

Via Electronic Submission

To: Directorate-General for Financial Stability,
Financial Services and Capital Markets Union
at the European Commission

[*supporting side letter to be uploaded alongside
the online response form
to the EC targeted consultation on the securitisation reforms*]

4 December 2024

Dear Sir/ Madam

Pacific Investment Management Company LLC (“PIMCO”), a \$2.0 trillion¹ global asset manager with significant assets under management across Europe² and a 50-year track-record of investing in securitisation markets, is writing to supplement various aspects of its online response to the European Commission’s Targeted Consultation on the Functioning of the EU Securitisation Framework (the “Consultation”) submitted on 4 December 2024.

Broadly, we commend the EU on its efforts to better understand the potential obstacles hampering the growth of the European securitisation market and for considering necessary changes to facilitate the supply of – as well as the demand for – this vital market. We would agree with the recent report authored by Mario Draghi, “*The Future of European Competitiveness*”³ (the “Draghi Report”), which highlights the need to move away from the reliance on bank loans and to “*revive*” the European securitisation market in a broader effort to “*increase the financing capacity of the banking sector*” and to ultimately grow the EU economy.⁴

As one of the largest fixed income asset managers in the world and most longstanding investors in the securitisation markets in both the EU and United States, we believe we are uniquely positioned to provide the European Commission with technical expertise and general insights into the issues facing securitisations, and we look forward to further engagement on this important topic.

In this letter, we aim to address three critical issues concerning the current regulatory framework for securitisations, as follows:

- 1. Article 56 (2)(b) of the UCITS Directive, which limits UCITS investment to acquiring a maximum of 10% of the debt securities of a single issuing body (“the 10% limit”), is overly restrictive for securitisations.** This limitation unwittingly suppresses investor demand for, and participation in, the securitisation markets, ultimately hampering the growth of the EU securitisation market. Indeed, broad-based investor demand and participation will be essential for the large, deep securitisation market envisioned by the Draghi Report to emerge in Europe. By our calculations,

¹ As of September 30, 2024

² As of September 30, 2024, PIMCO manages €581 billion assets in Europe.

³ https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en

⁴ Mario Draghi, “The Future of European Competitiveness”, September 2024, p. 57

which we expand on later, we think that the European securitisation market could potentially grow by an additional €100 - 150 billion should investors, such as PIMCO, be allowed to invest in greater size and scope in EU securitisations through UCITS investments.

Eliminating the 10% limit for securitisation would offer several distinct advantages. Firstly, it would broaden access for more investors, including savers and retirees who are holders of UCITS funds across Europe and globally, to the numerous benefits that securitisations provide. These advantages include high-quality, resilient investment opportunities that serve as valuable components of diversified portfolios. Second, securitisations typically offer enhanced liquidity profiles that provide a prudent buffer during market stress. Removing this limit would not only enhance market participation but also contribute to a more robust and inclusive financial ecosystem, while maintaining a highly regulated framework that ensures investor protections remain intact.

Third, removing the 10% limit would reduce Europe's reliance on bank financing and unlock the numerous advantages that a broader, deeper securitisation market offers for the banking system, access to credit, and the broader economy. Many of these benefits of a more mature securitisation market were enumerated in the Draghi Report, including *"making bank balance sheets more flexible by allowing them to transfer some risk to investors, release capital and unlock additional lending,"* as well as being a more *"well-suited"* form of financing *"to fund innovative projects."*⁵ To this end, the Draghi Report discusses the importance of reconsidering capital requirements and other hurdles that could impact the attractiveness and supply of the securitisation market.⁶

While addressing the various supply considerations is important, we believe that policymakers should take a holistic approach to evaluate the market and remove existing obstacles that needlessly limit investor demand, such as the 10% limit. Removing the UCITS restriction is crucial for fostering a vibrant and sustainable EU securitisation market that can drive economic growth and innovation, while also helping to reduce reliance on bank financing. Therefore, in addition to focusing on obstacles to market supply, it is equally important to modernise the UCITS cap on securitisations to unlock broad-based, unlevered demand.

- 2. We support the proposal to make the due diligence requirements under Article 5 of the SECR more principles-based, proportionate, and less complex, as outlined in Option 1 proposed by the European Commission in Question 4.3 of the Consultation.** This change would create a more effective regulatory environment for securitisations, enabling a more practical approach to investment assessment. Simplifying the due diligence process, which currently imposes a significant regulatory burden on securitised assets compared to other asset classes, should increase investor participation and, in turn, help contribute to the growth and stability of this asset class.
- 3. We do not support any of the European Commission's proposed options for the transparency regime under Article 7 of the SECR, as detailed in Question 5.5 of the Consultation.** We are concerned that none of the three proposed options would adequately address the needs of the entire securitisation market, including transactions involving third countries. Instead, we

⁵ Mario Draghi, "The Future of European Competitiveness", September 2024, p. 55

⁶ Mario Draghi, "The Future of European Competitiveness". September 2024, p. 57

propose an alternative option which we believe would yield significant benefits for the entire securitisation market.

We have expanded on these points in greater detail below.

1. DISAPPLICATION OF ARTICLE 56 (2)(B) OF THE UCITS DIRECTIVE – ADDITIONAL COMMENTS RELATING TO SECTION 12.10 OF THE ONLINE RESPONSE

As noted in our published paper '[Navigating the Challenges: EU Securitisation Regulation and its Effects on Investors and Markets](#)⁷' the EU securitisation market has transformed significantly over the past 15 years, driven predominantly by regulatory change; however it has unequivocally failed as an alternative credit channel to the broader economy. One of the key reasons for this failure is the inability of certain regulated funds, such as UCITS, to fully access this market due to constraints imposed by legislation that, while intended to address various regulatory concerns, may unintentionally limit the ability of UCITS to participate in the securitisation market. In particular, PIMCO believes that the 10% acquisition limit for debt securities of a single issuing body set out in Article 56 of the UCITS Directive should not apply in the context of securitisation investments.

While PIMCO and the broader financial markets tend to view many of the changes introduced by the EU Securitisation Regulation ("SECR") as positive developments, we consider the 10% issuer limit rule for UCITS as a legacy restriction that is unnecessary for securitisations, given that the SECR provides a robust framework with stress testing, risk-retention and surveillance. By forcing European investors to move toward riskier asset classes (such as unsecured corporate credit risk), the UCITS 10% limit not only acts as a significant bottleneck for the growth of public securitisation markets, but also inadvertently encourages the growth of private unregulated markets and limits the future growth of Europe. As a result, EU securitisation issuance levels, which the Draghi Report rightly identifies as critical to future growth in Europe, remains well below volumes before the global financial crisis, while U.S. issuance levels have experienced continued growth during the same period.

1.1 Why it is appropriate to consider introducing a securitisation-specific exemption

Impact on the growth of the securitisation market

Unlocking Investor Demand:

The most compelling argument for EU policymakers focused on economic growth is the significant potential for the EU securitisation market to flourish if the 10% limit in Article 56 of the UCITS Directive is lifted.⁸ By removing this restriction, as expanded on below, the EU could unlock an estimated increase in demand of €100 - 150 billion, significantly impacting the size of annual issuance levels. Such a shift would facilitate deeper participation in capital markets while maintaining a highly regulated framework that ensures investor protections remain intact.

⁷ Available at: <https://www.pimco.com/us/en/insights/navigating-the-challenges-eu-securitisation-regulation-and-its-effects-on-investors-and-markets> and included as **Appendix 3** to this paper.

⁸ See **Appendix 2** with suggested amendments to Article 56 of the UCITS Directive.

Addressing bank financing limitations:

As noted in the Draghi Report, the “EU relies excessively on bank financing,”⁹ which is often ill-suited for funding innovative projects due to banks' limited expertise in screening and monitoring such ventures, as well as difficulties in valuing their largely intangible collateral. Although the global financial crisis and subsequent bank deleveraging have led to a greater role for capital markets and non-bank finance in Europe, the Draghi Report highlights that “bank loans are still the most important source of external finance for companies.” EU banks face several constraints, however, including lower profitability compared to their US counterparts and specific regulatory hurdles that limit their lending capacity. Notably, EU banks cannot leverage securitisations to the same extent as US banks, with annual issuance of securitisations in the EU standing at just 0.3% of GDP in 2022, compared to 4% in the U.S.¹⁰

Reforming the securitisation framework would not only make European banks' balance sheets more flexible by allowing them to transfer risk to investors and release capital for additional lending as the Draghi Report outlines, but it could also serve as a substitute for the lack of capital market integration, enabling banks to package loans from different Member States into standardised, tradeable assets accessible to non-bank investors.¹¹ This reform would align with the overarching goal of revitalising the EU economy and fostering sustainable growth.

PIMCO's Experience:

The case for lifting the 10% limit in the UCITS Directive is not merely theoretical; it is further supported by our own experiences. As a leading global asset manager, PIMCO has had to limit the growth of its multi-sector fixed income strategies in Europe due to the constraints imposed by the UCITS framework. For instance, our largest UCITS vehicle, the PIMCO GIS Income Fund, which has €86 billion in assets under management, currently holds only approximately 8% (€6.8 billion) exposure to European securitised products, primarily constrained by the 10% issuer limit in the UCITS Directive. If the 10% issuer limit were relaxed, allowing the fund to hold an increased amount of any given securitisation deal, the fund's overall securitised allocation could increase to 25% or more (which would bring it more in line with our US Income products, which typically have 30-50% exposure to the sector). If other large PIMCO UCITS funds were to make similar shifts, PIMCO could generate an additional demand of approximately €20-30 billion for European securitisations.

If we extrapolate this logic to the broader UCITS market and other funds constrained by the same 10% limit, it becomes evident that the European securitisation market could see a one-off increase in demand of €100 – 150 billion. If we assume reinvestments of amortisation for the one-off increase of €100 - 150 billion, this would result in additional €20 – 30 billion annual demand, which would have a long term meaningful impact on annual issuance size.

Investor Interest:

Moreover, PIMCO has received feedback from current and prospective investors expressing interest in securitisation-focused vehicles as a means of diversifying away from traditional corporate credit investments. Investors have identified several key funds they would like to establish, including a Securitised Credit Fund, CLO Fund, and Short-Term ABS Fund. These funds have the potential for significant growth if the UCITS regulatory environment were more conducive. Over the next five years, we anticipate the following growth potential in these asset classes:

⁹ Mario Draghi, “The Future of European Competitiveness”. September 2024, p. 60

¹⁰ Mario Draghi, “The Future of European Competitiveness”. September 2024, p. 56

¹¹ Mario Draghi, “The Future of European Competitiveness”. September 2024, p. 59

- Securitised Credit Fund or ETF: Starting size: €4-8bn, which could grow to + €20bn.
- CLO Fund or ETF: Starting size: €1-1.5bn, which could grow to €3-5bn.
- Short Term ABS Fund or ETF: Starting size: €1-2bn, which could grow to €4-6bn.

This growth potential not only underscores the demand for securitised products but also illustrates how lifting the 10% limit could catalyse the development of new investment vehicles, ultimately enhancing the EU's capital markets and supporting economic growth.

Other challenges posed by the 10% limitation

Disparity in investment opportunity:

The much smaller size of securitised deals compared to corporate issuance, combined with structural differences between the securitised and corporate markets, amplifies the arbitrary nature of the 10% limit, creating significant barriers to investment in the securitisation market. Securitised products, such as asset-backed securities and mortgage-backed securities, almost always involve smaller transaction sizes than corporate bonds. This disparity in issue size is further exacerbated by the distinct ways in which transactions are structured in securitised markets, making the 10% limit even more punitive.

For example, mainstream debt issuers commonly issue different types of debt securities from the same or a single issuing entity under stand-alone bond issuances or bond programs (e.g., Euro Medium Term Notes / Global Medium Term Notes). In practice, this means that the 10% acquisition limit is calculated by reference to all debt securities that may be issued by the mainstream debt issuer, allowing investors to spread their risk across multiple securities from a single issuer, making it easier to meet investment targets and maintain portfolio balance. This contrasts with the securitisation market, where securitisation special purpose entities (“SSPE”) programmatic issuers are not very common, and instead the majority of securitisations are issued as stand-alone, bespoke transactions by new SSPE issuers. As a result, the 10% acquisition limit significantly restricts the ability of UCITS to invest in any single stand-alone securitisation and achieve desired investment targets. Ultimately, this limit restricts the potential for effective diversification at the portfolio level.

Amortised Structures:

Furthermore, the amortisation structure of securitisations compared to the bullet maturity structure of corporate bonds, results in a gradual reduction of securitisation positions over time. The smaller size of securitised deals, combined with the 10% limit, can exacerbate market fragmentation, lead to undersized positions in portfolios and thereby constrain the potential growth of the securitisation market. This limit compels fund managers to focus on newer, less attractive issues with larger deal sizes, rather than older, smaller issues that have more loan seasoning and, consequently, more attractive cash flow profiles.

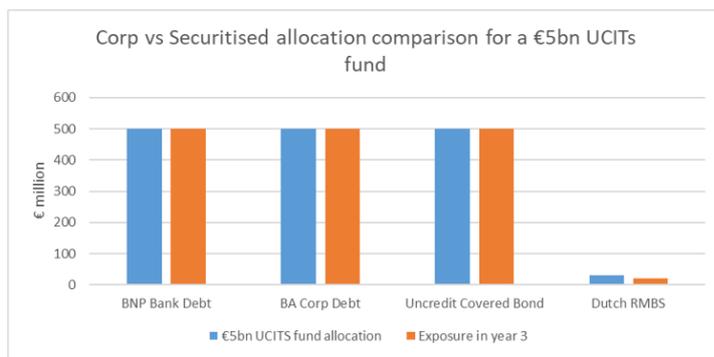
Additionally, the amortisation of tranches that a UCITS does not own can lead to unintended consequences for the UCITS’s investment. As these non-owned tranches are paid down, the relative value of the tranche that the UCITS does own may increase. If this increase pushes the UCITS's holding above the regulatory limit of 10%, it may be forced to sell the excess portion to comply with the regulations.

While the primary goal of this rule is to prevent a UCITS having too much exposure to a single issuer, the 10% limit is counterproductive in the context of securitisations. By their very nature,

securitisations are diversified pools of underlying loans, mitigating the risk of overexposure to a single issuer. Please refer to the following chart for an illustrative example among corporates, financials, covered bonds and ABS, which underscores the practical limitations of the 10% issuer limit on securitisations given their small size and amortising natures.

Applying 10% issuer limits as well as fund limits to all sectors

Sector	Issuing Body	Total Debt outstanding	UCITS Issuing body allowance	Allowance in this example	€10 bn UCITS fund	%NAV	€5 bn UCITS fund	%NAV	Outstanding in 3yrs time (%NAV)
Bank Debt	BNP Paribas	€350 bn	10%	€35 bn	€1 bn	10%	€500 mn	10%	€500 mn (10%)
IG Corp Debt	BA Airways	€6 bn	10%	€600 mn	€600 mn	6%	€500 mn	10%	€500 mn (10%)
Covered Bond	Unicredit	€100 bn	25%	€25 bn	€1 bn	10%	€500 mn	10%	€500 mn (10%)
Dutch RMBS	Static SPV	€300 mn (Typical size)	Currently Interpreted as 10%	€30 mn	€30 mn	0.3%	€30 mn	0.6%	€20 mn (0.4%)



Securitisation positions naturally shrink via amortisation by a substantial portion, decreasing concentration risk

UCITS regulation is heavily penalising securitized credit issues issued from a standalone SSPE, requiring funds to invest in hundreds of issuers in order to comply with UCITS Article 56

The smaller size of securitised deals, combined with the unique structure of the securitisation market and the inherent risk-mitigating features of amortisation, exacerbates the punitive effects of the 10% limit. By lifting this restriction, EU policymakers could facilitate greater participation in the securitisation market, ultimately fostering a more robust and dynamic financial ecosystem that benefits both investors and the broader economy.

1.2 Benefits for Investor

Investing in securitised assets offers several compelling benefits for investors, making securitisations an attractive addition to diversified portfolios. Among the primary advantages are the resilience and defensiveness of these investments, which provide a valuable buffer during market fluctuations and economic downturns. This stability allows securitised assets to serve as a protective layer within a diversified investment strategy.

In addition, securitisations are typically characterised by highly granular and diversified portfolios of the securitised assets, effectively mitigating concentration risk by spreading exposure across a broad range of loans or receivables. When structured, the cash-flow modelling of securitisations takes these factors into account, determining the necessary credit enhancement needed to ensure uninterrupted flow of payments to the most senior positions throughout the life of a transaction.

For investors in securitisations, such as UCITS, the presence of credit enhancement features significantly increases the safety of these assets compared to corporate bonds. This allows investors

to assume the associated risk with greater confidence in the performance of underlying securitised assets. In contrast, mainstream debt securities often lack these protective features, as many are unsecured financial products—some rated at sub-investment grade—offering far less protection to UCITS as investors.

In addition to stable cash flows and effective risk diversification, securitised assets present an appealing option for investors seeking to optimise their investment strategies while benefiting from the structural advantages that these products provide.

1.3 Securitisations are highly regulated products in Europe.

Securitisations in Europe are governed by a comprehensive set of regulations, making them highly regulated products that provide a secure investment option for UCITS investors.

Managers of UCITS are required to conduct extensive due diligence when investing in securitisations, particularly in comparison to other investment options, such as unsecured debt, which may carry greater risks and typically offer lower rates of return. While this requirement for thorough scrutiny is designed to ensure informed investment decisions that align with regulatory obligations, it may seem excessive, especially given that UCITS are already subject to stringent regulations, including robust risk management frameworks, detailed diversification rules, and effective liquidity management. This raises important questions about the proportionality of the due diligence requirements relative to the inherent risks associated with the securitised assets.

The UCITS Directive, established in 1985, has provided a robust framework for investment funds, but post-global financial crisis (“GFC”) reforms, including the SECR, missed the opportunity to holistically review the UCITS regime concerning restrictions that impact securitisation investments. Post-GFC regulations have successfully limited predatory lending practices, compelled securitisation originators and sponsors (through risk retention rules) to retain exposure to their securitisations, eliminated excessive layering of securitisations that created undue economic leverage, and led to a significant improvement in the quality of underlying loans. This has resulted in a decline in loan defaults, and the enhancement of the securities themselves, leading to a more resilient and robust banking system along with a heavily regulated securitisation market.

Given the evolving market landscape, now is the perfect time to examine these issues more closely as part of the wider securitisation reforms.

2. ARTICLE 5 DUE DILIGENCE REQUIREMENTS - ADDITIONAL COMMENTS RELATING TO SECTION 4.4 OF THE ONLINE RESPONSE

We support the proposal to make the due diligence requirements under Article 5 of the SECR more principles-based, proportionate, and less complex, as outlined in Option 1 proposed by the European Commission in Question 4.3 of the Consultation. This change would foster a more effective regulatory environment for securitisations, enabling a more nuanced approach to investment assessment. By adopting a principles-based framework, particularly in relation to Article 5(1) and Article 5(3), investors would gain the discretion to evaluate deal characteristics and other

relevant factors on a case-by-case basis, tailoring their assessments to what is most pertinent for their investment strategies.

Furthermore, regulated public markets, such as UCITS, should play a bigger role in supporting access to finance. Making the securitisation regulatory framework less restrictive and addressing caps and limits on securitisation investments (such as the 10% limit that we refer to above) will go a long way to address this. We believe this will be beneficial from both a market and a supervisory perspective. This is because an improved securitisation framework will drive more investment into the regulated securitisation space, bringing significant benefits to the market by providing long-term financing. In our view, private credit markets benefit from less strict regulatory frameworks and, as a result, investments are channelled there rather than into the more regulated public markets. Improving the securitisation framework will also address concerns expressed by regulatory supervisors and institutions like the IMF, who are concerned that if private credit remains opaque and continues to grow under limited prudential oversight, the vulnerabilities of the private credit market could give rise to systemic risk. The revised securitisation framework can provide a solution by bringing more securitisation issuance into the highly supervised and regulated public markets.

3. ARTICLE 7 – TRANSPARENCY REQUIREMENTS - ADDITIONAL COMMENTS RELATING TO SECTIONS 5.5 AND 12.10 OF THE ONLINE RESPONSE

As noted in our comments in Section 5 of the response to the Consultation, we do not support any of the European Commission’s proposed options for the transparency regime under Article 7 of the SECR. We are concerned that none of the three proposed options would adequately address the needs of the entire securitisation market, including transactions involving third countries. However, we propose an alternative option - ‘Option 4’ - which we believe would yield significant benefits for the entire securitisation market.

We have specific concerns regarding the distinction between “public” and “private” securitisation. Any option that broadens the parameters defining what constitutes a “public” securitisation could adversely impact the reporting requirements for third country securitisations and inadvertently encompass private EU and non-EU transactions that have a technical listing. This could lead to burdensome reporting obligations, creating disincentives for structuring transactions as securitisations. Consequently, we would support any option where the distinction between “public” and “private” applies solely to securitisations issued within the EU, specifically those involving EU sell-side parties, while carefully considering any listing triggers. For third country securitisations, it may be more pragmatic to adopt a “sufficient information” test like that in the UK, as discussed in our response to Question 12.7 of the Consultation. This approach would help mitigate competitive disadvantages for EU investors.

Alternatively, if the EU reforms simplify reporting for “private” securitisations, it should be feasible for third country transactions to benefit from this simplification, irrespective of whether they are publicly placed. If a transaction is subject to the public offer regime in its respective third country jurisdiction, it is likely to be governed by other regulatory requirements (e.g., UK securitisations will need to produce UK reporting templates, and U.S. SEC-registered ABS will be subject to applicable disclosure and reporting rules in the U.S.).

If the desire is to create a level playing field between EU and non-EU reporting standards, substantial work will be required to enhance current EU reporting templates for third country securitisations, particularly concerning asset-level reporting. We note that the industry has previously provided extensive feedback on this issue, and we anticipate that ESMA will release its feedback statement in December 2024 regarding the outcomes of its consultation on reporting reforms. We are committed to engaging in further consultations with ESMA on this topic to ensure that any proposed reforms to the technical standards for reporting templates both align with the policy objectives of the European Commission reforms to the Level 1 text and provide a viable solution for both EU and third country securitisation reporting requirements.

Additionally, we aim to avoid unnecessary costs for existing securitisation issuers who have established infrastructure and systems to comply with ESMA templates. PIMCO, along with several other major market players, has already implemented the IT infrastructure necessary to adhere to the ESMA reporting templates for the securitisations it issues. If the distinction between “public” and “private” remains, PIMCO would welcome the simplification and removal of template-based reporting for “private” securitisations. However, if template-based reporting continues for “public” deals, meaningful transitional and grandfathering provisions will be essential to minimise market disruption, unnecessary costs, and administrative burdens that such changes may entail.

Finally, regarding access to information, if the simplification of the SECR reporting regime depends on all securitisations being required to report through a securitisation repository, careful consideration must be given to the concerns surrounding private and third country securitisations. This approach will only be practical if the existing securitisation framework is amended to ensure that all regulatory supervisors can automatically access all relevant information. At the same time sell-side parties should have the option to store their deal information in a “private” space, allowing them to control access for potential investors. Furthermore, reporting of third country securitisations to a securitisation repository should be voluntary rather than mandatory. The securitisation framework should be adjusted accordingly to facilitate such reporting, which will require further consultation with the industry.

4. CONCLUSION

We appreciate the opportunity to share our insights and recommendations regarding the regulatory framework for securitisations. We believe that by addressing the limits imposed by the current UCITS Directive and enhancing the due diligence and transparency requirements, the EU can foster a more robust and accessible securitisation market. We look forward to further discussions with the European Commission to explore these proposals and contribute to the development of a regulatory environment that supports sustainable growth and innovation in the securitisation space.

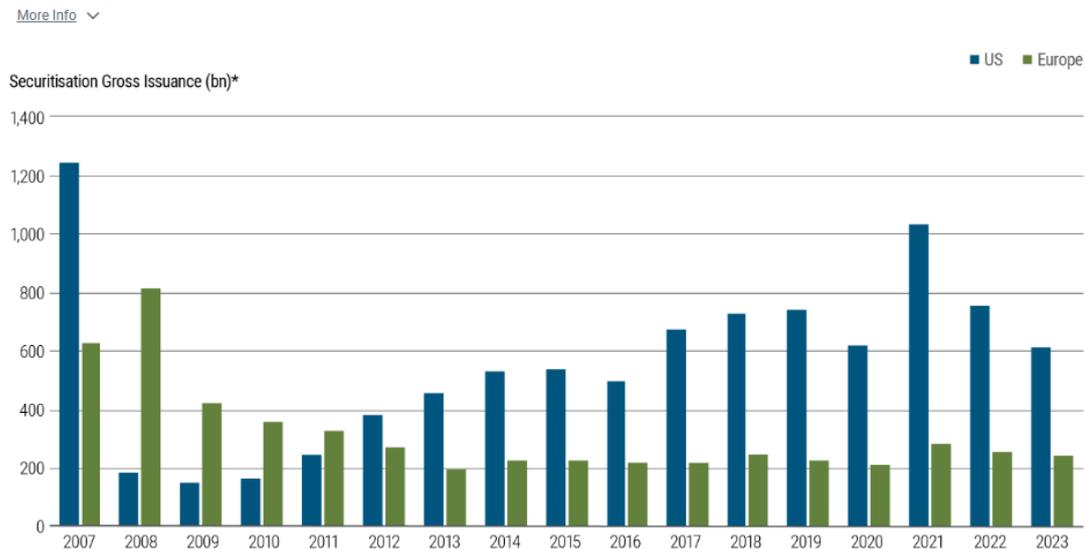
Yours sincerely,

APPENDIX 1

Section 12.7 – Additional data illustrating how U.S. securitisation issuance has outpaced European issuance since the GFC.

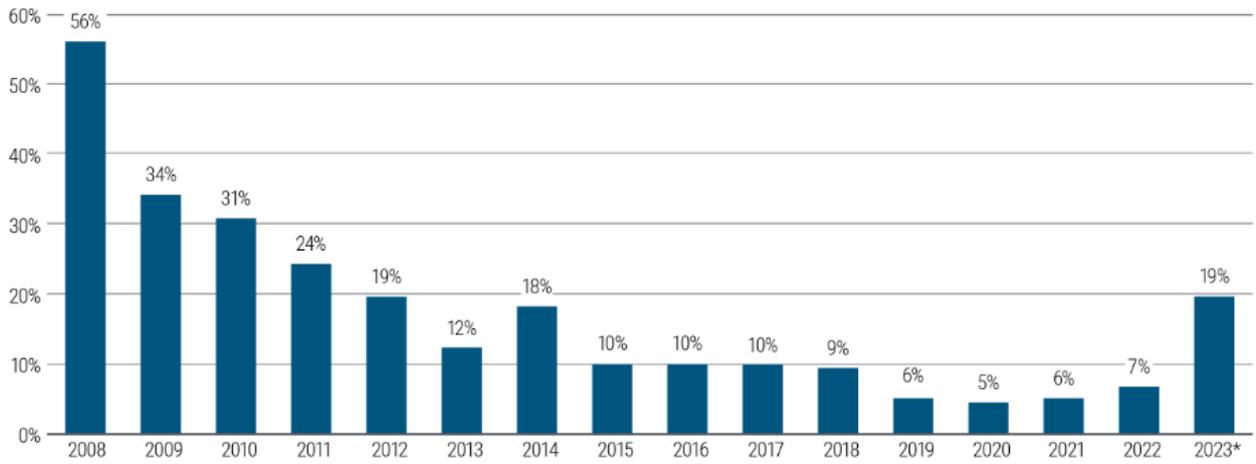
We again refer to our article *“Navigating the challenges: EU Securitisation Regulation and its effects on investors and markets”* and copy below Figure 1 from the article that illustrates how post-GFC regulations have contributed to a reduction in issuance and fewer investment opportunities in the European securitisation markets over the past decade. With securitisations being a very efficient and important tool for funding and financing the economy, the US has a significant advantage in this respect. PIMCO appreciates the European Commission is considering regulatory revisions with a focus on increasing the investment opportunity set and, by extension, increasing the opportunity set for investments within UCITS vehicles. In the above-mentioned article, we also touched on the fact that a large proportion of European mortgages are not sold into securitisation vehicles, rather kept on bank balance sheets and banks continue to be predominant credit channel in Europe. We believe that a) a proportionality-based approach to SECR. b) removal of the 10% issuer limit with respect to securitisations for UCITS and c) reform of the EU Transparency Requirements, in particular, as they apply to non-EU securitisations could give a significant boost to the overall European securitisation platform by incentivising originators and banks to issue more securitisations, which we believe would be catalysed through an increase in demand from institutional investors.

Figure 1: US securitisation issuance has outpaced European issuance since the financial crisis



Source: J.P. Morgan as of 31 December 2023. Securitisation issuance includes asset-backed securities (ABS), non-agency residential mortgage-backed securities (MBS), collateralised loan obligations (CLOs), and commercial MBS. * US issuance in US dollars; Europe issuance in euros. Europe figures include both distributed and retained issuance.

Eurozone RMBS issuance as % of eurozone mortgage originations



Source: European Mortgage Federation Hypostat, European Mortgage Federation National Experts, European Central Bank, National Central Banks, J.P. Morgan as of 31 December 2023. * Data is preliminary.

APPENDIX 2

How should the Article 56 of the UCITS Directive be amended?

PIMCO has considered the provisions of Article 56 of the UCITS Directive and proposes the following revised wording for an exemption for securitisations in Article 56, presented below in italics. We believe that this amendment will better align the regulatory framework with the characteristics of securitisation investments. We welcome the opportunity to engage in further discussion with the European Commission team to explore the implications of this proposal and to consider potential refinements:

“Article 56

1. An investment company or a management company acting in connection with all of the common funds which it manages, and which fall within the scope of this Directive shall not acquire any shares carrying voting rights which would enable it to exercise significant influence over the management of an issuing body.

Pending further coordination, Member States shall take account of existing rules defining the principle stated in the first subparagraph in the law of other Member States.

2. A UCITS may acquire no more than:

- (a) 10 % of the non-voting shares of a single issuing body;
- (b) 10 % of the debt securities of a single issuing body;
- (c) 25 % of the units of a single UCITS or other collective investment undertaking within the meaning of Article 1(2)(a) and (b); or
- (d) 10 % of the money market instruments of a single issuing body.

The limits laid down in points (b), (c) and (d) may be disregarded at the time of acquisition if at that time the gross amount of the debt securities or of the money market instruments, or the net amount of the securities in issue, cannot be calculated. *Point (b) may also be disregarded where the relevant debt securities constitute an investment in a securitisation as defined in Article 2(1) of Regulation (EU)2017/2402 of the European Parliament and of the Council.*”

We acknowledge that, from the general UCITS policy perspective, it is important that any securitisation-specific amendments are in line with the spirit of Article 56. Our review of the background materials related to Article 56 (historically Article 25 and then Article 51), reveals a lack of securitisation-specific discussions.

Specifically, the “Vandamme report”¹² explains the thinking behind the provisions of the original UCITS Directive and discusses the acquisition limits in the section entitled (emphasis added)

“Application of the principle prohibiting UCITS from pursuing a takeover policy” (see paragraph 108 onwards):

- a. there were concerns relating to the safeguards needed to ensure that UCITS may not acquire any shares carrying voting rights that would enable it to exercise “significant

¹² <https://op.europa.eu/en/publication-detail/-/publication/8c53197e-f1ae-45c8-8edb-0def73559d0b>

influence over management of an issuing body,” but this is clearly not relevant for non-convertible debt securities (including securitisations);

- b. the report contains very limited discussion on the thinking behind the acquisition limits for debt securities and simply notes that (see paragraphs 110-111, emphasis added):

*“In the case of transferable securities carrying no voting rights, the Directive stipulates that an investment company or a unit trust (not, in this instance, a management company acting in connection with all of the unit trusts which it manages) may acquire no more than: [...] 10% of the debt securities of any single issuing body;[...] These provisions call for several comments. (a) **The limit on the acquisition of transferable securities carrying no voting rights is to be seen as a reinforcement of the rule requiring risks to be spread.** (b) **Rather than rely on the criterion - which is open to discussion - of "significant influence that can be exercised over the management of an issuing body", a number of Member States had found it preferable in their legislation to express this concept of significant influence in quantitative terms, to which end they had set a percentage limit [...]**”*

Further amendments in later years to the UCITS Directive did not provide any additional background materials regarding the reasons behind the 10% limit for debt securities.

The first European securitisation was issued after the original UCITS Directive came into effect. Article 56 of the UCITS Directive appears to have been primarily drafted with operating entities (e.g. ordinary corporate issuers) as the “issuing body” in mind, aiming to ensure that a UCITS fund did not assume control, or exercise significant influence over any ordinary corporate issuer. This focus seems to overlook the unique nature of securitisations issued by orphan SSPEs. In addition, it appears a further aim behind the 10% limit for debt securities was to ensure spread of risk and prevent a UCITS fund from holding investment portfolios with overly concentrated exposures to individual issuers. In this regard, it is important to note that most securitisations inherently have diversification embedded in the structure due to the granularity of the underlying assets - for example, residential mortgage-backed securitisations can be collateralised by thousands of underlying mortgage loans.

APPENDIX 3

Include PIMCO Published Paper **Navigating the Challenges: EU Securitisation Regulation and its Effect on Investors and Markets**

<https://www.pimco.com/gb/en/insights/navigating-the-challenges-eu-securitisation-regulation-and-its-effects-on-investors-and-markets>