

ALFI response to **Commission Targeted Consultation** on the Functioning of the EU Securitisation Regulation

**ALFI response to the Commission targeted consultation on the functioning of the EU securitisation framework**

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge. Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector.

ALFI has in the past responded to the EU Commission consultation on the functioning of the EU Securitisation Regulation (“SECR”). The SECR, which was aimed at laying down rules for securitisations and developing a simple, transparent and standardised securitisation market. ALFI has in the past commented that overall these objectives have not or have only partially been achieved. ALFI welcomed the findings of the subsequent EU Commission report on the functioning of the SECR and written to the EU Commission and ESMA with an appeal to address this matter urgently.

ALFI has also responded to the ESMA consultation on the securitisation disclosure templates, where we stressed the importance that the disclosure templates subject Article 7 SECR are under review.

The main concerns that ALFI has highlighted are the impact of the SECR in terms of triggering material additional human and financial costs without any obvious added-value, especially as far as institutional investors are concerned.

Moreover, the SECR has generated some adverse effects, such as disadvantaging EU institutional investors, in particular to the accessibility of EU institutional investors to the third country securitisation markets.

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|  | *Question* | *Answer* |
| **1.1** | Do you agree that the securitisation framework (including the Securitisation Regulation and relevant applicable provisions of the CRR, Solvency II and LCR) has been successful in, or has contributed to, achieving the following objectives: • Revival of a safer securitisation market | Disagree |
| **1.2** | • Improving financing of the EU economy by creating a more balanced and stable funding structure of the EU economy | Fully Disagree |
| **1.3** | • Weakening the link between banks’ deleveraging needs and credit tightening | Somewhat Disagree |
| **1.4** | • Reducing investor stigma towards EU securitisations | Somewhat Disagree (As still too costly) |
| **1.5** | • Removing regulatory disadvantages for simple and transparent securitisation products | Neutral |
| **1.6** | • Reducing/eliminating unduly high operational costs for issuers and investors | Fully Disagree |
| **1.7** | • Differentiating simple, transparent and standardised (STS) securitisation products from more opaque and complex ones | Neutral |
| **1.7.1** | • Increasing the price difference between STS vs non-STS products | Neutral |
| **1.7.2** | • Increasing the growth in issuance of STS vs non-STS products | Neutral |
| **1.8** | • Supporting the standardisation of processes and practices in securitisation markets | Neutral |
| **1.8.1** | • Increasing the degree of standardisation of marketing and reporting material | Neutral |
| **1.8.2** | • Reducing operational costs linked to standardised securitisation products | Neutral |
| **1.9** | • Tackling regulatory inconsistencies | Neutral |
| **2.1** | Have you come across any impediments to securitise SME loans or to invest in SME loan securitisations? | Yes, securitising SME loans or investing in SME loan securitisations face several impediments.  SME securitisations often attract higher capital charges under Basel III / CRD IV rules, which make them less attractive for institutional investors such as banks and insurance companies.  More importantly, the compliance with the SECR is complex and costly. As has been outlined in the various reports that were published on the functions on the EU Securitisation framework and more recently by recommendations in the Letta and Noyer reports.  Pain points for investors and issuers of securitisations are the extensive reporting requirements triggered by the Regulation as well as the excessive due diligence and more precisely transparency requirements laid out in the European framework. Risk retention requirements (typically 5% of the transaction value) add to the issuer burden.  Our members have stressed in particular that "loan by loan" reporting is extremely cumbersome. The arranger of such securitisations that needs to report to national competent authorities and investors. The fact that Investors do not require the level of granularity that is required under the SECR etc. are all matter that do not lead to a larger uptake of the framework.  Solution: There is a need for more pragmatic reporting requirements and ultimately a risk-based approach, not just in relation to SME loans. |
| **2.2** | How can securitisation support access to finance for SMEs? | The Ecosystems needs to be incentivised, whilst banks traditionally grant loans there need to be buyers for such bank loan portfolios.  Reporting and transparency requirements set out in the SECR need to be revisited, as either the data required to be reported is not available or too complicated to be obtained.  In Luxembourg we understand from members that there is an increasing demand from funds to step into this space (i.e. to invest in financial instruments issued by securitisation vehicles?), however the pressure on costs / margins means that managers need to decide which securitisations they are ultimately prioritising to invest into as a possible eligible investment. If therefor SMEs cannot provide certain information, which are required by EU Regulation, investment fund managers will not want to consider such transactions that automatically disqualify the underlying securitisation due to lack of information. |
| **3.2** | 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-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? | The EU Securitisation Regulation has generated adverse effects, such as disadvantaging EU institutional investors in certain segments of the market. We refer in particular to the accessibility of EU institutional investors to the US (or other third country) securitisation market. Indeed, although this market is very attractive and the demand is high (particularly US CMBS), our members have not invested, or with significant constraints, in US securitisation positions.  One of the main reasons, which we have previously mentioned, is the reluctance of US issuers to commit to comply with the transparency requirements contemplated by Article 7 of SECR and the corresponding disclosure in their offering documents (i.e. disclosure stating no intention or covenant to comply with Article 7 SECR). As a consequence, our members were prevented from purchasing such securitisation positions or altogether decided to remove securitisations from the list of eligible assets from their funds. The removal of securitisations from the eligible investments would hence also impact EU securitisations.  ALFI would hence welcome ensuring that the objective of improving the competitiveness of the European financial industry be part of the review of the securitisation framework. |
| **3.3** | **Do you think the definition of a securitisation transaction in Article 2 of SECR should be changed? You may select more than one option.** • Yes, the definition should be expanded to include transactions or vehicles that could be considered securitisations from an economic perspective; • Yes, the definition should be narrowed to exclude certain transactions or introduce specific exceptions; • No, it should not be changed; • No opinion. | Yes, we believe that the definition should be narrowed to exclude certain transactions or introduce specific exception.  Transactions that should be excluded, should be those that do not represent any additional risk to the financial markets that the Securitisation Regulation is seeking to address. Here we refer to deals where the creation or management of the pool is already subject to another regulatory framework (e.g. where the transaction is managed on a discretionary basis by an AIFM, a UCITS Management Company or an investment firm). Transactions with very few underlying disclosures (since this enables the full disclosure of information and meaningful due diligence by investors on each underlying exposure and as such the risk stemming from tranching a number of different credit risks is remote). |
| **3.4** | Should the definition of a securitisation exclude transactions or vehicles that are derisked (e.g. by providing junior equity tranche) by an EU-level or national institution (e.g. a promotional bank) with a view to crowding-in private investors towards public policy objectives? | YES - whenever EU or national institutions co-invest / provide guarantees to funds for example. |
| **3.6** | **Should the definition of a sponsor be expanded to include alternative investment firm managers established in the EU?** | No. ALFI members do not believe that an AIFM should fall under the definition of a "sponsor" under the SECR.  Unlike credit institutions, an AIFM does not have any "balance sheet", hence the main scope of the activity of an AIFM is to manage and, as the case may be, market AIFs. Changing the definition would also imply additional requirements to be met by an AIFM, including the risk retention under Article 6 SECR. |
| **4.1** | Please provide an estimate of the total annual recurring costs and/or the average cost per transaction (in EUR) of complying with the due diligence requirements under Article 5. Please differentiate between costs that are only due to Article 5 and the costs that you would incur during your regular due diligence process regardless of Article 5. Please compare the total due diligence costs for securitisations with the total due diligence costs of other instruments with similar risk characteristics. | Whilst, no precise cost estimate has been received by members.  One manager outlined that over the period of three years, a dedicated securitisation team had assessed close to 90 eligible securitisations. 70 transactions were outright denied or withdrawn, because:  - the offering documents related to the applicable issuance stated no intention to comply with EU risk retention parameters (10%);  - the offering documents related to the applicable issuance stated an intention to comply with EU risk retention parameters, but also stated no intention or covenant to comply with Article 7 Transparency Requirements (54%) of the SECR.  - 36% of the requests were withdrawn by the investment team when they determined that the related issuance would not comply with the SECR.  The remainder of transactions that were eligible (internally approved) were mostly based in the US (19) and 1 was based in the EU. It is our understanding that only 1 securitisation was ultimately purchased. The costs for assessing compliance of securitisations with the complex EU regulatory framework are extensive. |
| **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.  • Option 1: The requirements should be made more principles-based, proportionate, and less complex;  • Option 2: The requirements should be made more detailed and prescriptive for legal certainty;  • Option 3: There is no need to change the text of the due diligence requirements;  • No opinion | Option 1 - The requirements should be made more principles-based, proportionate, and less complex. |
| **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? | Yes, the emphasis must be on performing meaningful due diligence and ongoing monitoring.  Investor due diligence and risk assessment is incumbent on all professional investors and is a central component of their functions. This applies regardless of the SECR, however the SECR’s prescriptiveness adds excessive administrative burden.  Asset managers will always incorporate the risk into their investment analysis. However, it is unnecessary to stipulate excessive steps and a pre-defined set of data points that investors have to go through and analyse to determine investment suitability. Per the UCITS and AIFMD requirements, a coherent and robust due diligence, credit analysis and management needs to apply for all asset classes, including securitised assets. Based on that, investors have in place own processes to analyse their investment risk, in a way that adjust to the securitisation in question and the relevant data. Providing specifics and data points of less relevance to the underlying assets does not add investment protection, while it leads to a tick the box exercise and possibly false assumptions that proper due diligence has been performed.  ALFI is aligned with the EFAMA response. |
| **4.7** | Should due diligence requirements differ based on the different characteristics of a securitisation transaction? | Yes |
| **4.8** | If you answered yes to question 4.7., please select one or more of the following options to differentiate due diligence requirements:  • Due diligence requirements should differ based on the risk of the position (e.g. senior vs non-senior)  • Due diligence requirements should differ based on the risk of the underlying assets  • Due diligence requirements should differ based on the STS status of the securitisation (STS vs non-STS)  • Other | The aim should be to avoid additional complexity. |
| **4.10 (i)** | 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, • Yes • No • No opinion | Yes |
| **4.10 (ii)** | (ii) credit granting criteria requirements, • Yes • No • No opinion | Yes |
| **4.10 (iii)** | (iii) disclosure requirements, • Yes • No • No opinion | Yes |
| **4.10 (iv)** | (iv) STS requirements, where the transaction is notified as STS • Yes • No • No opinion | TBC |
| **4.12** | **Do the due diligence requirements under Article 5 disincentivise investing into securitisations on the secondary market?** • Yes • No • No opinion | Yes |
| **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? • Yes • No • No opinion | Yes |
| **4.16** | Do the due diligence requirements under Article 5 disincentivise investing into repeat securitisation issuances? • Yes • No • No opinion | Yes |
| **4.23** | 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? • the institutional investor • the party to which the institutional investor has delegated the due diligence obligations | The party to which the institutional investor has delegated the due diligence obligations |
| **5.4** | Is the information that investors need to carry out their due diligence under Article 5 different from the information that supervisors need? • Significantly different • Moderately different • Similar | Significantly different |
| **5.5** | To ensure that investors and supervisors have sufficient access to information under Article 7, please select your preferred option below.  • Option 1:  ▪ Streamline the current disclosure templates for public securitisations  ▪ Introduce a simplified template for private securitisations and require private securitisations to report to securitisation repositories (this reporting will not be public).  • 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.  • Option 3: No change to the existing regime under Article 7 | ALFI does not believe that any of the Options are ideal, as members saw merit in some points under Option 1 and some points under Option 2. ALFI clearly would welcome that the introduction of introducing principles-based disclosure for investors without a prescribed template, as outlined under Option 2.  ALFI has responded to the ESMA consultation on the securitisation disclosure templates under Article 7 SECR. See [link](https://www.alfi.lu/en-gb/news/alfi-responds-to-esma-consultation-paper-on-the-se).  In addition, ALFI has bilaterally raised its concerns in respect of the disclosure templates under Article 7 SECR to the EU Commission and ESMA by letter in February 2023.  The current disclosure framework restricts the scope of issuers to those already complying with the standards, primarily EU issuers, or those issuers (in third countries) willing to voluntarily adhere to them.  The impact of Article 5 and Article 7 SECR has lead a significant reduction in securitisations being purchased by investment funds in the EU. Investment funds even took the decision to remove securitisations from the list of investable assets in their fund documentation. For this reason, we would favour a principles-based approach.  We would like to underline that a significant number of issuers of securitisations, particularly from the US, are excluded from EU investment products, as they are not bound by reporting under the cumbersome EU templates, given that they already provide such information in their prospectuses or are prepared to offer it to investors during the due diligence process. This exclusion leads de facto to a less diversified market and missed opportunities for institutional investors.  When reviewing the securitisation framework the principle of EU’s competitiveness should also be a critical element, as raised in the recent declarations by Heads of State as well as in the Draghi and Letta report. In this context, we would like to highlight that the UK FCA has sought to make the UK rules, applicable to institutional investors, more principles-based and proportionate, among others via deleting the requirement for prescriptive templates for institutional investors as a means to ensure efficient transparency in relation to non-UK originators and sponsors. Instead, based on a principles-based approach the requirement for UK institutional investors is to ensure that the originator, sponsor etc. has made available sufficient information for asset managers to independently and effectively assess the risks and monitor the securitisation position.  This will inevitably enhance the competitiveness of the UK compared with the EU. Global investors through EU funds will need to rely on prescriptive EU templates to ensure compliance with EU rules when investing in securitised assets across the globe. |
| **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. | Prescriptiveness must be avoided, as this would be counter intuitive for a “principle-based” approach. |