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Regulatory Update for Non-performing Loan Securitisation

We report on recent regulatory changes that impact the securitisations of non-performing loans (NPL, also referred to as non-performing exposures - NPE). Today, the European Securities and Markets Authority (ESMA) confirmed that the long awaited elements of the new disclosure regime under the securitisation regulation (SR) will come into force on 23 September 2020 following the publication of seven technical standards implementing the SR in the Official Journal of the European Union.

This year has seen the introduction of the regulatory technical standards of detailed disclosure requirements (the Disclosure RTS) on the underlying exposures in securitisation transactions covered by the European Securitisation Regulation (EU) 2017/2402. The UK adopted a similar regulation as Securitisation (Amendment) (EU Exit) Regulation Nr 660. Securitisation originators, sponsors or securitisation special purpose entities need to prepare for the detailed disclosures for private and public securitisations issued on or after January 1, 2019. The uncertainty around the effective timing of the Disclosure RTS has finally been lifted by the publication of a number of technical standards in the Official Journal on September 3, 2020. The new rules will become effective 20 days later on September 23 which means that data providers must produce compliant reports on the first reporting date of their securitisations after that date (ESMA 2020 and European DataWarehouse 2020). Regarding NPL securitisations we commented on the disclosure requirements and the use of the no-data option in NPL Markets (2020a, b).

New elements of the SR will come into force on September 23, 2020

The publication of the technical standards in the Official Journal means that the disclosure templates will enter into force on September 23 and applications for entities to register as securitisation repositories will open on that date. Securitisation repositories will centrally collect and maintain the records of securitisations and will be registered and supervised by ESMA. Until ESMA has registered at least one

repository, information that should be made available by reporting entities to repositories on public securitisations must be made available via a website which meets certain requirements.

ESMA has developed a set of securitisation disclosure templates to improve and standardise the information made available to investors, potential investors and competent authorities. As of September 23rd these disclosure templates must be used to make any new information available about a securitisation in accordance with Article 7 of the SR.

Revised disclosure RTS XML schemata and technical reporting instructions

On August 19, ESMA published revised XML schemata and technical reporting instructions for the reporting of the different disclosure annexes (ESMA 2020b). The changes made in version 1.2.0 are corrections and clarification of the technical implementation details, but no major change in the overall reporting requirements. Reporting entities may choose to use either version 1.1.0 or version 1.2.0 of the XML schema and validation rules until 1 February 2021 and version 1.2.0 will become mandatory thereafter.

Amendments to the regulatory treatment of NPL securitisations

On 24 July 2020, the European Commission announced a legislative proposal regarding the approach to the NPL securitisations and to permit synthetic balance sheet securitisations to qualify for STS treatment. The two proposals are set out by way of suggested amendments to bank capital requirements regulation and the securitisation regulation. The reason for the amendments is to help the recovery from the COVID-19 pandemic.

The EC finds the current treatment of NPL securitisation as not fit for purpose. The proposal is based upon a report by EBA setting out concerns with the regulatory treatment of NPL securitisations. The EC accepts that the usual rules relating to the risk retention requirement are difficult to comply with for NPL structures and so proposes that this requirement could be fulfilled by the special servicer in such a transaction. In addition, real values (meaning net book values), as opposed to nominal values (gross book values), may be used for the retention calculation. There is a clarification in relation to credit-granting

standards, acknowledging that the current terms of securitisation regulation are problematic for NPL deals.

In summary, the draft amendments set out relevant new definitions for non-performing exposure securitisation to align with the work of the Basel Committee on Banking Supervision (Art 2), amendments to allow the servicer to act as the risk retainer and lower (net book) values to be used for the 5 percent risk retention calculation (Art 6) and to disapply the specific credit standards where the exposures are NPLs (Art 9).

BCBS technical amendment for bank capital treatment of NPL securitisations

On June 23rd, the Basel Committee published a technical amendment on the capital treatment of NPL securitisations. The proposal addresses a gap in the bank regulatory framework and sets out a prudent treatment for NPL securitisation exposures. The technical amendment establishes a 100% risk weight for certain senior tranches of NPL securitisations. The risk weight applicable to the other positions are determined by the existing hierarchy of approaches, in conjunction with a 100% risk weight floor and a ban on the use of certain inputs for capital requirements. The proposed amendment is expected to come into effect by no later than January 01, 2023.

BCBS establishes a standardised definition of NPL securitisations as securitisations where there is a percentage of at least 90% of defaulted assets in the portfolio at inception and at a later time where assets are added to or removed from the underlying pool. The proposal bans the use of foundation internal ratings-based parameters as inputs for the SEC-IRBA for all NPL securitisations and introduces risk-weight floor of 100% for all NPL securitisation exposures. A fixed 100% risk-weight is applicable to the most senior tranche of qualifying NPL securitizations, where “qualifying” refers to traditional securitizations in which the non refundable purchase price discount is equal to or larger than 50% of the outstanding amount of the NPL.

In our view, these proposed amendments are positive for the market of NPL securitisation as they address gaps in the existing regulatory framework. We expect the use of NPL securitisation to increase based on higher NPL volumes as a result of the Covid economic downturn. However, we do not expect these

changes to have a material impact on deal volumes. The new ESMA disclosure regime is particularly demanding on NPL securitisations and may deter or delay the use of securitisation deals in the near term. Other challenges for NPL securitisations include the design and availability of accurate cash flow models which we plan to address in an upcoming publication.

References

[Bank for International Settlements 2020](#)

[European Commission 2020](#)

[European DataWarehouse 2020](#)

[European Securities and Markets Authority \(ESMA\) 2020](#)

[European Securities and Markets Authority \(ESMA\) 2020b](#)

[NPL Markets 2020a](#)

[NPL Markets 2020b](#)

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With the help of its proprietary data mapping and transformation tool NPL Markets helps financial institutions to map their data to the data formats defined by EBA for NPL transactions, by EBA for the valuation in resolution, and by ESMA for securitisation disclosures. Once standardized and validated the loan-level data can be uploaded to the NPL Markets valuation tool to conduct a detailed discounted cash flow analysis using pre-populated pricing parameters in different macroeconomic scenarios. We support the transfer analysis of all major asset classes by outright sale or by means of structured transactions and securitisations.

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