MFA

4 December, 2024

By online submission

Directorate-General for Financial Stability,
Financial Services and Capital Markets Union
European Commission
1049 Bruxelles
Belgium

Re: Targeted Consultation on the Functioning of the EU Securitisation Framework

Dear Sir/Madam,

MFA[i] appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the European Commission's ("**Commission**") targeted consultation on the functioning of the EU securitisation framework (the "**Consultation**").[ii] MFA strongly supports the Commission's review of the EU securitisation framework. We believe targeted reforms will maximize the full potential of the EU securitisation markets by allowing the financial services sector to serve the needs of the European economy and contribute to the development of a European Savings and Investments Union.

The alternative investment industry sees value in achieving these reforms, both as potential investors in EU securitisations but also as a means of affording investors in the EU and US the ability to invest in securitisations on a cross-border basis.

i 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.

ii European Commission, Directorate-General for Financial Stability, Targeted Consultation of the Functioning of the EU Securitisation Framework (9 October 2024), avail. at https://finance.ec.europa.eu/document/download/fb451cdc-4e5b-4d74-9411-cb8bd0789090_en?filename=2024-eu-securitisation-framework-consultation-document_en.pdf.

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To this end, MFA commends the Commission's publication of the Consultation, as it is a valuable opportunity for the Commission to reassess the effectiveness of several fundamental features of the EU Securitisation Regulation (the "**SECR**"). One of the key concerns of our members is the application of the due diligence requirements under Article 5 of the SECR to alternative investment fund managers ("**AIFMs**") and the cross-border application of the SECR.

Executive Summary

We are concerned that the due diligence requirements in the SECR, as discussed further in the attached Annex, are disproportionate to the risks associated with securitisations and fail to recognise the distinct nature of the categories of institutional investors that invest in securitisations. The due diligence requirements have served as a significant, unnecessary impediment to would-be securitisation investors, especially as they are duplicative of the requirements placed directly on sell-side parties. MFA represents AIFMs across the globe and across a spectrum of investment strategies. In their collective experience, the SECR has created a significant barrier to investing in the EU securitisation market. MFA argues strongly that a more proportionate and principles-based approach to due diligence would allow the market to reach its full potential. Crucially, in respect of AIFMs, this would involve deferring to sectoral risk management requirements under the Alternative Investment Fund Managers Directive ("**AIFMD**") and removing the SECR due diligence requirements altogether for AIFMs.

One solution meriting serious consideration would be to recognize the sell-side risk-retention and transparency obligations imposed on originators and sponsors but not impose corresponding buy-side requirements on AIFMs by way of Article 5 of the SECR. A simple solution would be to remove AIFMs from the "institutional investor" definition altogether. However, if the Commission determines this approach to be unfeasible, at a minimum the definition should not extend to non-EU AIFMs managing or marketing an alternative investment fund in the EU.

MFA encourages the Commission to consider again MFA's letter of September 17, 2021 ("**MFA September 2021 Letter**"),[iii] which addresses our members' concerns as to the potential application of the "institutional investor" definition to non-EU AIFMs. We have submitted the MFA September 2021 Letter as a supporting document, and we request that the Commission revisits the arguments contained in that letter in conjunction with our responses to this Consultation.

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iii Comment Letter from Managed Funds Association to European Commission (17 Sept. 2021), avail. at https://www.mfaalts.org/wp-content/uploads/2021/09/FA-Comment-Letter-European-Commission-consultation-on-the-functioning-of-the-EU-Securitisation-Framework.pdf.

We have set out our responses to the relevant questions of the Consultation below, and in the online form to which this letter is enclosed. Where relevant, our responses below include citations in the footnotes.

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MFA appreciates the opportunity to provide these comments to the Commission in response to the Consultation. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Rob Hailey (rhailey@mfaalts.org) or the undersigned (jflores@mfaalts.org).

Respectfully submitted,

/s/ Jillien Flores

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ANNEX – CONSULTATION RESPONSES

Question 3.1

In your opinion, should the current jurisdictional scope of application of the SECR be set out more clearly in the legislation?

MFA Response

Option: "Yes"

MFA's view is that the primary flaw with the scope of the SECR is the disproportionate application of the due diligence requirements under Article 5. Stimulating investment in the EU securitisation markets requires that the Commission look to measures that will have a meaningful impact on the ability of investors to deploy capital. As this relates to the private funds sector, the Commission should consider removing AIFMs from the scope of the "institutional investor" definition altogether.

The deployment of capital would allow banks to de-risk, thereby reducing macroprudential risks and allowing banks to deploy additional capital, whether for additional lending, infrastructure, or internal investment or development. As this relates to the private funds sector, and as MFA noted in the MFA September 2021 comment Letter,[1] the Commission should recognize the applicability of the SECR on securitisation manufacturers and not impose secondary requirements onto investors that exist essentially to ensure that the manufacturer is complying with the requirements. The application of the due diligence on manufacturers supports the removal of AIFMs from the scope of the "institutional investor" definition altogether.

In our view, Article 5 requirements should be proportionate both to the risks associated with securitisations and to the nature of the institutional investor (including the sectoral frameworks to which the relevant investor is subject). The context in which due diligence measures were first imposed under CRD II (Directive 2009/111/EC) – namely, widespread

1 Comment Letter from Managed Funds Association to European Commission (17 Sept. 2021), avail. at https://www.mfaalts.org/wp-content/uploads/2021/09/FA-Comment-Letter-European-Commission-consultation-on-the-functioning-of-the-EU-Securitisation-Framework.pdf.

inadequate risk management controls in the banking sector – should be distinguished from the present state of the markets giving rise to this and other securitisation consultations. Inadequate bank risk management procedures were compounded by a lack of transparency in complex structures (such as CDOs) and securities backed by low quality assets. Originators and sponsors are now held to higher standards – not just in the EU, but also in the US and other jurisdictions as a result of reforms following the 2008 global financial crisis (the "**GFC**"). Now that the GFC-related rules have been in use for several years in several jurisdictions, it is an appropriate time for the Commission to reconsider the extent to which due diligence requirements for AIFMs are necessary under the SECR: the burdens are considerable – enough to themselves dampen the securitisation markets– with little ascertainable benefit.

AIFMs should be distinguished from other types of institutional investors. First, an AIF's investor base is typically institutional only, rather than retail (in contrast to, for example, deposit-holders with banks and policyholders with insurers and pension schemes). Second, an AIF's investor base is typically global in nature; and the AIFM itself would in no event be bailed out by an EU member state, in contrast to the various measures contemplated under the EU bank resolution framework. Third, an AIF's investors are typically sophisticated, institutional investors who can assess the risks associated with their investments (and are fully apprised to do so owing to disclosure requirements imposed upon AIFMs under the AIFMD). Finally, AIFMs are subject to the risk management provisions of the AIFMD which are intended to address any systemic risks associated with AIFMs and their AIFs (please see our response to Question 4.19 for further discussion of this point). The features highlighted above demonstrate the appropriateness of disapplying the entirety of Article 5 of the SECR to AIFMs.

If the Commission considers it unfeasible to remove the due diligence obligations for AIFMs altogether, at a minimum those requirements should be aligned more closely with other international securitisation regulations that were implemented after the GFC. This should include, for example, recognising the framework in the US, which supports by far the largest global securitisation market.

Cross-border recognition of this kind is not a new proposal; it can be traced back to the opening of the European markets in the early 1990s, and afterwards in IOSCO's policy recommendations for risk retention following the GFC. There, IOSCO suggested that "*EU regulators could consider adopting some form of recognition for equivalent risk* *requirements in the US.*"[2] In view of the substantial improvements in incentive alignment and transparency in the global securitisation markets, considerably stronger risk management controls in the origination of and investment in securitisations, a more proportionate approach to due diligence requirements would permit AIFMs to invest in securitisations in jurisdictions which impose similar requirements for sell-side parties (such as the US).

Finally, if the Commission remains of the view that some form of Article 5 should continue to apply to AIFMs, it is essential that such requirements should not extend to non-EU AIFMs managing or marketing AIFs in the EU under Article 42 of the AIFMD. Applying the "institutional investor" definition to non-EU AIFMs would be an anti-competitive position for the Commission that would not help the EU securitisation markets begin to reach their potential for growth.

Commission application of the "institutional investor" to non-EU AIFMs has resulted in non-EU AIFMs, whose strategy involves investing in securitisations, being prohibitively disincentivised from marketing their AIFs under Article 42 of the AIFMD. This regulatory barrier to entry is primarily due to the SECR's onerous due diligence requirements. The ultimate losses resulting from this well-intended but ultimately unfavourable policy have been borne by EU investors in the alternative investments sector whose investment opportunities have been limited solely because of the SECR requirements. Such a limitation is contrary to the Commission's objective to support and encourage growth in the EU markets. Resolving this issue would promote competition and attract US and other non-US business back to the EU markets. MFA noted in its September 2021 comment letter the benefits of excluding non-EU AIFMs from the scope of the SECR and we continue to do so today.

Question 3.2

If you answered yes to question 3.1, do you think it would be useful to include a specific article that states that SECR applies to any securitisation where at least one party (sell-side or buy-

[2] IOSCO, Global Developments in Securitisation Regulation (Nov. 2012), at page 26.

side) is based or authorised in the EU, and to clarify that the EU-based or EU-authorised entity(ies) shall be in charge of fulfilling the relevant provisions in the SECR?

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

Option: "No"

From a sell-side perspective (i.e., in respect of Articles 6,7 and 9), it is not necessary to mandate that EU parties in cross-border transactions fulfil the relevant provisions of the SECR. For example, it could be the case that the only EU sell-side party in a securitisation transaction does not possess the requisite substance to fulfil Article 6, whereas a non-EU sell-side originator in the same transaction could be the appropriate entity of substance. In that case, the provision proposed under Question 3.2 would preclude the transaction from being able to comply with the SECR and the EU party could not participate in the transaction.

From a buy-side perspective (i.e., in respect of Article 5), as noted in our response to Question 3.1, we do not believe is the appropriate regulatory policy to mandate indirectly the SECR's risk-retention, transparency and credit-granting requirements through imposing due diligence obligations on AIFMs.

<u>**Question 3.3**</u>

Do you think the definition of a securitisation transaction in Article 2 of SECR should be changed? You may select more than one option.

Please explain and specify, if necessary, how the definition should be expanded or narrowed in your view.

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

Option: "Yes, the definition should be narrowed to exclude certain transactions or introduce specific exceptions"

The definition of a securitisation under the SECR is extremely broad. The fact that such a broad scope of transactions could constitute securitisations for the purpose of the EU regime can result in costly analyses for market participants (both sell-side and buy-side) simply to determine whether the SECR applies. The breadth and vagueness of the securitisation definition has created a genuine reluctance to participate in transactions that fall within this unclear "grey area," as a regulatory determination to the contrary would put both parties at risk of regulatory penalties.

ESMA's Chair, Verena Ross, has emphasised the importance of providing clarity and predictability around the requirements of the SECR.[3] She specifically notes that jurisdictional uncertainty may have caused investors to limit their investment in – and originators to limit the issuance of – new securitisations. MFA strongly agrees, and we believe that the limitations in investments extend to the lack of clarity around the securitisation definition, which has generated significant uncertainty in the EU securitisation market. From the perspective of MFA members, to encourage greater investment in the EU, the Commission should amend the securitisation definition by clarifying its scope, rather than creating express exclusions while maintaining the current broad and vague definition.

The definition of "asset-backed security" introduced in US Securities Exchange Act of 1934 after the GFC, serves as a useful comparison and a potential model for a more refined securitisation definition under the SECR. This definition helpfully includes examples of transactions that would fall within scope of the definition. If the EU adopts a similar style of definition for the meaning of securitisation under the SECR, it would reap the benefits from greater industry certainty of the scope of SECR, as well as decrease compliance barriers by harmonizing with the largest global securitisation market. Securitisation investors often are active in both the EU and US markets and participants are accustomed to interpreting and complying with the US rule. MFA members are unaware of any downsides to incorporating a definition aligned with the US definition and would welcome clarity of drafting in this manner. MFA member AIFMs have already developed systems and controls to determine whether an investment met the US "asset-backed security" definition and thus could leverage this experience in operating under an identical definition in the EU.

3 ESMA (2024), Keynote address by Verena Ross at AFME's 8th Annual European Compliance and Legal Conference, 23 September, London.

Question 3.6

Should the definition of a sponsor be expanded to include alternative investment firm managers established in the EU?

Please explain, including if the definition should be expanded to any other market participants.

MFA Response

Option: "Yes"

The definition of sponsor should be expanded to accommodate situations where an AIFM would otherwise fall within the meaning of sponsor. AIFMs are generally well-equipped to satisfy the related sponsor obligations under the SECR. For example, they operate within the parameters of a business strategy and maintain governance arrangements to carry out their strategy and have access to a range of economic resources (including, for example, income sources based on management fees). Accordingly, they typically have sufficient involvement and substance to fulfil the requirements of the SECR (such as risk-retention and transparency requirements).[4]

As it stands, the SECR compels AIFMs to resort to artificial structuring arrangements if they wish to issue a securitisation. For example, one option is to set up a separate EU MiFID investment firm, but this is a highly inefficient solution from a cost and timing perspective. For many AIFMs (and particularly smaller AIFMs) the more feasible option is simply not to issue a securitisation in the EU. These challenges are particularly relevant in the CLO markets, where in addition to the above, AIFMs typically play an important role as collateral managers, by sourcing assets, negotiating the terms of the deal more generally, and advising on the structure of the CLO tranches. As noted above, however, this exercise is understandably more expensive and complex for EU AIFMs than their non-EU

[4] One problem that can arise under the risk retention requirement is where there is no clear "originator," "sponsor" or "original lender" in the transaction. For example, in a collateralised loan obligation ("**CLO**") transaction, or another type of transaction where an AIF simply holds a portfolio of assets (which it did not originate) and wishes to sell it on into a structure utilising senior/subordinated financing, which could be classified as a securitisation for the purpose of the SECR. In such a scenario, the AIFM would be the natural party to fulfil the sponsor obligations under the SECR, but under current law, the AIFM would not be able to perform this role.

counterparts. This could, in part, explain the lower rate of CLO issuances in the EU as compared with the US, which was highlighted in the Financial Stability Board's Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation.[5]

There also are several advantages to expanding the definition of "sponsor" for AIFMs that are worthy of Commission consideration. If AIFMs were included in the sponsor definition, they would have direct access to the securitisation markets and could lead to the evolution and development of a new range of investment strategies, enabling AIFMs to structure and manage securitisations. AIFMs could use the securitisation structure to develop tailor-made investment structures to meet the needs of their investors. Acting as a sponsor also would give the AIFM more control over the securitisation process, allowing them to manage and structure portfolios more effectively. If AIFMs could act as sponsors, they also could participate more fully in structured finance.

Accordingly, we are supportive of measures which provide market participants with more flexibility to structure their businesses in a logical and cost-effective manner, and we believe that this is necessary to support the growth of the EU markets.

Question 3.7

If you answered yes to question 3.6., are any specific adaptions or safeguards necessary in the Alternative Investment Firms Directive (AIFMD), taking into account the originate-to-distribute prohibition in the AIFMD, to enable AIFMs to fulfil the functions of a sponsor in a securitisation transaction, as stipulated in the SECR?

MFA Response

Option: "No safeguards are needed"

The current regime under the AIFMD already provides adequate safeguards should any risks arise in the context of securitisations sponsored by an AIFM.

5 Financial Stability Board (2024), Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation: Consultation report, page 20 (see Graph 4).

Question 4.3

Please select your preferred option to ensure that investors are aware of what they are buying and appropriately assess the risks of their investments.

MFA Response

Option: "Option 1: The requirements should be made more principles-based, proportionate, and less complex"

Question 4.4

Should the text of Article 5(3) be simplified to mandate investors to assess at minimum the risk characteristics and the structural features of the securitisation?

MFA Response

Yes

Please explain.

The Article 5 due diligence rules are disproportionate, do not achieve their intended goals and should instead be high-level "investor due diligence" obligations, bringing them in line with all other instruments. This is particularly the case with respect to third-country securitisations, which may be in the interests of AIFs with EU investors to hold. MFA makes several points in support of this view:

- The EU securitisation rules in our view are beset by overly prescriptive rules that have hampered the development of securitisation as an asset class. While the UCITS framework features a range of requirements given their retail focus, even that framework does not require UCITS managers to consider specific data elements in the securitisation before the UCITS manager can purchase them for one of its UCITS. Rather, the Level 2 Rules for both UCITS and AIFs set out high level investment 'due diligence' rules that managers must meet, which we feel is more proportionate.
- More fundamentally, the rules for securitisations are vastly disproportionate to the risks. When comparing the historic default rates of securitisations with corporate bonds of the same credit rating, the rate for securitisations is typically lower. As an illustrative example, if a UCITS' investment policy so allows, a UCITS fund could invest in distressed debt securities and not have to complete any prescribed due diligence; it would be assumed that the

manager conducts an appropriate risk assessment per its fiduciary obligations and higher-level rules. Yet, purchasing a senior triple-A rated tranche of a Freddie Mac[6] securitisation for a fund limited to sophisticated, institutional investors would require substantial additional verifications and potentially might not be eligible, despite the far lower risk to the AIF. For many AIFMs, the compliance risk simply is not worth it.

- Due diligence in an AIF's portfolio holdings is already embedded into the fiduciary standard of care that AIFMs owe their clients, the AIFs they manage. This means ensuring that the AIFM has considered the relevant risks of any investment opportunities.
    - However, the current securitisation due diligence rules have nothing to do with investors improving credit risk analyses or otherwise being more judicious in the securitisations in which they invest. The requirements instead serve as a data collection and reporting exercise.
    - Additionally, the strictness of the due diligence obligations restricts the investment opportunity, based on the technical basis of whether certain information is provided by issuers on a securitisation and not the (more important) fundamentals of that securitisation. Unlike previous iterations of the UK securitisation rules, there moreover is no provision for deeming the information provided by third country issuers as 'substantially the same' as there was in the previous version of the UK rules.
- In the context of AIFMs acting in the capacity of institutional investors, while the due diligence obligations try to address the alleged intrinsic risks of securitisations, they fail to acknowledge the corresponding costs to AIF investors which have manifested as barriers to invest in some securitisations. The unintended outcome is that EU investors are at a substantial disadvantage to non-EU investors as they are restricted on a technical basis from investing in certain third country securitisations, much larger than the EU market. MFA's members manage the same securitised investment strategies for both EU and non-EU AIFs and there is significant dispersion in the holdings of each, sometimes to the performance-related detriment of the EU AIF investors, and so counter to the interests of the ultimate beneficiaries.

[6] Freddie Mac is the common name for the Federal Home Loan Mortgage Corporation, a US government sponsored enterprise created by Congress to support home ownership for middle-income Americans. Freddie Mac purchases, guarantees, and securitizes home loans in the US. *See generally* http://www.freddimac.com.

Question 4.7

Should due diligence requirements differ based on the different characteristics of a securitisation transaction?

MFA Response

No

While the Commission has not requested written feedback to this question specifically, differing due diligence requirements would result in an increased compliance and administrative burden for the investor: differing due diligence requirements would result in a multitude of due diligence templates and increased complexity (and risk of error). Differing and potentially inconsistent due diligence requirements would further increase costs and disincentivize investors from participating in the securitisation markets. As a result, EU banks would find fewer investors interested in purchasing securitisations which would shift credit risk off of bank balance sheets; and in turn, would be able to offer fewer loans to European businesses and households.

Question 4.10

For EU investors investing in securitisations where the originator, sponsor or original lender is established in the Union and is the responsible entity for complying with those requirements, should certain due diligence verification requirements be removed as the compliance with these requirements is already subject to supervision elsewhere? This could apply to the requirements for investors to check whether the originator, sponsor or original lender complied with:

(i) risk retention requirements,

(ii) credit granting criteria requirements,

(iii) disclosure requirements,

(iv) STS requirements, where the transaction is notified as STS

Please explain if you see any risks arising from the removal of these requirements, and if so, how they should be mitigated.

MFA Response

Options: (i) "Yes"; (ii) "Yes"; (iii) "Yes"; (iv) "Yes"

The premise of Question 4.10 acknowledges that investors themselves do not directly benefit from the due diligence requirements under the SECR. The premise also suggests that mandating indirect enforcement of risk-retention, credit-granting and transparency requirements is an inappropriate burden to impose on investors – ironically, the very party to whom the securitisation is being marketed. MFA agrees strongly that it would be appropriate to remove the due diligence requirements as suggested in Question 4.10. Further, MFA encourages the Commission to take the additional step of harmonising the EU framework with the global securitisation markets: the due diligence requirements for AIFMs should be removed altogether (regardless of whether the sell-side parties are located inside or outside of the EU). Please see our response to Question 3.1 for further discussion of this point.

As noted in our response to Question 3.10 above and Question 4.19 below, the risk management provisions in the AIFMD render the due diligence requirements in the SECR redundant in the context of AIFMs. The risk management procedures mandated under the AIFMD are jurisdiction-agnostic – the country of issuance of an investment is not relevant. In any event, AIFMs are required to assess whether the relevant investment is aligned with the investment strategy, objectives and risk profile of the relevant AIF in accordance with the requirements of Article 15 of the AIFMD. Therefore, if the Commission is proposing to remove due diligence requirements for AIFMs investing in EU securitisations, it should also consider removing due diligence requirements for AIFMs investing in non-EU securitisations – in each case, the AIFMD requires AIFMs to apply the same standards of risk management procedures.

As it relates specifically to simple, transparent, and standardised ("**STS**") securitisations, the requirement to verify compliance for entities not benefitting from preferential capital treatment (e.g., UCITS and AIFs) is illogical and in fact does disadvantage the investor from purchasing these securities given the extra due diligence required. Investors should be able to rely on an issuer attestation that a securitisation investment in fact is "S" and "T" and "S."

Question 4.12

Do the due diligence requirements under Article 5 disincentivise investing into securitisations on the secondary market?

MFA Response

Yes

Participation in certain secondary market deals may be more challenging for AIFs and other investors given the granularity of the current securitisation rules. Some deals, particularly from non-EU issuers, can move very quickly (intraday), and for these deals completing all the due diligence obligations in the limited time available can prove challenging if not impossible. This is particularly true if the investor must verify that the issuer will comply with Article 7 of the SECR. MFA recommends revising the due diligence requirements, as mentioned above, to remove the investor's obligation to verify the presence of Article 7 reporting on a deal. In addressing questions 4.13-14, this reform also should be addressed by allowing for additional time for any due diligence to be completed.

Question 4.13

If you answered yes to question 4.12., should investors be provided with a defined period of time after the investment to document compliance with the verification requirements as part of the due diligence requirements under Article 5?

MFA Response

No

No specific timeframe should be mandated.

Question 4.16

Do the due diligence requirements under Article 5 disincentivise investing into repeat securitisation issuances?

MFA Response

Yes

Question 4.17

If you answered yes to question 4.16., how should repeat or similar transactions be identified in the legal text and how should the respective due diligence requirements be amended?

We understand "repeat securitisation issuances" to refer to offerings where substantively the same securitisation, with the same features, is issued multiple times (so, if the first issuance is compliant with the requirements of the SECR, then all subsequent issuances of that series also will be). If so, investors should be able leverage the initial representation made by the sponsor or issuer regarding the transaction's compliance with requirements of the SECR and rely on the same documentation for each. MFA requests clarification on this point from the Commission.

Question 4.18

Should Article 32(1) be amended to require Member States to lay down rules establishing appropriate administrative sanctions, in the case of negligence or intentional infringement, and remedial measures in case institutional investors fail to meet the requirements provided for in Article 5?

MFA Response

Option: "No"

MFA members operate in the private funds sector, and as such our comments are limited to the operation of the administrative sanctions in the AIFMD. MFA members have not reported any issues with the effectiveness of Article 17 of the AIFMD and the related provisions for administrative sanctions. It is unnecessary to move these provisions into the SECR, and doing so would risk disrupting the market's common understanding of the functioning of these administrative sanctions.

<u>Question 4.19</u>

Taking into account the answers to the questions above on due diligence requirements, do you think any safeguards should be introduced in Article 5 to prevent the build-up of financial stability risks?

<u>MFA Response</u>

No. MFA's view is that Article 5 is not the appropriate medium through which to introduce safeguards against financial stability risks. The purpose of Article 5 has been and should be to protect investors, not to indirectly enforce the sell-side's financial stability objectives. The financial stability objectives of the SECR are more appropriately addressed through obligations on sell-side parties.

As noted in our response to Question 4.10, the current state of Article 5 reflects an outdated view that securitisations are inherently risky. The sell-side requirements imposed under the SECR have resulted in securitisations becoming considerably safer products than before the GFC, with investors now benefitting from enhanced incentive alignment, stronger credit due diligence, and improved transparency. Those factors have contributed to financial stability in the securitisation markets and, in the US and other jurisdictions that have right-sized securitisation regulation to align with the respective risks, considerable growth in the securitisation markets since the GFC.

If Article 5's primary objective is to protect investors, MFA submits that imposing due diligence on AIFMs for this purpose is redundant. As we have noted in our responses to previous questions, AIFMs are sophisticated institutional investors who make well-informed investment decisions – regardless of their obligations under the SECR. It is disproportionate to prescribe the conditions that AIFMs must satisfy in respect of securitisations, when they do not otherwise face mandated investment limitations under the AIFMD. In addition, investors in AIFs are typically experienced, large institutional investors, who are provided with detailed pre-contractual disclosures under the AIFMD, are often advised by sophisticated investment and legal advisors, and carry out extensive initial and ongoing diligence on AIFs and their AIFMs before investing.

The risk management provisions under Article 15 of the AIFMD sufficiently address the potential risks posed by securitisation investments. Article 15 requires AIFMs to maintain rigorous systems and controls, and crucially it allows AIFMs to tailor these measures to the investment strategy and risk profile of its AIFs. For example, while Article 15(3) of the

AIFMD requires AIFMs to maintain due diligence processes, it does not mandate specific conditions that need to be satisfied during this process (in contrast to Article 5(1) of the SECR). Similarly, Article 15(3) of the AIFMD requires AIFMs to maintain ongoing monitoring and stress testing procedures, but it does not dictate the factors that need to be monitored in respect of investments (in contrast to Article 5(4)(a) of the SECR). AIFMD recognises the sophisticated nature of AIFMs and sets out a principles-based framework that provides AIFMs with flexibility in complying in an effective, tailored, and cost-efficient manner.

If, however, the Commission remains concerned from a financial stability perspective, note that the primary objective of the AIFMD framework is to address systemic risks associated with AIFMs. For example, they are subject to various liquidity and capital requirements under the AIFMD, notwithstanding the fact they are far less likely to suffer investor "runs" because of the redemption and transfer terms that are a common feature of an AIF's constitutional documents. In addition, AIFMs are subject to Annex IV reporting obligations to competent authorities under Article 24 of the AIFMD; these requirements create regulatory accountability for the risk management systems implemented under Article 15 of the AIFMD and allow competent authorities to monitor any systemic risks posed by the relevant AIFM. Such provisions are substantially more effective at achieving financial stability objectives than Article 5 of the SECR.

Question 4.20

Taking into account your answers to the previous questions in this section, by how much would these changes impact the volume of securitisations that you invest in?

While quantifying the anticipated volume increase or decrease in securitisation volume if the Commission were to adopt the approaches MFA has laid out herein are unknown, the disincentives in securitisation holdings resulting from the current regulatory framework are real: AIFMs and other investors have restricted the purchase of securitisations specifically due to concerns with the reporting requirements.

Question 4.22

Should the National Competent Authorities (NCAs) continue to have the possibility to apply administrative sanctions under Article 32 and 33 of SECR in case of infringements of the

requirements of Article 5 SECR to either the institutional investor or the party to which the institutional investor has delegated the due diligence obligations?

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

Option: "No"

MFA recognises that the drafting of Article 5(5) has generated uncertainty as to whether sanctions could be imposed upon the delegating institutional investor *as well as* the managing party to which responsibility for due diligence has been delegated (provided that the relevant managing party is also an institutional investor). In our view, if the delegating institutional investor were to remain subject to sanctions in addition to the managing party, this would offset the benefits of being able to delegate under Article 5(5) in the first place. Therefore, MFA welcomes clarification that, once responsibility for fulfilling due diligence requirements has been delegated to another institutional investor, it should only follow that any regulatory liability for failure to comply with Article 5 pass to the managing party. The parties would expressly agree to this delegation of function and obligation.

<u>**Question 4.23**</u>

If you answered no to question 4.22, which party should be subject to administrative sanctions in case of infringement of the due diligence requirements?

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

Option: "the party to which the institutional investor has delegated the due diligence obligations"

<u>**Question 5.4**</u>

Is the information that investors need to carry out their due diligence under Article 5 different from the information that supervisors need?

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

Option: "Significantly different"

MFA cannot speak to the needs of supervisors or non-AIFM institutional investors. However, as a matter of principle, the objectives of supervisors and investors are clearly distinct. AIFMs conduct their due diligence to assess the suitability of an investment for its AIFs' strategies, as well as to assess the risk characteristics of the investment in consideration of the overall risk profile of its AIFs' portfolios. Below, we describe the typical information needs of AIFMs investing in securitisations. Some of this information tracks the requirements under Article 5. This generally can be explained by the fact that Article 5 is duplicating due diligence procedures which would otherwise be carried out by AIFMs. However, that is not to say that Article 5 is harmless – compliance is frequently costly (and in some cases, impossible to achieve when investing in non-EU deals).

AIFMs will typically obtain relevant transaction documents before investing in a securitisation (regardless of whether the originator or sponsor is subject to Article 7(1)(b) of the SECR). Those documents typically enable the AIFM to review (among other things): the characteristics of the underlying collateral; underwriting and/or asset selection procedures; security arrangements; the transaction structure; the priority of payments; servicing arrangements; any applicable forms of credit enhancement; hedging arrangements; any applicable fees; collateral quality tests and triggers; concentration limits; and redemption/transfer measures. All of this information will be used to inform the AIFM's overall assessment of the suitability of the investment.

As noted previously, while do not believe that it is appropriate to impose risk-retention due diligence requirements on AIFMs; identifying forms of incentive alignment between the originator/sponsor and the investor is a natural outcome of the due diligence that AIFMs typically carry out. In some cases, this is achieved through risk retention (albeit, not always in accordance with the methodologies under Article 6); in other cases, AIFMs will look to different forms of incentive alignment, such as over-collateralisation. This information is typically disclosed in transaction documentation as a matter of course (and not purely for regulatory compliance purposes).

AIFMs will also receive information on an ongoing basis throughout the life of a securitisation transaction. For example, they will typically have access to any material updates to the transaction documents. Regardless of their jurisdiction, it is also common for originators and sponsors to prepare periodic reports (often monthly), which provide information on the performance of the underlying collateral, as well as information on distributions and any applicable fee payments. A global market practice has developed such that these periodic reports suffice to give investors the level of information that they require to monitor their investments adequately. In this regard, we note that our members typically have not found the reporting templates prescribed under Article 7 of the SECR to be any more informative than reports that they would otherwise receive from originators and sponsors.

As noted in our response to Question 3.1, the most effective way to make Article 5 more proportionate in the context of AIFMs is simply to remove them from the “institutional investor” definition. As an alternative approach, the Commission could consider replacing Article 5(1) to Article 5(4) of the SECR with cross-references to Article 15 of the AIFMD, which forms the basis of AIFMs’ due diligence procedures. Considering these existing procedures, it is unnecessary to impose additional investment-specific due diligence obligations under the SECR. Removing such obligations would have a positive impact on reducing compliance costs, while still satisfying similar risk management objectives.

As for the information required by supervisors, while we cannot speak to their needs, given their different objectives, we expect that supervisors do not require granular details on the performance of underlying collateral, and that an aggregated overview of transactions would be sufficient for their monitoring purposes (thus reducing the burden of processing and interpreting data). Accordingly, MFA expects that the level of detail currently contained in Article 7 reports far exceeds the needs of supervisors.

Question 5.5

To ensure that investors and supervisors have sufficient access to information under Article 7, please select your preferred option below

MFA Response

Option: “Option 2:

- **Remove the distinction between public and private securitisations.**
- **Introduce principles-based disclosure for investors without a prescribed template.**
- **Replace the current disclosure templates with a simplified prescribed template that fits the needs of competent authorities with a reduced scope/reduced number of fields than the current templates.”**

Question 5.10

Under Option 1, should the current definition of a public securitisation be expanded to a securitisation fulfilling any of the following criteria: (1) a prospectus has been drawn up in compliance with the EU Prospectus Regulation; or (2) notes were admitted to a trading venue; or (3) it was marketed (to a broad range/audience of investors) and the relevant terms and conditions are non-negotiable among the parties?

MFA Response

Option: "Yes"

As indicated in our response to Question 5.5, MFA recommends that the Commission adopt Option 2. The current distinction between private and public securitisations under the SECR does not relate to the risk characteristics of the securitisation, nor the characteristics of the institutional investor. Accordingly, it appears artificial to prescribe different transparency requirements simply based on the range of investors to which the deal is offered when the two deals could be substantively the same.

However, if the Commission ultimately decides that the better approach is to maintain the distinction between private and public securitisations, MFA cautions against expanding the scope such that more transactions are brought within the meaning of public securitisations. The Commission is aware that market participants have found the reporting templates prescribed under Article 7 to be unduly granular and of limited benefit to investors (please refer to our response to Question 5.4 for further discussion of this point). For example, we note that the Commission observed in its 2022 report that 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 [SECR] entered into force*."

MFA members are concerned that capturing a wider range of transactions under the public definition would only increase the already considerable regulatory reporting burdens associated with issuing securitisations in the EU (notwithstanding the Commission's proposal to streamline the templates for public securitisations), which would further deter securitisation issuance.

In particular, we are opposed to the notion that public securitisations could include those listed on trading venues (and especially if this proposal is also intended to capture non-EU trading venues). For example, securities listed on EU venues such as the Irish Euronext GEM are currently "private" securitisations; if they were to become "public," EU issuers would be subject to additional reporting requirements under the SECR on top of the disclosure requirements which such venues impose as a condition for admission to trading. We are not aware of investors finding those disclosure requirements insufficient in any way to satisfy their due diligence needs. MFA argues that it is unnecessary and disproportionate for the EU securitisation regime to impose additional reporting requirements based on whether, or where, a security is listed.

Question 5.16

Under Option 2, what should be included in the principle-based disclosure requirements for investors to reduce compliance costs while ensuring access to information?

How should investors access this information?

Please explain your answer, listing all relevant information that you think investors need to do proper due diligence that could be common across all securitisations.

MFA Response

In terms of the information that is relevant to AIFMs for their due diligence procedures, please refer to our response to Question 5.4. However, as a matter of principle MFA believes that the SECR should take a principles-based approach to appropriate disclosure, rather than prescribe the specific information to be disclosed to investors. A truly principles-based disclosure regime would not prescriptively list each item of information, nor the frequency at which it should be provided and how investors should access this information.

Each securitisation is unique, and the originator is best positioned to determine the disclosure to be provided based on the securitisation itself. Similarly, the foundational principle for disclosure requirements under SECR should afford each investor the ability to obtain the information that it requires to make a well-informed and risk-based investment decision. The information that an investor requires will vary on a case-by-case, deal-by-deal basis. The SECR disclosure provisions therefore should allow sell-side parties to disclose information in a manner that is consistent with market practices for the relevant transaction, such as via the periodic reporting that has become common in the market, as discussed in our response to Question 5.4.

Question 12.3

Please specify which regulatory and non-regulatory measures have the strongest potential to stimulate the issuance of placed traditional securitisation.

MFA Response

Reducing the due diligence requirements under the SECR (in particular, by removing the risk-retention verification requirement) would have the strongest potential to stimulate the issuance of traditional securitisation. As noted above, the due diligence requirements are needlessly burdensome for each investor and increase the costs and risks of investing. These heightened costs and risks reduces the natural buyer base.

Question 12.7

Does the EU securitisation framework impact the international competitiveness of EU issuers, sponsors and investors?

Please explain your answer and where possible elaborate on the difference in regulatory costs stemming from the prudential, due diligence and transparency requirements in non-EU jurisdictions, in comparison to the EU securitisation framework.

MFA Response

Option: "Yes"

MFA contends that the SECR framework has come at a heavy cost to the international competitiveness of the EU capital markets. The Commission itself acknowledges that the EU securitisation market is yet to reach its full potential, offering a stark contrast with the size of the US market (page 3 of the Consultation).

The SECR framework, we contend, has contributed to a relative lack of EU securitisation issuances, partly because as we note EU investors are deterred from investing in securitisation vehicles due to the risks and burdens posed by the due diligence and reporting requirements. Compounding this lack of securitisation issuances is that, from a cost-benefit perspective, the EU securitisation market is not sufficiently sizable or developed for many US and other non-EU investment managers to commit to the staffing, operational, and technological investments required to support investment in EU securitsations.

In our view, the key distinction between the US and EU markets is the implementation of regulatory reforms in response to the GFC. MFA's view is that the EU took a well-intentioned but ultimately overly cautious, "one-size-fits-all" approach to regulating the securitisation markets. One clear example is the current approach of imposing disproportionate due diligence requirements on investors such as AIFMs that do not otherwise face investment limitations under their sectoral legislation. The result is that the SECR framework has placed EU market participants at a considerable competitive disadvantage compared to, for example, their US and other global counterparts.

The current SECR framework unnecessarily and considerably reduces EU investors' access to deal flow. Because of the added difficulty and expense of Article 7 reporting, many non-EU sponsors securitisation sponsors have elected to not market the securitisation issuance into the EU to avoid the compliance and reporting obligations that go along with it, effectively sacrificing the European market in favor of the larger US market as well as other jurisdictions. Because EU investors such as AIFMs must ensure that all securitisation positions held in AIFs are SECR-compliant, a much smaller pool of assets is left to choose from, putting them at a competitive disadvantage. The incongruous approach to securities regulation when compared to the US and other jurisdictions works to penalize EU investors given the broad similarities in at least the sponsor capital retention requirements under the SECR and US rules.

In addition, as noted in our response to question 3.1, the Commission's application of the "institutional investor" to non-EU AIFMs has resulted in non-EU AIFMs, whose strategy involves investing in securitisations, being prohibitively disincentivized from marketing their AIFs under Article 42 of the AIFMD. This regulatory barrier to entry is primarily due to the SECR's onerous due diligence requirements. The losses resulting from this well-intended but ultimately unfavourable policy have been borne by EU investors in the alternative investments sector whose investment opportunities have been limited solely because of the SECR requirements. Such a limitation is contrary to the Commission's objective to support and encourage growth in the EU markets. Resolving this issue would promote competition and attract US and other non-US business back to the EU markets.

To address these issues on the buy-side, MFA urges amendment to the SECR to make it more deferential to sectoral legislation and allow investors to deploy capital as they see fit within those frameworks. As noted previously, MFA views it as unnecessary to impose additional and duplicative due diligence requirements on sophisticated market participants such as AIFMs. At a minimum, the EU should seek to harmonise the SECR with the US model by permitting investment in equivalent structures (even where risk retention requirements under Article 6 cannot be satisfied under the relevant transaction). Removing these requirements would help to minimise compliance costs, and crucially it would expand the investible universe of AIFMs by making it easier for them to invest in a wider variety of securitisation transactions – all within the parameters of the risk management framework under the AIFMD.

From a sell-side perspective, the SECR should contain more flexible reporting requirements and defer to common market practices which have arisen independently of regulatory reporting regimes. In this regard, MFA agrees with the proposal under Option 2 of Question 5.5 to remove prescribed templates for the reports to be provided to investors. This would allow investors to rely on well-established reporting practices for the purposes of their ongoing monitoring.

Improved harmonisation with other global frameworks, like the US, will help to place EU participants on a level playing field. The current requirements act as a significant barrier to issuance and investment in the EU, and in many instances, the cost and compliance burdens outweigh the benefits of participating in the EU markets. Once unnecessary regulatory burdens are removed, the appetitive for issuing and investing in EU securitisations will improve.

Question 12.9

Are there any other relevant issues (outside of those addressed in the specific sections of the consultation paper above) that affect securitisation issuance and investments that you consider should be addressed?

MFA Response

Option: "Yes"

Question 12.10

If you answered yes to question 12.9., please explain your answer.

MFA Response

MFA welcomes greater clarity in the text of the SECR concerning the meaning of "securitisation position" in the context of Article 5. Article 2(19) defines a "securitisation position" as "an exposure to a securitisation." There is no indication in the SECR as to whether "exposure" should be taken as a reference to indirect exposures as well as direct exposures to securitisations.

MFA does not support application of Article 5 to indirect securitisation exposures, as it would result in exceedingly complex and impractical due diligence requirements for investors. Indirect exposures to securitisations for example can be assumed by holding an interest in a fund whose underlying portfolio consists of one or more securitisation positions. This could be a multi-strategy fund with a diverse portfolio – securitisation positions may only account for a small proportion of the portfolio. The multi-strategy fund manager is looking at its securitisation investment as one of many holdings within its portfolio. Investors in funds typically assess the overall risks of the fund (considering its strategy and objectives, including any investment restrictions). It therefore would be unnecessary and unduly burdensome to indirectly oppose the due diligence requirements on a multi-strategy fund manager that may invest in a securitisation periodically as part of a larger overall strategy.

While MFA opposes an SECR-requirement that institutional investors assess compliance in respect of individual underlying portfolio investments on a look-through basis, we recognise that on occasion some institutional investor take such an approach. We understand that insurance companies, as an isolated example, have applied a look-through approach to Article 5 of the SECR for purposes of the risk-based capital regime under Solvency II. This approach, respectfully, is flawed: to support a look-through, it would mean that the application of Article 5 would be subject to interpretation based on another regulatory framework.

This cannot be the case. Instead, the application of Article 5 should be consistent as between the different categories of the institutional investors, since there is nothing in the SECR to indicate that certain institutional investors should be applying Article 5 on a different basis.

In the absence of any indication in the SECR that Article 5 applies with respect to indirect exposures, we are of the view that it should apply only with respect to direct exposures to securitisation positions. However, MFA urges clarity on this point, as it should not be left to institutional investors to decide whether to apply a look-through approach to Article 5 on a case-by-case basis. Not only is this detrimental to legal certainty, but it also increases the costs associated with complying with the SECR.

However, if the Commission is of the opinion that Article 5 should apply with respect to indirect securitisation exposures, MFA would urge the Commission to consider some form of relief for institutional investors who invest in commingled multi-strategy funds that are managed by third-party managers, such the relevant institutional investor is not required to apply Article 5 to any underlying securitisation positions in the fund's portfolio on a look-through basis.