eligible credit institution, investment firm or financial institution that created the securitised exposures. However, third-party servicers are generally barred from retaining the 5% net economic interest in a securitisation on behalf of sell-side entities in a securitisation transaction. Following the CMRP amendments to the Securitisation Regulation, servicers of traditional NPE securitisations can fulfil the retention requirement, provided they demonstrate sufficient expertise in servicing exposures of a similar nature and implement well-documented and adequate policies, procedures and risk-management controls.

The EBA's draft RTS are not yet finalised. The EBA kept the draft RTS broadly in line with draft technical standards it had submitted in July 2018 (which were never adopted). However, the draft RTS introduce new provisions relating to, among other things, retention of risk by servicers of traditional NPE securitisations. Such new provisions set out the criteria for servicers of NPEs to satisfy supervisory authorities they have the necessary expertise required under Art 6(1) of the Securitisation Regulation.

SERVICING EXPERTISE REQUIREMENTS

Article 19 of the draft RTS provides three alternative approaches to demonstrating sufficient expertise. The first approach assesses whether senior staff and members of the servicer's management have adequate

knowledge and skills in the servicing of NPEs. Up and coming servicers that lack a five-year track record of servicing NPEs can act as retainer of risk. However, measuring "adequate knowledge and skills" may not be straightforward, and national competent authorities could evaluate knowledge and skills with varying levels of detail and rigour.

Under the second approach, the business of the servicer or of its corporate group (consolidated for accounting or prudential purposes) must have five years' experience servicing NPEs before the securitisation. This approach is much more straightforward to measure but it locks out servicers new to servicing this asset class.

The third approach relies on a combination of individual experience and the appointment of a back-up servicer with at least five years' experience servicing NPEs. Servicers new to this asset class can rely on the individual experience of senior staff and management to retain risk. Senior staff and at least two members of the servicer's management must have at least five years' experience in servicing NPEs. This approach also requires the appointment of a back-up servicer with at least five years' experience in servicing NPEs. Interestingly, the draft RTS are agnostic between appointing a "hot" back-up servicer running a parallel servicing platform, ready to step in at a moment's notice, or a "cold" back-up servicer committed to migrating over servicing functions in due course. The securitisation special purpose entity will bear the added costs associated with either arrangement, which means this approach's suitability will vary depending on the economics of any given securitisation transaction.

TAKEAWAYS

Servicer retainers should be prepared to disclose in sufficient detail the relevant expertise to permit investors to perform their due-diligence obligations under Art 5 of the Securitisation Regulation. The first and third approaches under Art 19 of the draft RTS could involve personal details of senior staff and management, and servicers should ensure that any disclosure of personal data complies with Regulation (EU) 2016/679 (the General Data Protection Regulation) and any relevant domestic privacy legislation.

The draft RTS remain subject to change, and prospective servicer retainers should stay up to date on any further developments relating to the expertise requirement, as well as changing requirements of wider application not covered by this article, such as restrictions on fees payable to the retainer, and jurisdictional requirements relating to the retainer of risk. ■

Biog box

Jeremiah Wagner is a partner in the London office of Latham & Watkins and a member of the Structured Finance and Securitisation Practice. Email: jeremiah.wagner@lw.com

Christopher Sullivan is a knowledge management lawyer in the London office of Latham & Watkins. Email: christopher.sullivan@lw.com