# Looking ahead: structured finance in 2021

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After the turmoil due to the health, social and economic devastation of the past 12 months, we consider what 2021 (and beyond) could hold for the world of structured finance. Certainly Brexit, the COVID-19 pandemic and changes in the US political leadership will have an impact, but so too will the gathering momentum behind environmental, social and governance (ESG) issues and developments in technology.

## Brexit

London remains a pre-eminent global financial centre and there is currently no serious challenger to London from within the EU. Both English law and the English judicial system should continue to be attractive to international market participants. Although we expect that an increasing number of Euro-denominated financings may be arranged by EU arrangers and hedged by EU swap providers. The main downside of Brexit for structured finance is likely to be that new UK securitisations cannot be STS-compliant under the EU Securitisation Regulation. Although UK securitisations can comply with the UK STS regime, and many existing deals have been notified to the FCA accordingly. Additionally, EU-compliant STS deals are recognised as STS-compliant by UK authorities for a limited two-year grandfathering period, beginning 31 December 2020. However, so far there has been no reciprocation under the EU STS regime or from the European Securities and Markets Authority (ESMA). It should also be borne in mind that the absence of passporting rights for UK firms and banks to provide cross-border financial services and the lack of an agreement between the EU and UK on financial services present some obstacles for UK-based market participants.

## Divergence

The European Union (Withdrawal) Act 2018 was enacted on 26 June 2018 and repealed the European Communities Act 1972. Although, going forward, EU law will no longer be part of UK law, EU law which pre-dates the end of the Brexit transition period has become part of the UK's domestic legal framework as "retained EU law". In order for the EU Securitisation Regulation to operate effectively in a purely UK context, it was amended by The Securitisation (Amendment) (EU Exit) Regulations 2019, and the retained EU law (as amended) forms the "UK Securitisation Regulation". This process of onshoring has resulted in some subtle divergences from the EU Securitisation Regulation. We have already mentioned the impact on STS labels but, furthermore, the UK Securitisation Regulation has amended the due diligence requirements for UK Institutional Investors (as defined in the UK Securitisation Regulation) which now clarifies some of the uncertainties around Article 5(1) of the EU Securitisation Regulation and includes some flexibility not present in the original EU Securitisation Regulation. Article 5(1)(e) of the UK Securitisation Regulation only applies to an originator, sponsor or securitisation special purpose entity (SSPE) if established in the UK, while Article 5(1)(f) of the UK Securitisation Regulation (which does not exist in the EU Securitisation Regulation) provides that a UK Institutional Investor need only verify that an originator, sponsor or SSPE established outside the UK has, where applicable: (i) made available information which is **substantially the same** (our emphasis) as that which it would have made available in accordance with Article 5(1)(e) of the UK Securitisation Regulation if it had been established in the UK; and (ii) has done so with such frequency and modalities as are substantially the same as those with which it would have made information available in accordance with such Article 5(1)(e) if it had been so established. In addition, there is the possibility that the UK could at some point in the future take its regulatory regime for securitisations in a different direction from that advanced by Brussels.

## New US president

With the inauguration of President Biden in January, we would anticipate that the US will look to have a greater role on the global stage, which could be positive for the global economy and structured finance.

## COVID-19

As much of the world continues to be in lockdown and/or imposes restrictions on cross-border travel, the adverse impact of this on the global economy will no doubt continue, with the consequence of increasing unemployment, corporate insolvencies and potentially mortgage loan foreclosures. Although in the UK, mortgage loan foreclosures are subject to the existing forbearance requirements, which may be extended. As a result, we would anticipate seeing further use of payment holidays, as well as actual loan defaults. In this regard, we have observed that most securitisations, including UK RMBS structures, have proved to be robust enough to absorb the impact of payment holidays. At some point, it is also to be hoped that there will be a "bounce" as the world comes out of the strictures imposed by the pandemic. We also believe there will be more non-performing loan portfolio sales and "single asset" loan sales and that there will continue to be legacy loan portfolio sales in 2021 (often by funds, rather than banks), followed by COVID-19-affected loan portfolio sales (in particular SME and unsecured retail loans).

## Securitisation as a funding tool

As governments and central banks look to inject cash back into economies where it is most needed, we would also anticipate that, for this purpose, they will use securitisation structures as an efficient tool, particularly in the SME arena. Whether that is through state guarantees of underlying asset performance or state institutions acting as direct financiers of such transactions. We have also observed an increased use of securitisation structures for balance sheet management tools, in order to effect risk transfer and achieve significant risk transfer treatment. In addition, the EU has been promoting measures for synthetic securitisations to be STS-eligible. The current recognised benefits of securitisation are in stark contrast to how it was perceived in the aftermath of the global financial crisis. We suspect that there will be some tension between, on the one hand, the desire to utilise the advantages which it offers and, on the other, the scepticism with which it is viewed in some quarters.

## LIBOR

During the course of 2020, we saw a great deal of work on LIBOR discontinuation projects and a transition of LIBOR securitisations to SONIA, and this will continue into 2021. However, the pressure is partly relieved through the continuation of EURIBOR and USD LIBOR (in the latter case, until mid-2023).

## ESG

We believe that ESG factors will only increase in importance in society at large and in the financial markets, particularly as a key component in financial institutions deciding whether to go ahead with transactions. There will also be an increase in focus on renewables and electric power, and a corresponding decrease in fossil fuel dependency. Some of these big projects are likely to be funded in part through the capital markets, with various risks assumed by relevant governments under financial guarantees or support agreements.

## Technology

Related to other items on the list is the relentless pace of technological advancement. This will be felt, not just in "real" life and the "real" economy, but also in structured finance transactions as fintech and automation play more integral roles in the financial markets and the way we all do business. Furthermore, there has been an increased use of "securitisation technology" by non-bank lenders and alternative lending platforms for both public and private securitisations. In particular, technology has assisted non-bank lenders and alternative lending platforms in funding their lending activities, especially due to the fact that they cannot fund lending activities from central banks or Bank of England schemes.

## Hunt for yield

In a low interest rate environment, investors' hunt for yield will continue and this could lead to new innovations, structures and asset classes being born, as well as more securitisations by non-G10 issuers.

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Dentons is the largest law firm in the world and has advised clients on all of the above topics, including: the UK securitisation and STS regime; the loss of passporting rights due to Brexit; COVID-19-connected issues; NPL and SME portfolio financings; CBILS and other state-backed lending platforms; LIBOR discontinuation and transition projects; and online and marketplace lenders on financing transactions.

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