THE LEGAL FRAMEWORK OF SECURITISATION ON THE ROMANIAN CAPITAL MARKET

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Abstract

Securitisation scheme enables credit institutions to refinance a set of loans, exposures or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables. These loans, transferred to a special purpose vehicle, are transformed in tradable securities offered to investors.

The lender organises loans into different risk categories for investors, thus giving them access to investments in loans and other exposures to which they normally would not have direct access. Returns to investors are originated in payments made by debtors of the underlying loans.

Domestic law regarding securitisation (Law no 31/2006) does not meet the market expectations in order to generate securitisation schemes. Moreover, the domestic law came into conflict with European legislation (Regulation UE 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation).

Finally, domestic law has been repealed to leave room for application of the European regulation.

Keywords: *securitisation, capital market, securitisation special purpose entity (SSPE), originator, investment firm.*

1. Introduction

This paper covers the matter of securitisation, a still new topic for Romanian capital market. In traditional Western economies securitisation scheme has proven useful in debt refinancing. In the most common situation securitisation allows credit institutions to refinance a set of loans. Investors acquires tranches of these loans as securities issued by the collectors of these loans, SSPE (securitisation special purpose entity).

Securitisation proved to be an important element of developed financial markets. It allows for a broader distribution of financial risk and can help free up creditors" balance sheets to allow for further lending to the economy. Securitisation creates a bridge between credit institutions and capital markets[1].

We will study the securitisation process in terms of Romanian law. First law in the field was Law no 31/2006) that did not meet the market expectations in order to generate securitisation schemes. Moreover, the domestic law came into conflict with European legislation (Regulation UE 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent

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[1] Regulation (EU) no 2017/2402, Preamble 4. The Regulation recognises the risks of increased interconnectedness and of excessive leverage that securitisation raises, and enhances the microprudential supervision by competent authorities of a financial institution's participation in the securitisation market.

and standardised securitisation). In present the domestic law has been repealed to leave room for application of the European regulation.

2. Concept of securitisation

Securitisation is a mechanism used by the lenders, *originato*rs in terms of securitisation, mainly credit institutions, to refinance a set of loans, exposures or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables.

In principle, these originators" loans are transferred to a SSPE (securitisation special purpose entity), although securitisation may involve the transfer of risk achieved by the use of credit derivatives. In this case the exposures being securitised remain exposures of the originator.

The credit risk associated with exposures is "tranched". "Tranche" means a segment of the credit risk (associated with an exposure or a pool of exposures). Usually securitisation entity (SSPE) initiates a programme of securitisations. The securities issued by this programme predominantly take the form of asset-backed commercial paper (ABCP) with an original maturity of one year or less.

The lender organises loans into different risk categories for different investors, thus giving investors access to investments in loans to which they normally would not have direct access. Returns to investors are originated in payments made by debtors of the underlying loans.

The selling of a securitisation position is prohibited to a retail client unless the seller of the securitisation position has performed a suitability test[2] with the outcome that the securitisation position is suitable for that retail client.

Regarding institutional investor, European Regulation lay down due-diligence requirements. Prior to holding a securitisation position, an institutional investor shall verify that the originator or original lender grants all the credits (giving rise to the underlying exposures) on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits[3].

Risk retention principle applying to a securitisation obliges the originator or sponsor to retain a material net economic interest in the securitisation of not less than 5 %. That interest shall be measured in a manner explained by Regulation[4].

Transparency requirements for originators, sponsors and SSPEs.[5] The originator, sponsor and SSPE of a securitisation shall make certain information available to holders of a securitisation position and competent authorities. Such information includes: information on the underlying exposures on a quarterly basis; all underlying documentation that is essential for the understanding of the transaction; where a prospectus has not been drawn up, a transaction summary or overview of the main features of the securitisation; quarterly investor reports, any inside information relating to the securitisation that the originator, sponsor or SSPE is obliged to make public[6].

Details of a securitisation are collected by a repository. A securitisation repository

[2] In accordance with Article 25(2) of Directive 2014/65/EU.
[3] Art. 5 Regulation (EU) no 2017/2402.
[4] Art. 6 Regulation (EU) no 2017/2402.
[5] Art. 7 Regulation (EU) no 2017/2402.
[6] In accordance with Article 17 of Regulation (EU) No 596/2014 of the European Parliament and of the Council on insider dealing and market manipulation.

shall be a legal person established in the Union and shall comply at all times with the conditions for registration. A securitisation repository shall, without undue delay, notify ESMA of any material changes to the conditions for registration[7].

3. Participants to securitisation

SSPE "securitisation special purpose entity" means a corporation or other legal person which is established for the purpose of carrying out one or more securitisations schemes, the activities of which are limited to those appropriate to accomplishing that objective. SSPE is intended to isolate the obligations of the SSPE from those of the originator who transfers the exposures.

"Originator" means a person which was involved in the original agreement which created the obligations of the debtor giving rise to the exposures being securitized. It can also be the purchaser of a third party"s exposures on its own account and then securitises them. *"Original lender"* means an entity which concluded the original agreement which created the obligations of the debtor giving rise to the exposures being securitised[8].

"*Sponsor*" means a credit institution[9], located in the Union or not, or an investment firm[10] other than an originator, that establishes and manages an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities. Sponsor can delegates the day-to-day active portfolio management involved in that securitisation to an entity authorised to perform such activity such an undertakings for collective investment in transferable securities (UCITS)[11], an Alternative Investment Fund Managers (AIFM)[12] or investment firm[13].

"*Investor*" means a natural or legal person holding a securitisation position.

"Securitisation repository" means a legal person that centrally collects and maintains the records of securitisations[14].

4. Legal framework

Domestic Law. Former internal law regarding securitisation (Law no 31/2006) did not meet the market expectations in order to generate securitisation schemes.

Securitisation was defined as a financial operation initiated by an investment vehicle (IV) that acquires receivables, groups and affects them to guarantee a securities issue. Receivables subject to securitisation can arise from credit agreements (including mortgage credit agreements, credit agreements for the purchase of cars, contracts for the issuance of credit cards), leasing contracts, term payment contracts (including sale-purchase contracts with payment in instalments) and finally any other debt securities provided that the rights they confer may be the subject of an assignment.

Under this domestic law an investment vehicle was an entity set up as a securitisation fund on the basis of a civil society contract or as a securitisation

[7] Art. 10-12 Regulation (EU) no 2017/2402.
[8] Art. 2 (20) Regulation (EU) no 2017/2402.
[9] As defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013.
[10] As defined in point (1) of Article 4(1) of Directive 2014/65/EU.
[11] In accordance with Directive 2009/65/EC.
[12] Directive 2011/61/EU.
[13] Directive 2014/65/EU.
[14] Art. 2 al. 23 Regulation (EU) no 2017/2402.

company organized in the form of a joint stock company.[15]

The administration of funds and securitisation companies was performed by legal entities established in the form of a joint stock company. The registration at the trade register office of a company having as object of activity the administration of investment vehicles was made only with its prior authorization by CNVM.[16]

The above provisions of the domestic law came into conflict with European legislation (Regulation UE 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation)[17]. Still, this conflict has an intrinsic solution. European law takes precedence over the national laws of the Member States. The principle of supremacy applies to all European acts that are binding. Member States may not apply a national rule which is contrary to European law. In EU Court of Justice wording, the law stemming from the treaty could not be overridden by domestic legal provisions[18]. Romanian Constitution states the same principles of the pre-eminence of European law over national law.19

The European regulatory act is a regulation [Regulation (EU) 2017/2402]. Such an act is directly applicable in national law, without a national implementation. Moreover, such an implementation would create a normative redundancy because the regulation has general applicability. It shall be binding in its entirety and directly applicable in all Member States (Article 288 of the Treaty on the Functioning of the European Union).

European Law. Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 lay down a general framework for securitisation and creates a specific framework for simple, transparent and standardised securitisation[20].

The Union is striving to improve the legislative framework implemented after the financial crisis. EU aims to address the risks inherent in highly complex, opaque and risky securitisation. EU legislator tries to ensure that rules are adopted to better differentiate simple, transparent and standardised (STS) products from complex, opaque and risky instruments. [21]

Finally, domestic law has been repealed to leave room for application of the European regulation. Now are enacted in domestic law measures implementing Regulation (EU) 2017/2.402 of the European Parliament establishing a general framework for securitisation and creating a specific framework for simple, transparent and standardized securitisation.[22] Romanian Law establishes competent authority in

[15] Art. 12 Law no 31/2006.

[16] Ibidem, art. 21. CNVM is former Romanian capital market authority, now Financial Supervisory Authority (ASF).

[17] Official Journal of the European Union L 347/35, 28.12.2017.

[18] Case 6/64 Costa v ENEL [1964] ECR 593: *the law stemming from the treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as community law and without the legal basis of the community itself being called into question.*

[19] Art. 148 Romanian Constitution: *Following accession, the provisions of the Constitutive Treaties of the European Union, as well as other binding Community regulations, shall take precedence over the contrary provisions of national law, in compliance with the provisions of the Act of Accession.*

[20] Official Journal of the European Union L 347/358, 12.2017.

[21] Regulation (EU) no 2017/2402, Preamble 2.

[22] Law no 158/2020, Chapter XI.

securitisation field (FSA – Financial Supervisory Authority) with particular competencies[23], supervisory powers[24] and powers to apply punishments for the violation of the rules[25]. With these implementing rules the European Regulation is directly applicable on Romanian capital market.

5. Simple, transparent and standardised ("STS") securitisation

European Regulation creates a specific framework for simple, transparent and standardised ("STS") securitisation, a unique defined operation throughout the Union. It should be established a general applicable definition of STS securitisation based on clearly laid down criteria. The implementation of the STS criteria throughout the Union should not lead to divergent approaches that would create potential barriers for cross-border investors. They would not be compelled to familiarize themselves with the details of the Member State frameworks, thereby undermining investor confidence in the STS criteria. A single source of interpretation would facilitate the adoption of the STS criteria by originators, sponsors and investors throughout the Union. The European Regulation and ESMA[26] should play an active role in addressing potential interpretation issues.

Traditional securitisation (true-sale securitisations) in Regulation wording[27] means a securitisation with the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to an SSPE. By contrast, s*ynthetic securitisation* means a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees. The exposures being securitised remain exposures of the originator.

The Regulation only accepts for traditional securitisation to be designated as simple, transparent and standardised STS. The transfer of the underlying exposures to the SSPE should not be subject to clawback provisions.

STS requirements are clearly laid down by the Regulation. In the end ESMA shall maintain on its official website[28] a list of all securitisations which the originators and sponsors have notified to it as meeting the STS requirements. ESMA shall add each securitisation so notified to that list immediately and shall update the list where the securitisations are no longer considered to be STS following a decision of competent authorities.

Requirements relating to simplicity[29] mean the title to the underlying exposures shall be acquired by the SSPE (by means of a true sale) and the transfer of the title to the SSPE shall not be subject to clawback provisions in the event of the seller"s insolvency.

Requirements relating to standardisation[30] mean the originator,

[23] Art. XV Law no 158/2020.
[24] Art. XVII Law no 158/2020.
[25] Art. XX Law no 158/2020.
[26] Regulation (EU) no 1095/2010 of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.
[27] Art. 2 (9) Regulation (EU) no 2017/2402.
[28] https://www.esma.europa.eu/.
[29] Art. 20 Regulation (EU) no 2017/2402.
[30] Art. 21 Regulation (EU) no 2017/2402.

sponsor or original lender shall satisfy the risk-retention requirement. Thus means they shall retain a material net economic interest in the securitisation of not less than 5 %., measured at the origination (e.g. the retention of not less than 5 % of the nominal value of each of the tranches sold or transferred to investors).

Requirements relating to transparency[31]. The originator and the sponsor shall make available data on static and dynamic historical default and loss performance.

The Regulation edict a ban on resecuritisation. Resecuritisation means securitisation where at least one of the underlying exposures is a securitisation position.[32] The reason for ban is that resecuritisations could hinder the level of transparency that the Regulation seeks to establish.

The Regulation lay down above mentioned requirements regarding non-ABCP[33] securitisation. Further the text deals with ABCP securitisation.

The Regulation allows for the different structural features of long-term securitisations and of short-term securitisations (namely ABCP programmes and ABCP transactions) and there should be two types of STS requirements: one for long term securitisations and one for short-term securitisations corresponding to those two differently functioning market segments[34].

6. Conclusions

Securitisation proved to be an important element of developed financial markets. It can help free up creditors" balance sheets to allow for further lending to the economy. Securitisation creates a bridge between credit and capital markets, giving investors access to investments in loans and other exposures to which they normally would not have direct access. They can use sophisticated financial instruments such as credit derivative but tradeable securities used in traditional securitisations are more accessible.

Still, holding a securitisation position implies many risks. It is important that the interests of originators and sponsors that are involved in a securitisation and investors be aligned. In order to achieve this goal original creditors or other participants in this scheme should retain a significant interest in the underlying exposures of the securitisation. It is therefore important for the originator or sponsor to retain an economic exposure to the underlying risks in question. Any breach of that obligation should be subject to sanctions to be imposed by competent authorities.

The main purpose of the general obligation for the originator, sponsor and the SSPE to make available information on securitisations (via the securitisation repository) is to provide the investors with a source of the data necessary for performing their due diligence. Dissemination of relevant information deter participants to enter into securitisation transactions without disclosing sensitive commercial information on the transaction.

Securitisation scheme are still new for Romanian capital market. These operations should be implemented to provide both investors and institutional creditors with a new financial instrument.

The Romanian authority (FSA) must provide the necessary framework for the use of securitisation on the internal market.

[31] Art. 22 Regulation (EU) no 2017/2402.

[32] Art. 2 (4) Regulation (EU) no 2017/2402.

[33] Art. 2 (7) Regulation (EU) no 2017/2402: asset-backed commercial paper programme' or 'ABCP programme'.

[34] Art. 23 Regulation (EU) no 2017/2402.

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