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One Step Forward, Two Steps Back: Clarification to the New Reporting Requirements for European Securitisation Vehicles

BY CONOR DOWNEY AND DIEGO SHIN

On 8th April 2009, Conor Downey of Paul Hastings, London attended a workshop hosted by the European Central Bank (ECB) in Frankfurt involving a variety of National Central Banks (NCBs) and representatives of the European securitisation industry to discuss the implementation of its new Regulation[1] imposing quarterly reporting obligations on securitisation vehicles (referred to in the Regulation as Financial Vehicle Corporations (FVCs)). A detailed description of the Regulation is available on the Paul Hastings website[2].

A Level Playing Field?

The ECB's view at this time is that the Regulation is in its final form and no changes will be made to it. As such, the next step is for each of the Eurozone NCBs to publish their own guidelines implementing the Regulation in their respective countries.

In response to questions on this and concerns that inconsistent implementation could lead to arrangers of securitisations "forum shopping" for jurisdictions for their securitisations which have implemented the Regulation in the most favourable way, the ECB indicated that it expected different countries to take different approaches to implementing the Regulation and accepted that this could lead to "regulatory arbitrage".

Further discussion with the NCBs present showed that radically different approaches to implementation are being contemplated with some countries looking to the legal form of entities and others looking at the nature of the transactions in which entities may be engaged. Countries such as Spain and France intend to apply the Regulation only to the very narrow range of companies formed under local specific securitisation laws. These countries do not intend to apply the Regulation to other types of entities even if they are engaged in securitisation transactions. Other countries which do not have securitisation laws allowing for the formation of specific entities, such as Netherlands and Germany plan on applying the Regulation to entities of any form engaged in transactions which fall within the definition of securitisation in the Regulation.

It is difficult to see how such radically differing approaches can meet the objective of the Regulation to provide consistent statistical information for

[1] Regulation (Regulation (EC) No 24/2009 of 19 December 2008 concerning the statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (http://www.ecb.int/ecb/legal/pdf/l_01520090120en00010013.pdf).

[2] http://www.paulhastings.com/PublicationDetail.aspx?PublicationId=1270.

Eurozone financial transactions. By way of example, under this approach certain countries will report many billions of Euros of transactions involving local FVCs acting as intermediate financing companies in ABCP funded trade receivables securitisations while other countries will report nothing on such transactions.

Furthermore, in allowing this the ECB would seem to running contrary to European Union policies on harmonisation of laws and discouraging legal competition among Member States.

Good News or More Uncertainty?

Somewhat predictably, over the course of the meeting the ECB conceded that the requirements of the Regulation could not be applied strictly in all cases. In particular:

1. FVCs have to report to their NCBs as to only their specific activities (assets and liabilities) and not those of any off-shore entities involved in the transaction.

For example, a Eurozone FVC buying assets with funding from a Delaware incorporated ABCP issuer would report only its assets and its funding loan from the Delaware entity. It would not have to report on the assets and liabilities of the Delaware issuer. Activities outside of the Eurozone do not need to be reported under the Regulation.

2. Transactions involving multiple FVCs in multiple jurisdictions will involve each FVC reporting separately. The ECB believes that its systems will be able to deal with multiple reporting of the same transaction (although this seems ambitious given that some European jurisdictions may not regard the entities involved as being FVCs at all).

3. Reporting under the Regulation is not required where local GAAP does not require equivalent reporting. For example, German GAAP does not require any valuations of hedging positions to be carried out and so the ECB will apparently not require German FVCs to report on the value of their hedges.

4. Where no information at all is available, "best estimates" should be used and figures should be revised when information becomes available. However, the regime of sanctions under the Regulation could result in FVCs following this approach being liable for providing incorrect or incomplete information.

5. Reporting is not required where it would not accord with relevant market practice. However, Article 4(5) of the Regulation does not seem to allow for such an approach.

6. In response to a question about the cost of valuing hedging and derivatives positions, the ECB referred to Article 4.4 under which:

- Reporting may not be required if the cost of doing so would be unreasonably high (for example, in relation to valuing hedges and derivatives on a quarterly basis). Again, a strict reading of Article 4.4 would not seem to allow for a dispensation as broad as this.
- On legacy transactions where information might not be available as to hedging positions, it would suffice to report payments made and received under the hedges.

7. De minimis amounts such as short-term, high-grade money market securities purchased with funds from reserves or bank accounts need not be reported.

While these are sensible and helpful to the industry, some of these concessions do not seem to accord with a strict interpretation of the Regulation and give rise to uncertainty as to whether penalties will or will not be imposed on FVCs that follow this oral guidance rather than the letter of the Regulation. Some of this uncertainty may result from the approach taken by the ECB in other areas (such as the guidelines for the operation of its repo facility) where the ECB deliberately takes a non-literal, non-legalistic approach, making general statements of policy and

objectives. While such an approach is understandable in relation to such matters, it is more difficult to reconcile with measures having the force of law such as the Regulation, non-compliance with which can result in serious penalties.

It's as bad as you think and they're out to get you

A particularly telling moment in the meeting came when an ECB official in apparent exasperation at the quantity of issues being raised by the industry representatives told them that they shouldn't be overly concerned with the Regulation as it would "pale into insignificance" compared with forthcoming regulation of the European securitisation market.

The ECB seems uninterested in concerns expressed by the industry that measures such as the Regulation could make Europe an unattractive location for securitisation issuers. Their response to this was that anyone wanting to finance their investments through the ECB's repo facility would have to issue through a Eurozone entity. This approach seems to somewhat contradict the view of many involved in securitisation in Europe that there is an urgent need to find alternative sources of funding to the ECB repo facility.

It seems clear that the credit crunch has perhaps understandably stifled those who would argue against interference in private commercial transactions save to the extent absolutely necessary. However, given the apparent refusal of the ECB and certain NCBs to consider the necessity or usefulness of the information to be gathered under the Regulation or the costs to be bourne by unrelated third party investors, perhaps the pendulum has swung too far in the other direction.

Conclusion

NCBs expect to start to publish their implementing guidelines over the coming months. Some have already started consultation exercises with local industry participants. It seems possible that at least some practical concessions may be won in this process although where these do not comply with the strict letter of the Regulation, reporting FVCs may be left with at least some risk of liability.

Many in the industry suspect that once reporting has commenced the ECB will come to realise that the information they will receive is not what they intended it to be. It is hoped that this will lead to a more practical and pragmatic version of the Regulation being issued. However, in the meantime, it would seem that securitisation professionals will be kept very busy trying to comply with the Regulation and investors may face shortfalls and possibly even ratings downgrades due to the resulting costs.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

London

Conor Downey
44-20-3023-5165
conordowney@paulhastings.com

Diego Shin
44-20-3023-5177
diegoshin@paulhastings.com