



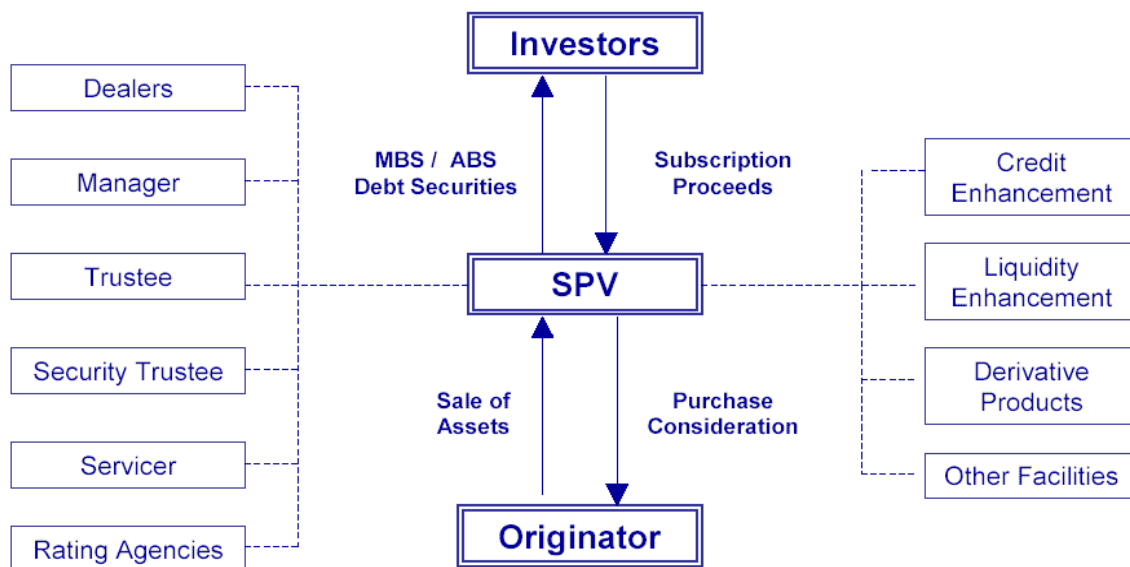
**Commercial Mortgage Securities Association Europe /  
European Securitisation Forum**

**INDUSTRY MEMO ON ISSUES FOR  
SECURITISATION UNDER THE MARKET ABUSE DIRECTIVE**

**1. Introduction: securitisation**

In this paper we are referring to “securitisation” as a financing technique whereby residential mortgages (RMBS), commercial mortgages (CMBS), auto loans, trade receivables, credit cards, insurance liabilities and other risk is transferred to special purpose vehicles (SPVs), which then fund themselves through the issuance of rated and unrated securities to capital markets investors.

A typical securitisation structure is as follows:





The structured nature of securitisation transactions presents a number of challenges for the interpretation of the Market Abuse Directive. The purpose of this document is to identify those challenges, present a list of issues for CESR to review and make suggestions for potential regulatory guidelines to address those issues.



## 2. Disclosure of inside information by the issuer

- *Relevant provision: art. 2 of Directive 2003/124/EC*

“Member States shall ensure that the inside information is made public by the issuer in a manner which enables fast access and complete, correct and timely assessment of the information by the public”.

- *The issuer SPV and other relevant parties in securitisations:*

In securitisation transactions, the “issuer” is a Special Purpose Vehicle (the **SPV**). In practical terms, this implies that:

- (i) The SPV is an entity set on “auto-pilot” – i.e. its only purpose is to acquire the pool of securitised assets and channel the cashflows from the pool to the investors; and
- (ii) The SPV is managed by a trust or by a specialised management company (the **SPV Manager**) whose role is primarily to provide a registered office and resources for administrative work to run the SPV and maintain its accounts.

The portfolio of securitised assets is directly managed by a servicer. On many occasions, the servicer is also the originator or seller of the assets, but sometimes it may be a third party. The servicer has primarily two roles:

- (i) **Investor reporting:** it monitors the performance of the portfolio and prepares a report to inform investors about the performance of the portfolio. The content of the report and the regularity of the reporting (normally quarterly or monthly, sometimes semi-annually) are normally predetermined in the transaction documents. In most jurisdictions, the servicer discloses this report directly, while in some jurisdictions this report is passed on to another party (the trustee, the reporting agent or the SPV manager) that will be ultimately responsible for the disclosure;
- (ii) **Portfolio administration:** the servicer administers the pool, which may include
  - (a) renegotiating the terms of the underlying contracts with the obligors;
  - (b) collecting the cashflows from the assets and passing them on to the SPV;
  - (c) replacing ineligible securitised assets with eligible assets; and
  - (d) enforcing the mortgages or other securities backing the securitisation bonds



The roles and functions of the SPV Manager, the servicer, the cash manager, the reporting agent, the trustee and other parties to the transaction are normally predetermined in a very precise manner in the transaction documentation. In particular, a Servicing Agreement governs the duties of the servicer as agent of the SPV issuer, which include in particular the regular investor reporting, and a Cash Management Agreement does the same with regard to the cash manager/reporting agent, which include reporting on the asset-backed securities.

- *Issue: disclosure responsibility/liability*

The MAD assumes an active issuer to regulate and impose the disclosure obligations. When applied to securitisations, these same provisions give rise to interpretation challenges given the role distribution described above between different parties. In particular, as post-issuance reporting is normally carried out by other parties (namely the servicer) different from the issuer, the responsibility/liability of such parties under the MAD is unclear.

The industry would welcome guidelines from CESR to clarify this disclosure responsibility/liability issue by confirming the following points:

- That the legal obligation to disclose falls on the issuer SPV, regardless of its nature as an auto-pilot entity;
- That the servicer, in disclosing the investor reports or any other inside information pursuant to the Servicing Agreement, is responsible/liable pursuant to the relevant Servicing Agreement and is not under any statutory liability pursuant to the MAD, such responsibility/liability remaining solely with the issuer SPV; and
- That, likewise, any other parties to the transaction (trustees, reporting agents or cash managers) are solely liable/responsible under their contractual agreements.

It should also be noted that none of those parties to the transaction is qualified to assess the price sensitivity of events on the asset-backed securities. However, the issuer SPV's activities will be limited to owning assets and issuing debt secured against them. Therefore, the value of the securities issued by the issuer SPV will be entirely subject to the performance of the securitised assets.

The servicer and the other transaction parties will, collectively, be aware of all of the activities of the issuer SPV and the performance of the securitised assets. The servicer will monitor and report material events occurring in the portfolio of securitised assets which could have an impact on the pricing of the asset-backed securities. While the transaction parties to the securitisation will not be able to assess price sensitivity as with



respect to the securities issued by the issuer SPV, they will be able to assess matters that could compromise the value of the assets and rights held by the issuer SPV. Therefore, disclosure of any matters that could impact price of the notes, would be made from the perspective of its impact to the assets and activities of the issuer SPV.



### 3. Form of disclosure of inside information

- *Relevant provision: Art. 2 of Directive 2003/124/EC*

“Member States shall ensure that the inside information is made public by the issuer in a manner which enables fast access and complete, correct and timely assessment of the information by the public”.

Member States have implemented this requirement very differently. The UK and Ireland require the inside information to be disclosed through a “Regulatory Information Service” (RIS). Spain and the Netherlands require that the issuer issue a press release with the relevant information and send a communication to the local securities regulator. Luxembourg allows disseminating inside information through any “agency specialised in financial information”, which includes news services such as Bloomberg or Trepp..

- *Disclosure of investor reports in securitisations:*

Investors in ABS customarily receive regular reports on the performance of the portfolio of securitised assets. The features of these reports include:

- (i) In terms of content, the reports provide investors with key financial and legal information on the portfolio of securitised assets which an investor will review to make its investment decision. In this sense, the investor reports contain material information which, depending on the circumstances arising, could make them totally or partially price sensitive information;
- (ii) As explained above, the servicer is responsible for preparing this report and, normally, for disclosing it pursuant to the Servicing Agreement. On other occasions, this information is passed on to another party (issuer SPV, reporting agent or trustee) that will make the disclosure. As mentioned above, a separate report on the asset-backed securities is prepared by a different party, the cash manager or the reporting agent (which may or may not include the servicer’s report); and
- (iii) In terms of location of the investor reports, they are normally posted on the servicer’s, reporting agent’s or trustee’s websites. In some cases, the transaction documents require these reports to be password-protected as they may contain confidential information and to be accessible only by current or prospective investors and transaction parties. In most cases, however, the reports are also disseminated through certain financial media, such as Bloomberg or Trepp (for CMBS in particular).



- *Issue: appropriate form of disclosure for investor reports under the MAD*

The disclosure of investor reports through specialised financial media is rapidly becoming a market practice within the securitisation industry. Such disclosure enables “fast access and complete, correct and timely assessment of the information by the public” as required by the MAD, and is compliant with the Luxembourg MAD implementation rules.

By contrast, disclosure of the investor reports through an RIS (UK and Ireland) or through a press release (Spain and Netherlands) does not achieve, in our view, the stated objective of the MAD and, in any event, is not practical for these transactions: these means are appropriate for disclosure of individual, non-recurring events but less so for the much more extensive and regular information contained in an investor report. Based upon input that we have received from investors in the ABS market, they would prefer to receive this disclosure through specialised financial media.

The form of disclosure required by the MAD implementation rules should be appropriate to allow the disclosure of the investor report in its entirety. This will prevent partial disclosure of individual events which, out of context, could be insufficient or misleading. In particular, the investor community is keen to be reassured that these reports are disclosed in a manner that is easily accessible by them as well as MAD compliant.

Therefore, the industry would welcome guidelines from CESR that would state:

- That the disclosure of the investor reports through specialised financial information media (in the terms of the Luxembourg MAD implementation rules) would be compliant with art. 2 of Directive 2003/124/EC. All Member States should adopt this rule, at least for asset-backed securities, which would be consistent with par. 14 and 15 of the Feedback Statement of the “Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market” (July 2007); and
- That, in addition to the above, the disclosure of the reports in the servicers’, trustees’ or SPV Managers’ websites without password protection would likewise satisfy art. 2 of Directive 2003/124/EC. This would be to recognise that this is already a widely spread practice in some jurisdictions or for certain asset classes, which the industry and the investor community acknowledge.



#### 4. Disclosure of inside information “as soon as possible”

- *Relevant provision: Art. 6 of the MAD*

“Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns to the said issuer”.

- *Regularity of investor reporting:*

Securitisation transaction documents normally provide for certain regularity for disclosure of investor reports (quarterly or monthly).

The process to prepare these reports is complex and time-consuming given the amount of information that is included in them. In addition, where the decision to disclose does not fall on the servicer directly, it will also require intra-transaction reporting between various parties (from servicer to trustee or SPV Manager, from cash manager to servicer or SPV Manager, etc.). Transaction reporting, thus, requires a data gathering period between disclosure dates which is necessary to ensure that the final report contains all necessary information.

An example of premature disclosure would be when various options are being considered in connection with a negotiation with a borrower under a loan. Premature public disclosure can compromise the negotiating position of the issuer SPV; as such information would be made public, such disclosure would allow the borrower access to information about its lender's strategy during the workout. Also, given the wide range of potential agreements during the workout of a defaulted loan, such information is unlikely to be useful to an investor until a firm strategy has been decided and agreed among the parties to the loan. If anything, premature information is more likely to confuse an investor.

- *Issue: what does “as soon as possible” imply for securitisation investor reporting?*

As explained above, the investor reports contain material information which could be price sensitive. During the data gathering period, however, individual information that will be added to the report will be known by the servicer but will remain undisclosed. Moreover, the report in its entirety will remain undisclosed until it is published by the transaction party responsible for final disclosure.

The disclosure “as soon as possible” is a very vague term. If it were to be interpreted as requiring the immediate disclosure of any individual information gathered by the servicer



prior to the reporting date, this would likely result in a premature and incomplete disclosure and, therefore, the disclosure of the investor report as a unit should normally be preferred. In relation to this, the industry would welcome CESR's guidance stating that:

- the disclosure of investor reports on pre-determined reporting dates would normally be consistent with the obligation to disclose the inside information contained in them "as soon as possible" that the MAD requires; and
- in order to strengthen the above principle, that Prospectuses for new ABS and CMBS should clearly indicate a maximum time interval after the end of the reporting period in which the investor reports will be released (which is consistent with section 4 of Annex VIII of Regulation (EC) 809/2004). Prospectuses should also indicate a minimum list of material information or follow an appropriate industry format (such as the ESF's RMBS Market Practice Guidelines or the CMSA-Europe's E-IRP) that the various parties agree to report on a quarterly basis. Highly material information (such as prepayment of a large loan securing CMBS notes) should, in any event, be disclosed via special notices before the release of the full report. Lastly, the Prospectus should indicate the location of the investor reports and the form of disclosure of special notices.



## 5. Assymetry of information:

- *Relevant provision: art. 9 of the MAD*

“The Directive shall apply to any financial instrument admitted to trading on a regulated market in at least one Member State, or for which a request for admission to trading has been made, irrespective of whether or not the transaction itself actually takes place in the market”.

- *Unlisted positions in securitisations:*

A key feature of securitisations is that they tranche the SPV liabilities, which result in positions with different risk profiles. Investors who invest in junior tranches may require more information to assess their risk, information which may be of less or no relevance to senior investors.

In addition, securitisations very commonly include unlisted positions closely linked with the listed positions in the same transactions. This is the case of the equity tranche, which is the first loss position in the waterfall of payments and that is normally not listed because its small size makes it unlikely to get an active secondary trading. Another example of such unlisted positions is B Notes in A/B note structures in CMBS transactions. As a matter of practice, listed securities that are often tranced down to BBB, BB or B rated classes share many of the risks of the equity tranches or the B notes in a A/B note structure.

- *Issue: asymmetry of information*

As provided for in its article 9, the MAD only applies to securities that are listed or whose admission to listing has been requested. Given the different risk profiles of the various investors in securitisations and, in particular, the concurrence of listed and unlisted positions, it is unclear how the MAD applies to these situations and, as a result, there may be cases of asymmetry of information to each group of investors (with investors in unlisted positions normally requesting and receiving more information). This, obviously, should not be the case with regard to information that may be price sensitive.

The industry would again welcome guidance from CESR on this issue stating that:

- All material information relating to a transaction should be made available to all investors in a transaction (whether listed or unlisted) on equal footing and to the public. The information that is material will be determined by the Prospectus and will



be contained in the investor reports and special notices (as described in paragraph 4 above);

- Any additional information on top of that identified as material in the Prospectus should be made available to any investor upon request, assuming that all material elements of such information are being disclosed to the public;
- Investors in unlisted positions may, however, receive additional information under a confidentiality agreement provided that such information is non-material, in which case it is not necessary to disclose it to the other investors and to the public, or that the material elements of the relevant information have already been disclosed in the prospectus, or are otherwise made publicly available. If so requested by the investors in listed tranches, this information may be made available to them subject to their prior execution of the confidentiality agreement.