2 September 2024

By online submission
Financial Stability Board
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation: Consultation report

Dear Sir/Madam,

MFA[1] appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the Financial Stability Board's ("**FSB**") consultation report on its evaluation of the effects of the G20 financial regulatory reforms on securitisation (the "**Report**"). We have set out our responses to the relevant questions of the Report in the online form to which this letter is enclosed.

A summary of our comments is as follows:

- While MFA is generally supportive of reforms that contribute to financial stability, we are of the view that some G20 recommendations have been implemented in a manner that is disproportionate to the risks associated with securitisations.
- In particular, we believe that the EU and UK securitisation markets are yet to reach their full potential and their growth has been hampered by excessive regulatory reforms.
- Divergent approaches to the implementation of G20 recommendations as between the US and the EU/UK have created a significant competitive disadvantage for EU and UK investors.
- MFA would welcome a recommendation by the FSB for the improved cross-border harmonisation of rules relating to the regulation of securitisations.

[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 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over $3.2 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.

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MFA appreciates the opportunity to provide these comments to the FSB in response to the Report. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Jeff Himstreet (jhimstreet@mfaalts.org) or the undersigned (jhan@mfaalts.org).

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
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ANNEX – CONSULTATION QUESTIONS

Question 4

Relevant reforms: Does the report appropriately describe the key aspects of the design and jurisdictional implementation of the BCBS and IOSCO reforms for analysing their impact on securitisation markets? Are there other important aspects of these reforms that should be considered for inclusion?

MFA Response

Managed Funds Association ("**MFA**") is based in Washington, DC, New York, Brussels, and London. It represents the global alternative asset management industry across a spectrum of investment strategies, with members including managers of traditional hedge funds, credit funds and crossover funds. Our response to this Question 4 focuses on the reforms that are of most relevance to our members – namely, IOSCO's risk retention recommendation.

In MFA's view, the Report appropriately describes key aspects of IOSCO's risk retention recommendation. However, the Report risks minimising the impact of differing approaches to its implementation across jurisdictions – particularly, in terms of limiting access by certain investors to major global markets, which we believe is an unintended but significant consequence of the reforms. MFA is of the view that analysing the varying jurisdictional approaches to IOSCO's risk retention recommendation is crucial to understanding the impact of these reforms.

Lack of global harmonisation

As noted in the Report, IOSCO recommended the global harmonisation of risk retention requirements by regulators to facilitate cross-border transactions. The Report recognises that there are some significant differences in the implementation of risk retention requirements between regulators of some of the largest global securitisation markets. For example, 'L-shaped' retention is permitted in the US, but not under the EU Securitisation Regulation ("**EUSR**") or the UK Securitisation Regulation ("**UKSR**"); in addition, CLOs are exempted from the risk retention requirement in the US, but not in the EU and the UK.

The impact of this divergence has been magnified by the EU and UK's additional 'indirect' risk retention requirement under the EUSR and UKSR, which is most problematic in the context of investments in non-EU/non-UK deals. In cases where the originator/sponsor is established outside of the EU or UK, respectively, the EUSR and UKSR each mandate the verification of risk retention in accordance with the rules applicable to the relevant investor (Article 5(1)(d) of each of the EUSR and UKSR). IOSCO recognised the risk that such a requirement could create cross-border friction and suggested that "*EU regulators could consider adopting some form of recognition for equivalent risk requirements in the US*". However, the lack of international harmonisation remains, with no such "equivalence" approach in the EU and the UK despite IOSCO's recommendation.

As the Report notes, it is difficult to identify suitable metrics for the effects of reforms on securitisations due to a scarcity of data (particularly as regards private securitisations). Anecdotally, MFA members have found that, in their experience, US securitisations that are compliant with the specific risk retention requirements under the EUSR and UKSR are in the minority.

The effect of this divergence is that certain EU and UK institutional investors, such as EU/EU alternative investment fund managers ("**AIFMs**"), are prevented from accessing substantial portions of the US securitisation markets (including the US CLO market, which – as the Report observes – is substantially larger than the European CLO market). Arguably, narrowing the investible universe of EU/UK AIFMs is at odds with the financial stability objectives of the reforms by forcing these investors to concentrate their investments in specific jurisdictions. This has also created an uneven playing field between US AIFMs and EU/UK AIFMs, who face greater challenges in diversifying their portfolios which, in turn, limits the appeal of investing in the funds that they manage.

In MFA's view, EU and UK regulators have failed to adequately address IOSCO's recommendation for harmonisation of cross-border risk retention requirements. MFA believes that a more proportionate approach to risk retention would permit the recognition of similar foreign risk retention requirements and give comity to compliance with local laws. For example, where no risk retention rules are applicable (e.g., in the case of US CLOs), EU and UK institutional investors should not be prevented from investing in these transactions.

Other aspects of the reforms to consider

While the reforms have arguably contributed to the stability of the economy, MFA would caution against a generalist view of risk retention reforms. In MFA's view, mandating risk retention may be less proportionate – and less effective – in certain sectors of the markets, which is a fact worth exploring in the Report. The Report acknowledges that the GFC was predominantly caused by banks' lack of understanding of their risk exposure through investments in asset backed commercial paper ("**ABCP**") conduits and structured investment vehicles ("**SIVs**") (pages 21 - 22). In the EU, one of the earliest regulatory reactions was to mandate indirect risk retention by imposing a requirement on banks to verify compliance with prescribed risk retention modes (which took effect through an amendment to the Capital Requirements Directive). Similar requirements followed for AIFMs in the Alternative Investment Fund Managers Directive ("**AIFMD**") and insurance and reinsurance undertakings in the Solvency II Directive, which were ultimately consolidated amongst other investor due diligence requirements in the EUSR (including an additional direct risk retention requirement on originators, sponsors and original lenders).

As the Report notes, risk retention was perceived as an important way of addressing misaligned incentives and preventing the 'originate to distribute' models that had arisen prior to the GFC. Some 15 years later, market participants like AIFMs are still subject to reforms that were designed to address a mischief unrelated to their business models. In fact, for many AIFMs, aligning their own incentives with those of their investors is a fundamental objective of their business strategy. Please see our response to Question 8 for our comments other means of incentive alignment that are utilised by CLO managers.

MFA respectfully submits that the incentive-aligning capabilities of risk retention are somewhat overstated in the Report. There will be scenarios where, for example, indirect risk retention requirements are disproportionate to the risks involved. One such case is indirect risk retention mandated on AIFMs under the EUSR and UKSR. AIFMs are already subject to strict due diligence and ongoing monitoring requirements under the AIFMD regime, making an additional indirect risk retention effectively redundant. A more proportionate approach to regulating securitisations would recognise the sophisticated nature of AIFMs and allow them to make their own assessment as to the suitability of an investment without mandating verification of risk retention. As noted above, at a minimum, EU and UK AIFMs should be permitted to invest in foreign securitisations that comply with applicable local requirements without needing to verify compliance with the EUSR/UKSR.

Question 5

Other reforms: Does the report accurately identify other G20 and domestic financial reforms that are most relevant for securitisation markets? Are there other reforms that should be considered in terms of their impact on market participants?

MFA Response

The Report cites the G20 recommendation to strengthen requirements relating to investor due diligence. In MFA's view, the negative impact of domestic responses to this recommendation should not be down-played – particularly in the context of the due diligence requirements under the EUSR and UKSR.

As noted in our response to Question 4, indirect risk retention requirements have been implemented by national regulators in a homogenous fashion with little appreciation for the varied capabilities of the different investors to which they apply. In our view, the same applies with respect to the other information due diligence requirements that EU/UK investors are subject to under the EUSR and UKSR. These requirements have had an especially detrimental effect on access by EU and UK investors to non-EU and non-UK deals. In particular, the EUSR offers no sensitivity to local disclosure requirements, instead requiring EU investors to obtain information from sponsors/originators in a highly prescriptive format (Article 5(1)(e) EUSR). In the experience of MFA members, the granularity of information in the EU prescribed reporting templates is excessive and largely superfluous. The current equivalent UK requirement with respect to foreign sponsors/originators (Article 5(1)(f) UKSR) allows UK investors to obtain information that is "substantially the same" as that which it would have received were sponsor/originator directly subject to the UKSR; and, under the new UK regulatory framework for securitisations, the equivalent UK requirement with respect to all originators (whether foreign or established in the UK) will operate on a similar principles-based approach, requiring a minimum standard of information to be obtained by investors (but, crucially, not dictating the format in which such information must be received).

In our view, the UK's requirements are more beneficial to cross-border transactions. Nevertheless, MFA submits that prescribing due diligence requirements for AIFMs specifically in the context of securitisations is a disproportionate measure which should be re-assessed by national regulators. As noted previously, the duplicative nature of adjacent due diligence regimes (e.g., under the AIFMD) has created significant compliance burdens without contributing to the robustness of internal due diligence procedures. The result is that EU and UK AIFMs have been placed at a considerable competitive disadvantage compared to, for example, their US and other global counterparts. MFA believes that the most appropriate measure would be for regulators to remove detailed securitisation due diligence requirements altogether for sophisticated investors such as AIFMs given existing due diligence requirements.

Question 8

Risk retention in CLOs: Does the report accurately describe risk retention practices in the CLO market before and after the reforms? What additional analysis could be included to assess the effectiveness of risk retention in CLOs across FSB jurisdictions, including on how financing of risk retention deals by third party investors impacts effectiveness?

MFA Response

The Report contains important observations about the impact of the *LSTA vs SEC (2018)* decision on the US CLO market – namely, that the US CLO market has continued to grow beyond 2018, and the removal of risk retention for US CLOs has not resulted in the loss of incentive alignment between CLO issuers and investors. The Report notes, for example, that there have been no defaults of post-2018 US CLOs (Graph 14) and there has been no significant change in the quality of underlying assets at issuance as compared with issuances prior to the court decision (page 47).

While the report finds that the European markets have also experienced growth since the GFC, it should not be inferred that these positive developments are a result of risk retention reforms. There frankly is little evidence to demonstrate a direct causal link between reforms and market growth.

The report recognises numerous other features of CLO 2.0 structures which achieve some form of incentive alignment between issuers and investors – none of which are mandated by reforms, but which have been adopted by issuers on a voluntary basis and have become standard market practice. For example, CLO managers actively select assets with the intention of maximising the quality of collateral based on performance; other forms of credit enhancement (such as over-collateralisation and subordination) are typical features of CLO 2.0 structures; and fee structures further incentivise managers to ensure their CLOs perform well. Features such as these have contributed to the resilience of the CLO markets.

On a related point, MFA does not agree that a causal link should be made between the removal of the risk retention requirement and increased levels of subordination in US CLOs. There are other macro-economic factors which dictate the extent to which issuers adopt such mechanisms. MFA members have found that investors in CLOs do not seek to compensate for lack of risk retention – they either require risk retention because of their own regulatory obligations, or they do not, in which case they may look to other structural features offering investor protection.

The Report notes that the financing in certain cases of CLO managers' retained risk by third-party investors has contributed to the establishment of risk retention vehicles to attract such third-party investors such as pension funds or family offices. The Report notes that such third-party risk retention vehicles are widely used, and notes that these constructs do not achieve incentive alignment. In fact, MFA is of the view that the existence of such third-party risk retention vehicles challenges the notion that risk retention is able to have any meaningful impact in the context of CLOs. As noted above, CLO managers have 'skin in the game' by virtue of other structural features, making the risk retention concept redundant for these structures.

MFA believes that the removal of risk retention requirements for CLOs is a logical step for all national regulators to take. As noted in our response to Question 4, the impact of this would be significant for EU/UK AIFMs who are currently restricted from investing in US CLOs that do not comply with the EU/UK risk retention rules. The result would be improved access to more diverse investment opportunities and the chance to address the competitive disadvantage that EU/UK AIFMs currently face. Indeed, exempting EU/UK CLOs from risk retention requirements would not be a departure from IOSCO's original recommendation, which acknowledges that the unique features of CLOs make them a suitable candidate for an exemption from risk retention requirements. At a minimum, EU and UK regulators should recognise compliance with applicable local rules and enable to EU/UK AIFMs to invest in US CLOs, notwithstanding the lack of risk retention.

Question 13

Effects on financing the economy: Does the report accurately describe the main effects of the reforms on financing the economy? Is there additional analysis that could be undertaken to estimate the benefits and costs of these reforms and to assess their impact on securitisation as a financing tool?

MFA Response

MFA broadly agrees with the FSB's observation that comparisons with the pre-GFC securitisation markets have their limitations (page 56). In addition, it is not possible to conduct a counterfactual assessment of the opportunity cost of the EUSR and UKSR in the European markets. However, the fact that the European securitisation markets remain considerably smaller than the US securitisation market would indicate that the differing approaches in the implementation of reforms may be a contributing factor to the lack of growth in the EU and UK. MFA submits that a proportionate and harmonised set of global regulatory frameworks should not have a long-term dampening effect on the use of securitisations as a financing tool.

On a related point, based on our members' experience, MFA does not agree with the suggestions that the reforms may have had a net positive effect on the use of securitisation as a financing tool, and it does not support the conclusion that the availability of other means of financing has mitigated the negative effects of underperforming securitisation markets.

Question 14

Effects on financial system structure and resilience: Does the report accurately describe the extent to which there has been a redistribution of risk from the banking to the non-bank financial intermediation sector? What role did the reforms play in this process and what are the main benefits and risks from a system-wide perspective? How have the reforms impacted the demand and supply of liquidity in securitisation markets?

MFA Response

MFA agrees with the Report's finding that there has generally been a redistribution of risk from the banking to the non-bank financial intermediation sector, but the value of this observation is – in our view – limited by the fact that 'NBFI' is a broad term that captures a variety of business types. Accordingly, we would caution against a one size fits all' approach to evaluating the risks and benefits of NBFIs participating in the global securitisation markets. To draw any meaningful conclusions, it would be necessary to separate the term 'NBFI' into its composite sectors and evaluate each in turn. Our members operate in the private funds sector, and accordingly we consider the issues presented in the Report through this lens (and we do not comment on the potential impact of the redistribution to other NBFIs such as insurance companies and pensions funds).

The NBFI sector is a growing portion of the financial ecosystem. Therefore, its increased participation in securitisation markets can primarily be explained by the increase in its presence *overall* in global financial systems. As it relates to MFA's members, we do not consider there to be a correlation between securitisation reforms and the increase in private fund participation in the markets.

In our view, such a redistribution helps to spread risk among different market participants and avoids any particular sector from becoming over-exposed to a specific financial product. MFA agrees that it would be inappropriate to make broad-brush statements about the abilities of NBFIs to withstand market stresses. In fact, we would argue that the private funds industry is generally well-positioned to withstand stress events. In the EU and UK, private funds are already subject to a regulatory framework (derived from the AIFMD) that is specifically designed to address systemic risks for investment fund activities.

The Report cites liquidity concerns as a potential indicator of the financial instability of NBFIs. As far as the private funds industry is concerned, the AIFMD contains rules on levels of leverage, liquidity management limits and stress tests, including that AIFMs must carry out stress tests for each fund under both normal and exceptional liquidity conditions. Levels of liquidity vary within the private funds sector, and the liquidity management tools of a given private fund are correlated with the liquidity of underlying investments. In turn, the calibration of redemption terms will be sensitive to the profile of a fund's investment portfolio in order to mitigate potential liquidity mismatches. Private funds are far less likely to suffers bank-like runs, since investors' capital is either locked in for a defined period of time, or withdrawals are subject to controlled redemption procedures.

In the EU, amendments to the AIFMD (known as "**AIFMD2**") will further increase liquidity risk management requirements by mandating the use of liquidity management tools from a prescribed list. In addition, loan origination funds will be subject to a new leverage cap and will be required to be closed-ended unless the AIFM can demonstrate that the fund's liquidity risk management system are aligned with its investment strategy and redemption policy.

Many private funds benefit from a sophisticated investor base. Their investors are typically institutional investors such as regulated financial institutions, foundations, endowments, and pension funds, who understand the limitations of the funds that they are invested in (e.g., liquidity limitations and restrictions on redemptions) and are capable of assessing the risk associated with an investment in the fund. Therefore, they are able to understand any risks associated with indirect exposures to the securitisation markets through an investment in a fund.

The Report also cites interconnectedness as a potential risk associated with NBFIs. It is true that there may be a degree of interconnectedness between NBFIs. For example, some private equity funds and private credit funds may be managed by the same manager, or some large private credit funds structures may integrate (re)insurance companies for capital-raising purposes. However, this phenomenon is not unique to NBFIs. Indeed, some private credit funds have become interconnected with the traditional banking sector. In view of this, it is important not to overstate the impact of interconnectedness on the risk of contagion in the context of NBFIs alone.

In light of the factors noted above, MFA agrees with the FSB that it is not possible to draw broad conclusions about the funding structures and resilience of NBFI investors. There will of course be private funds whose strategies and investor profile makes securitisations an unsuitable financing tool or investment; but in those cases, the fund's strategy will be tailored accordingly. Ultimately, MFA believes that maintaining a balance between banks and NBFI participants in the issuance of, and investment in, securitisations supports a well-balanced financial ecosystem that is better placed to withstand market turbulence.