

Current Regulatory Challenges of Non-Bank Digital Lenders Entering the Securitisation Market

By Geoff Grevers, COO at EuroABS



Non-bank lenders face significant regulatory hurdles when entering the securitisation market, especially when entering for the first time. The hurdles are compounded by fragmented regulatory oversight resulting from lending type, jurisdiction, and then ultimately which securitisation structure is decided upon. These challenges need to be overcome to create securitised products that are appealing to institutional investors. This article will give a (very) brief overview of some of the common challenges.

Lenders looking to scale through structured finance will come across many regulatory barriers. Being aware of these barriers early on will mean that they can be overcome efficiently when the time presents itself. This article will focus on the European viewpoint, particularly in regard to the EU and UK Securitisation Regulations.

Risk Retention and Capital Requirements

In 2011 the EU introduced the Capital Requirements Directive, where the mandatory risk retention rule of holding a material net economic interest in the securitisation was made into law. However, the current framework is outlined in the EU Securitisation Regulation, which states that “The originator, sponsor or original lender of a securitisation shall retain on an ongoing basis a material net economic interest in the securitisation of not less than 5%” . Colloquially known as the “skin-in-the-game” rule, the idea is to align the interests of the lender/originator with that of the securitisation investor, incentivising well performing issuance.

Due to the sole purpose test, where the entity holding the risk retention must be one of substance, and due to the way that the originator is defined by the regulation, it is not possible to get around this rule using a shell company.

Retaining 5%, for the life of the transaction, can be capital intensive. So careful considerations need to be made who (originator, sponsor or original lender), which method of risk retention (vertical, horizontal, and so on) and how on-going compliance monitoring will work.

Data Requirements and Data Privacy

Often underpinning many regulatory and investor needs will be the requirement for standardised data. While operational digital lenders are certainly aware of GDPR compliance, thought needs to be given to what information can and should be shared. A starting point for this is the data requirements outlined in the EU Securitisation Regulation. The data templates are anonymised, making them compliant with GDPR. While not as comprehensive as the ECB tape (which have been retired and replaced by the ESMA tapes), they are a great starting point for investors to view.

The ESMA data requirements of Article 7 of the EU Securitisation Regulation includes the need for loan-by-loan disclosures in a prescriptive format. Depending on the asset class, one of Annexes 2-9 (underlying exposures, per asset class) will need to be completed, alongside Annex 12 (investor report) for a private transaction. Public transactions will also require Annex 14 (inside information/significant events) to be filed in addition, all on a quarterly basis for the lifetime of the transaction, in XML format. There are two requirements here which are particularly onerous; one, the need to collect and correctly present all of the data contained within the loan-by-loan templates (as an example, the residential template contains 107 fields) and two, the regulator's requirement for this to be made available in machine-readable XML. If securitisation is being considered, it will be worthwhile doing a review of the datapoints that are being captured against the regulators templates as a first port of call.

While these are the current data requirements, it is worth noting that ESMA is currently undergoing a consultation review of the templates.

EU and UK Divergence

In a post-Brexit EU, where the UK is looking to de-regulate more and more, we are starting to see the UK regulations finally diverge away from the onshored EU rules. An example of this is the approach to UK institutional investors to overseas securitisations, where we have seen a shift towards a principles-based approach to due diligence requirements. While EU institutional investors require the full templates as laid out in Article 7, and checking with compliance of 5% risk retention, the UK has no such requirement and instead opted for a more liberal approach where: "the originator, sponsor or SSPE has made available sufficient information to enable the institutional investor independently to assess the risks of holding the securitisation position and has committed to make further information available on an ongoing basis, as appropriate [...]" .

Looking Ahead

While the exact solution to these problems needs to be fully understood and will need to be implemented differently on a case-by-case basis, the earlier the lender can start to think about these challenges the better, especially when it comes to data capture and standardisation.

There are of course many other aspects of regulation to think about, for example the STS standard, which isn't included in this article. But this provides a starting point for lenders.



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Looking to the future, both the EU and UK regulations are undergoing review. The landscape of EU/UK regulations could significantly change over the coming years, and divergence between the two standards is looking likely to grow further apart.

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