WHEN FINAL
Is not quite final...

Last week the EU signed off the final version of its long anticipated new regulations governing securitisation as part of the Capital Markets Union (CMU) legislation.

The European Commission, Council and latterly the Parliament have been developing these in consultation with the industry for the last 2-3 years.

These rules included the criteria for the new high-quality securitisation category (into which most Prime and much of Buy-to-Let RMBS is expected to fall) called STS (Simple, Transparent & Standardised).

Deals which meet these criteria will attract lower capital charges for regulated investors, and the finalisation of their long drawn out development has been welcomed by the whole securitisation community.

However, with the final release there is also one late sting in the tail. The proposed STS rules have always included language which prevent deals containing so called self-certified mortgages from achieving the STS designation.

Self-certified mortgage loans were a product offered by some lenders prior to the crisis where the borrower, for example the self-employed, was aware that the lender might not verify the information they provided; such as their income.

In a very late and probably well-meant, but surprising change the self-certified language has been copied over to the wider securitisation rules, effectively banning self-certified loans from all new securitisations. On the face of it, this might seem a prudent move, but because it was introduced (unlike almost all of the rest of the criteria) without consultation with the industry, no account seems to have been taken of the potential ramifications for existing securitisations that contain these loans.

> “Self-certified mortgage loans were a product offered by some lenders prior to the crisis”

Furthermore, mortgage lending regulations have changed and these loans can no longer be originated, meaning that the loans in existing deals are for the most part 10 years old and performing well – how they were originated 10 years ago is now irrelevant.

Unfortunately, because the text of the regulation is now essentially “final”, it could be difficult to change (although minor amendments may still be possible).

Whilst the regulations are not due to come into force until January 2019, and therefore deals currently in issuance are not affected, difficulties may arise when these deals come to be refinanced.

For most banks, there shouldn’t be any difficulty as they will be able to take these loans back on to balance sheet, but for non-bank lenders it may be economically more challenging to refinance their deals if securitisation is no longer an option for any self-certified loans in the pool.

There is also uncertainty about how it may affect Buy-to-Let (BTL) securitisations.

For example, income verification does not normally form part of BTL underwriting which is focussed rather on rental coverage. Because there is currently no technical guidance from the regulators on how this non-verification should be applied – e.g. can it be interpreted as self-certified – the outcome is a little uncertain.

Whilst both self-certified and BTL loans are predominantly a UK problem there are deals in other European jurisdictions, such as the Netherlands, Ireland, Spain and Sweden.

Furthermore, it’s possible that these rule changes could also inadvertently affect the securitisation of non-performing loans, which are a major part of the plan to revive the banking systems in Italy, Spain and Portugal.

This issue is still in its very early stages, and we would normally wait before commenting until the possible outcomes were clearer, but given the summer is essentially upon us and the European policymaker community will be out of circulation for the next month or so, any certainty may be some distance away.

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Simply making the rule applicable only for mortgages originated after the regulations come into force in January 2019 would effectively solve the issue. However the topic could become political and may get dragged out.

So far there has been little market reaction in terms of pricing, and in fact some deals which have high step-up coupons may actually benefit from not being refinanced.

In the UK, following Brexit there will be the ability to repeal this rule, should it not be resolved satisfactorily, although that will likely take time.

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