October 30, 2023

By email
Shiv Virk
Financial Conduct Authority
12 Endeavour Square London
E20 1JN

Re: Rules relation to securitisation: Consultation Paper

Dear Sir/Madam,

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the Financial Conduct Authority's ("**FCA**") consultation paper on rules relating to securitisation (the "**Consultation Paper**"). We have set out our responses to the relevant questions of the Consultation Paper in the Annex hereto.

We have considered the Consultation Paper in conjunction with the near-final draft of the Statutory Instrument (Securitisation Regulations 2023), which was published by HM Treasury on 10 July 2023 (the "**Near-final SI**"). Broadly, MFA agrees with the FCA proposals in the Consultation Paper; however, we continue to be of the view that the due diligence requirements for alternative investment fund managers ("**AIFMs**") should be removed. Our recent letter to the FCA on the reform of the UK securitisation regulatory framework, dated June 14, 2023 (our "**June Letter**"), discusses this issue. We highlight these concerns in our responses below and we ask that the FCA consider these concerns in conjunction with the arguments put forward in our June Letter.

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MFA appreciates the opportunity to provide these comments to the FCA in response to the Consultation Paper. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact the undersigned at (202) 730-2600 or Jeff Himstreet at jhimstreet@managedfunds.org.

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President and Chief Counsel
Head of Global Regulatory Affairs
Managed Funds Association

[1] Managed Funds Association (MFA), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

ANNEX

CHAPTER 4. DUE DILIGENCE REQUIREMENTS FOR INSTITUTIONAL INVESTORS.

Background

The proposed diligence rules will apply to "institutional investors" within the meaning of the new definition in the Near-final SI. Under the current, retained EU law UK Securitisation Regulation ("**UK SR**") there has been uncertainty as to whether the definition captures non-UK AIFMs. The Near-final SI tightens the drafting of the current definition and clarifies that, within the context of AIFMs, "institutional investors" should only include AIFMs that are authorised by the FCA. **Accordingly, the proposed rules discussed below would not be relevant to non-UK AIFMs.**

The current rules on due diligence for institutional investors are set out in Article 5 of the UK SR.

Under Article 5 of the UK SR, institutional investors are required to:

(a) verify that the credits giving rise to the underlying exposures have been granted by originators/original lenders pursuant to sound and well-defined criteria, which are subject to clearly established procedures and effective systems ("**credit-granting due diligence**");

(b) verify that the originator, sponsor or original lender retains on an ongoing basis a material net economic interest of not less than 5% in accordance with the risk retention requirements of the UK SR ("**risk retention due diligence**"); and

(c) ensure that certain disclosures are made: (i) where the originator, sponsor or special purpose securitisation entity ("**SSPE**") is established in the UK, information must be disclosed in accordance with the requirements of the UK SR (i.e., by using the reporting templates prescribed for such purpose in the prescribed frequency), and (ii) where the originator, sponsor or SSPE is not established in the UK, information must be disclosed which is "substantially the same" as the information that would have been disclosed had the originator, sponsor or SSPE been established in the UK, and a frequency and modality which is "substantially the same" ("**transparency due diligence**").

In addition, Article 5 also requires investors to assess the risks involved with the investment and, following investment, to maintain appropriate procedures to monitor the securitisation position on an ongoing basis.

Proposals

In Appendix 1 of the Consultation Paper, the FCA sets out draft rules in a new Securitisation Sourcebook ("**SECN**"). These would apply only to institutional investors that are FCA-authorised; the rules for PRA-authorised firms and occupational pension schemes ("**OPS**") are set out in the PRA's consultation paper and the Near-final SI, respectively.

Under SECN, the requirements to conduct pre-contractual credit-granting due diligence, risk retention due diligence and a risk assessment remain unchanged. The ongoing monitoring requirements also remain unchanged.

However, changes have been proposed to transparency due diligence in paragraph 1(e) of SECN 4.2.1 R.

The proposed new rule does not create a distinction based on the location of the originator, sponsor or SSPE. In all cases, institutional investors will be required to obtain a principles-based list of information to enable the investor to independently assess the risks of the investment. The minimum information requirements and frequencies for receiving this information are as follows:

	Information	Frequency
1	In the case of a non-ABCP securitisation, details of the underlying exposures.	At least quarterly.
2	In the case of an ABCP programme or an ABCP transaction, information on the underlying receivables or credit claims.	At least monthly.
3	Investor reports providing periodic updates on: (i) the credit quality and performance of the underlying exposures; (ii) any relevant financial or other triggers contained in the transaction documentation, including information on events which trigger changes to the priority of payments or a substitution of any counterparty to the transaction; (iii) data on the cash flows generated by the underlying exposures and by the liabilities of the securitisation; and (iv) the calculation and modality of retention of a material net economic interest in the transaction by the originator, sponsor or original lender.	(i) At least quarterly in the case of a non-ABCP securitisation; and (ii) At least monthly in the case of an ABCP programme or an ABCP transaction.
4	All information on the legal documentation needed to understand the transaction, including detail of the legal provisions governing the structure of the transaction, any credit enhancement or liquidity support features, the cash flows and loss waterfalls, investors' voting rights, and any triggers or other events that could result in a material impact on the performance of the securitisation position.	(i) Before pricing in draft or initial form; (ii) No later than 15 days after closing of the transaction in final form; and (iii) An updated version as soon as practicable following any material change.
5	Information describing any changes or events materially affecting the transaction, including	As soon as practicable following that material change or event.

	breaches of obligations under the transaction documents.	
6	Any approved prospectus or other offering or marketing document prepared with the cooperation of the originator or sponsor.	(i) Before pricing in draft or initial form; and (ii) No later than 15 days after closing of the transaction in final form.
7	If there is an STS notification in respect of the transaction, that STS notification.	(i) Before pricing in draft or initial form; (ii) No later than 15 days after closing of the transaction in final form; and (iii) An updated version as soon as practicable following any material change.

This list is broadly aligned with information that institutional investors are expected to receive under the current reporting regime for UK originators, sponsors and SSPEs.

Q2 Do you agree with our proposed clarification of what information an institutional investor should receive to conduct its due diligence?

MFA Response

MFA's position on due diligence requirements for AIFMs is as set out in our June Letter. Principally, it is our view that AIFMs should not be subject to any due diligence requirements under the UK's regulatory regime for securitisations.

Below, we invite the FCA to consider the key policy drivers for making further changes to the proposed rules, as well as setting out our detailed response to the due diligence requirements in the draft SECN Sourcebook.

Policy Considerations

The revised definition of "institutional investor" in the Near-final SI rightly removes non-UK AIFMs from the scope of due diligence requirements. Whilst MFA welcomes this clarification, we note that UK AIFMs are now placed at a greater competitive disadvantage to their international counterparts. The FCA acknowledges its international competitiveness objective in the Consultation Paper and recognises that revised due diligence requirements are a means to enabling UK investors to compete globally. As discussed further below, we believe that more can be done to make the UK an attractive place for investors to do business.

In our view, it is not appropriate or proportionate for UK AIFMs to be subject to the same investor due diligence requirements as, for example, UK banks and insurance companies, because their business models, sources of capital and clients differ fundamentally. In each case, banks and insurance companies must consider the interests of their shareholders and, respectively, the interests of their depositors and policyholders.

Depositors and policyholders of UK banks and insurance companies (respectively) tend to be domiciled in the UK (since UK banks and insurance companies cannot easily obtain customers from other countries, including from the EU post-Brexit). UK banks and insurance companies also tend to have large numbers of UK retail and other shareholders (even if the largest shareholders tend to be international asset managers). The failure of a UK bank or insurance company because of poor decision-making would have a significant detrimental effect not only on shareholders, depositors and policyholders in the UK from a financial and societal perspective, but also on business confidence in the UK generally.

A further point of distinction arises in connection with the systemic importance of UK banks. Where a UK bank fails or appears likely to fail, the UK Government will generally intervene to mitigate the risk of disruption to the UK financial system. During the Global Financial Crisis, UK Government intervention occurred in the form of a "bail-out" of the failing UK banks, at the expense of UK tax payers. Following reforms to the bank resolution regime, the process contemplated under the current framework would be that a pending UK bank failure would be handled using the various resolution powers granted to the Bank of England as the UK's resolution authority (which might include "bailing-in" the UK bank's shareholders). By way of a recent example, the Bank of England exercised certain of these resolution powers in connection with the resolution of Silicon Valley Bank UK Limited in March 2023.

UK AIFMs, on the other hand, typically form alternative investment funds ("**AIFs**") in offshore jurisdictions, and have a very different profile. First, the investor base in AIFs is typically institutional only, rather than retail. Second, such institutional investors are global in nature, rather than based in the UK. The impact of the failure of a UK AIFM, therefore, is that the institutional investors that invested in that AIF would lose the amounts invested in that AIF, but there would not be the kind of broad detrimental impact of the kind suffered by UK banks and insurance companies. Critically, the failure of a UK AIFM would in no event be expected to result in UK Government intervention, in contrast with the various measures contemplated under the UK bank resolution framework described above.

In consideration of these fundamental differences, we believe that there should be a distinct approach for rule-making with respect to AIFMs, so as to remove the investor due diligence requirements for AIFMs altogether, thus ensuring that UK AIFMs can compete with non-UK AIFMs.

We recognise that the application of due diligence requirements to institutional investors is principally a matter for HM Treasury to consider. Accordingly, we would encourage the FCA to engage in further conversation with HM Treasury to achieve a more proportionate outcome for UK AIFMs.

SECN Sourcebook: Chapter 4 (Due diligence)

As noted above, and with respect to the proposed due diligence rules in SECN 4, we believe that AIFMs should be carved out of these requirements altogether. As discussed further below, AIFMs are already subject to the risk management obligations imposed under the FUND Sourcebook. As a result, they are required to apply a high standard of scrutiny to all investment opportunities. MFA considers it disproportionate to impose additional regulatory burdens with respect to investments in securitisations, given the rigorous due diligence procedures that AIFMs already adopt.

Risk Retention Due Diligence:

In particular, our June Letter argues that the risk retention due diligence requirement under the UK SR has been particularly damaging to AIFMs. It has restricted investment opportunities to risk retention compliant securitisations, often with the result that AIFMs are unable to invest in securitisations whose sponsors or originators are established outside of the UK or the EU. This remains a key concern for our members.

We also note that this requirement has had the unintended consequence of encouraging UK AIFMs to resort to alternative fund structures to facilitate greater investment opportunities for their investors. For example, in order to invest in a US CLO, an investment management firm might structure the business so that, instead of using a UK AIFM in its group, a non-UK AIFM is used instead, with such non-UK AIFM then delegating portfolio management discretion to the staff in the UK (assuming the UK AIFM has MiFID top-up permissions). Once again, this creates anti-competitive results for UK AIFMs and prevents them from maximising their potential.

Accordingly, we respectfully request that the FCA excludes AIFMs from the scope of the requirements in paragraphs 1(c) and (d) of SECN 4.2.1 R. At a minimum, we encourage the FCA to consider removing AIFMs from the scope of the rule in paragraph 1(d) to promote investments in the global securitisation market and allow AIFMs to diversify their portfolio risk.

Equivalence:

If, notwithstanding the above, the FCA elects not to remove the risk retention due diligence requirements for AIFMs, then, as discussed in our June Letter, MFA would propose that – at a minimum – the reformed UK securitisation framework should allow AIFMs to invest in securitisations in foreign jurisdictions that have similar rules relating to risk retention and deliver similar outcomes as regards investor protection.

As discussed in our June Letter, if local law does not require risk retention for certain types of securitisations, we believe that UK rules should recognise and give comity to the compliance with local, applicable non-UK rules. We noted the example that, in the US, sponsors of open-market CLOs are not required to retain an interest in the transaction. UK AIFMs should not be prevented from investing in such US open-market CLOs as a result. The regulatory focus should be on the nature of the securitisation and the laws which govern it, rather than the domicile of the fund which is investing. We continue to believe that such an approach would considerably enhance UK competitiveness, in accordance with the FCA's international competitiveness objective.

We note, further, that the Financial Services and Markets Act 2023 introduces an equivalence regime for STS securitisations. Accordingly, the new rules should aim to adopt a principles- and outcomes-based approach wherever possible in order to improve flexibility of the UK regime. Regarding risk retention, we believe that it would be appropriate to give due regard and consideration to other international frameworks – especially the US – which has the largest securitisation market in the world.

Information Due Diligence:

MFA welcomes the concept of a more "principles-based" approach to rule-making for institutional investors. In our view, it is appropriate to allow institutional investors to determine the scope and content of disclosures required for the purpose of their due diligence. We note that our members typically have not found the reporting templates prescribed under the UK SR to be any more informative than information that they would otherwise have requested as part of their due diligence procedures when deciding whether to invest in a securitisation. On this basis, we agree that institutional investors should not be required to request reports in the form of the UK SR-prescribed templates (or anything "substantially the same" as these templates, in the case of non-UK manufacturers).

However, we submit that the list in paragraph 1(e) of SECN 4.2.1 R is too prescriptive and that a truly principles-based approach would not set out each item of information and the frequency at which it needs to be obtained.

Whilst we agree that AIFMs should receive information to enable them to independently assess the risks of investment opportunities, we do not feel that it is proportionate to prescribe the information that they need to obtain specifically with respect to investments in securitisations. In practice, AIFMs are already required to maintain due diligences procedures under FUND 3.7.5 R, which applies to all investment positions held by the relevant AIF (whether that be a securitisation position or otherwise).

In particular, we note the emphasis on risk management in FUND 3.7.5 R(1) and (2). For example, FUND 3.7.5 R(2)(b) requires AIFMs to maintain systems in order to identify, measure, manage and monitor the risks associated with the investment position of an AIF. This is aligned in principle with the proposed requirement to "assess the risks of holding the securitisation position" in SECN 4.2.1 R(1)(e) (as well as the requirement to conduct risk assessments in SECN 4.2.2 R). In addition, FUND 3.7.5 R provides that AIFMs must maintain documented due diligence processes on an ongoing basis, including appropriate stress testing procedures[2], which is aligned with the requirements in SECN 4.3 to maintain written procedures and perform stress tests.

In our view, there is no added benefit in prescribing a list of due diligence requirements, or the details of monitoring procedures, for investments in securitisations when FUND 3.7.5 R already provides adequate coverage. Therefore, in the interest of proportionality, we would encourage the FCA to extend the principles-based approach further with respect to AIFMs by removing the list in SECN 4.2.1 R(1)(e), as well as the related risk assessment and ongoing monitoring requirements in SECN 4.2.2 R and SECN 4.3.

More broadly, while MFA welcomes the concept of reforming the current information due diligence requirements, as discussed above, our members have found the risk retention due diligence requirements to be the most significant barrier to investing in securitisations whose sponsors or originators are outside of the UK or the EU. Accordingly, we believe that making reforms to the information due diligence requirements alone, without also reforming the risk retention due diligence requirements in the manner discussed above, would not have the desired effect of opening the UK for business in accordance with the FCA's international competitiveness objective.

CHAPTER 5. NON-PERFORMING EXPOSURE ("NPE") SECURITISATIONS AND RISK RETENTION

Q6 Do you agree with our proposals around the insolvency of the retainer?

MFA Response

MFA is supportive of this proposal, as it creates certainty that institutional investors would not need to dispose of their securitisation positions to ensure continued compliance with their own obligations in the event that the risk-retainer becomes insolvent. This would help to avoid situations where institutional investors might be forced into selling securitisation positions to the detriment of their own investors.

CHAPTER 6. OTHER MEASURES

Background

[2] See FUND 3.7.5 R (2)(a) and (b).

The UK SR has generated uncertainty about the geographical scope of some key provisions – particularly in cases where some, but not all, manufacturers of a securitisation are established in the UK (e.g., where a sponsor is established in the UK, but an SSPE is established elsewhere).

Proposals

The FCA is proposing to expressly limit the application of SECN to entities established in the UK (apart from with respect to the definition of "institutional investors", whose scope is set out in the Near-final SI).

However, it is not clear from the draft rules themselves how the FCA is proposing to expressly state this limitation, as the relevant rule appears to be absent from the draft SECN Sourcebook.

Q12 Do you agree with our proposals for the scope of our rules in geographically mixed scenarios?

MFA Response

MFA agrees that it is important to clearly define the scope of the rules in the new SECN Sourcebook. In our view, it is crucial to establish that the FCA's rules should not have extra-territorial reach.

However, it would be helpful if the FCA could provide for this point in a specific rule in the final version of the SECN Sourcebook, as there does not appear to be a rule addressing this in the Appendix 1 of the Consultation Paper.

CHAPTER 7. DISCUSSION: DEFINING PUBLIC AND PRIVATE SECURITISATIONS

Background

The Consultation Paper contains a discussion on how best to define the thresholds for private and public securitisations. This issue is primarily of concern to originators and sponsors, as it has implications on reporting requirements (e.g., public securitisations are required to report to a securitisation repository).

Currently, the UK SR creates a distinction between private and public securitisations based on whether a UK Prospectus Regulation-compliant prospectus has been produced for the offering of the securities issued under the securitisation (which is usually the case for securities admitted to trade on a regulated UK market). As a result of the narrow meaning of public securitisation, many securitisations that are public in substance are not currently caught by the relevant requirements.

It is important to note that the outcome of the discussion in the Consultation Paper will feed into the FCA's second consultation on transparency requirements for securitisations. This consultation is expected to commence in 2024. For that reason, the Consultation Paper does not deal with transparency requirements (currently, Article 7 of the UK SR) or the reporting templates (in the related RTS and implementing technical standards).

Proposals

The FCA is considering expanding the scope of the meaning of public securitisations to cover securitisations which are "in substance" publicly distributed to investors (i.e., what the market would recognise as a publicly distributed and traded transaction). The FCA envisages that, in addition to primary UK listings, "public" in this context should cover securities admitted to other types of venues; e.g., non-UK venues equivalent to UK regulated markets (only where there is at least one UK manufacturer); and appropriate UK MTF and similar non-UK venues (only where there is at least one UK manufacturer). This would mean, for example, that CLO securities being traded on a non-UK MTF, like the Irish GEM, could be considered "public" for this purpose.

The FCA notes that a more precise description of appropriate trading venues for an expanded description of public securitisations will be developed following the discussion.

Q19 Do you agree that the definition of a public and a private securitisation should be reviewed?

Q20: Do you agree with the approach of focusing on the definition of a public securitisation? If not, which approach would you suggest?

Q22 For the definition of a public securitisation, do you agree with the concept of considering admission to trading on venues outside of the UK? What, if any, might be the unintended consequences? What principles should be used in identifying the appropriate non-UK venues for these purposes?

<u>**MFA Response**</u>

MFA acknowledges that the current distinction between "public" and "private" securitisations may not reflect an intuitive interpretation of these two concepts. However, our primary concern is the practical impact that these definitions have, rather than the technical distinctions between the two concepts.

For this reason, we are opposed to any changes to these definitions that would lead to increased reporting burdens for UK manufacturers. In particular, we are opposed to the notion that public securitisations could include those listed on equivalent non-UK venues. For example, if securities listed on non-UK venues that are currently "private" were to become "public", and as a consequence the UK manufacturers of those securitisations were required to prepare inside information or significant event notifications in template format, this would increase reporting burdens for the relevant UK manufacturer and potentially act as a deterrent to future issuances.

In this regard, we note that listings on regulated markets and other trading venues typically have their own separate disclosure requirements, which are intended to provide investors with sufficient information. We would argue that it is not, therefore, proportionate for the UK securitisation regime to also impose reporting requirements on the basis of whether, or where, a security is listed.

Further, we note that the proposal to expand the scope of the public securitisation description to include "primary admissions to trading on an appropriate UK MTF and similar non-UK venues, where there is at least one UK manufacturer admitted to non-UK venues" could result in conflicts with the EU Securitisation Regulation ("**EU SR**").

This issue can be highlighted using the example trading venue referred to in the Consultation Paper; that of Euronext's Global Exchange Market ("**GEM**"). A securitisation involving securities admitted to trading on GEM only would be treated as a private securitisation for the purposes of the EU SR, on the basis that admission to trading on an EU MTF, rather than any EU regulated market, would not require a prospectus to be drawn up. However, the same securitisation would be treated as a public securitisation for the purposes of the UK SR (if amended in line with the current proposal) on the basis of its admission to trading on an EU MTF, which presumably would be regarded as "similar" to a UK MTF for these purposes.

As such, where such a securitisation involves at least one UK manufacturer, as well as one or more EU manufacturers subject to the EU SR, this could have the result that the securitisation would fall in scope of the public securitisation requirements for the purposes of the UK SR, and the private securitisation requirements for the purposes of the EU SR. This could significantly increase the complexity of the reporting requirements applicable to manufacturers.

We believe that the FCA's focus should be on making the disclosure requirements for *all* securitisations more proportionate (regardless of whether they are private or public). In our view, more attention should be given to the purpose of the UK's disclosure regime for securitisations, which should be to enable investors to access adequate information. Market participants have found the current reporting templates under the UK SR to be unnecessarily granular and prescriptive. The European Commission has also acknowledged that market participants find the reporting templates prescribed under the EU SR (which are materially the same as those prescribed under the UK SR) to be "too prescriptive and strict, especially when compared with the framework applicable to similar instruments, such as covered bonds". In addition, the Commission has noted that some investors find information in the reports "excessive", which investors might not use "but instead [they] rely on their existing due diligence arrangements that were in place before the Securitisation Regulation entered into force".[3]

As noted in our response to Question 2 above, our members, when acting in the capacity as institutional investors, generally do not find these reports helpful for the purpose of their own due diligence procedures. Moreover, an investor's information requirements are not contingent on whether a securitisation is public or private. For that reason, we would argue that the standard of disclosure requirements (e.g., the reporting format) should be adjusted to reflect the needs of institutional investors and the standard should be consistent between the two categories.

[3] *Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation*, European Commission (October 2022) (at page 9); available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022DC0517

In preparation of its second consultation on disclosure templates, MFA would encourage the FCA to scrutinise the effectiveness of the current reporting regime, rather than adjusting the parameters of the meaning of public and private securitisations. We also note that alleviating reporting burdens would also improve international competitiveness by potentially bolstering the volume of UK securitisation issuances (i.e., where at least one of the sponsor, originator or SSPE is located in the UK).