Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York

September 17, 2021

Via European Commission website portal

DG FISMA
European Commission
Rue de Spa, 2
1000 Bruxelles

Re: European Commission's consultation on the functioning of the EU Securitisation Framework

Dear Sir/Madam,

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to represent the views of the alternative investment industry in this written response to the European Commission's consultation on the functioning of the EU Securitisation Framework (the "**Consultation**").[2]

MFA supports the Commission's capital markets union ("**CMU**") action plan and its review of the current regulatory framework for securitisation under the Securitisation Regulation ("**SECR**") to enhance banks' credit provision to EU companies, in particular small and medium-sized enterprises, to scale-up the securitisation market in the EU.

We also support efforts to enhance the integration and interoperability of EU and U.S. markets for alternative assets, and we are keen to serve as a resource to the Commission in this regard.

Many MFA members are active participants in the U.S. and EU credit sectors and a number of these investment managers market their alternative investment funds ("**AIFs**") into the EU under Article 42 of the Alternative Investment Fund Managers Directive ("**AIFMD**"). Some manage funds that invest in fixed income/credit instruments globally, including instruments that may fall within the definition of a "securitisation position" under the SECR. Such members have thus had to consider the issue of whether they are "institutional investors" to whom the SECR's due diligence requirements might apply.

MFA is of the view that the Commission should clarify and confirm that non-EU AIFMs do not have to comply with the due diligence obligations set out in Article 17 of the AIFMD and Article 5 of the SECR with respect to those AIFs that they manage and/or market in the EU.

If a U.S. AIFM that markets its AIFs into the EU were to be subject to the SECR due diligence requirements, that U.S. AIFM would not be able to carry out its investment strategy, since it would not be able to invest in many securitisation transactions. This in turn would result in that U.S. AIFM not marketing such AIFs into the EU. The result of the above is that EU professional investors who wish to obtain exposure to such U.S. (and other non-EU) securitisations will not be able to properly review all the opportunities available, since U.S. AIFMs would decline to present their funds to EU investors.

[1] MFA represents the global alternative investment industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 140 member firms collectively manage nearly $1.6 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. MFA has a global presence and is active in Washington, London, Brussels, and Asia.
[2] https://ec.europa.eu/info/consultations/finance-2021-eu-securitisation-framework_en.

That in turn would negatively affect the competitiveness of the EU's financial market, which would be contrary to the aims of the EU's Capital Markets Union project.

We agree that a non-EU AIFM marketing its AIFs to EU investors should be required to comply with disclosure and reporting requirements to EU NCAs and to investors. However, operating conditions and other organizational matters such as regulatory capital, conflicts of interest, risk management, liquidity management, valuation, and investment restrictions such as the SECR due diligence requirements, should be a matter for the non-EU AIFM's home country regulator.

We have accordingly focused our comments on the issues in Section 4 (*Jurisdictional scope*) of the Consultation, and in particular Question 4.5 on the application of the due diligence obligations under Article 5 of the SECR on non-EU AIFMs.

We have set out our response to Question 4.5 in the Annex hereto.

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MFA appreciates the opportunity to provide these comments to the European 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 the undersigned at (202) 730-2600.

Respectfully submitted,

/s/

Michael Pedroni
Executive Vice President and Managing Director
Global Markets & Research
MFA

Annex

MFA's Response to Question 4.5 of the Consultation

Question 4.5. Should the SECR and the Alternative Investment Fund Managers Directive (AIFMD) be amended to clarify that non-EU AIFMs should comply with the due diligence obligations set out in Article 17 of the AIFMD and Article 5 of the SECR with respect to those AIFs that they manage and/or market in the Union?

No.

Article 5 of the SECR imposes certain due diligence requirements on "institutional investors" investing in securitisation positions.

The definition of "institutional investor" in Article 2(12)(d) of the SECR includes:

> *"an alternative investment fund manager (AIFM) as defined in point (b) of Article 4(1) of Directive 2011/61/EU that manages and/or markets alternative investment funds in the Union"*

Article 17 of the AIFMD (as amended by the SECR) provides:

> *"Where AIFMs are exposed to a securitisation that no longer meets the requirements provided for in [the SECR], they shall, in the best interest of the investors in the relevant AIFs, act and take corrective action, if appropriate."*

In the *ESAs' Opinion to the European Commission on the Jurisdictional Scope of Application of the Securitisation Regulation* (25 March 2021), the European Supervisory Authorities ("**ESAs**") expressed the view that:

> *"The SECR and AIFMD should be amended to ensure that non-EU AIFMs comply with the due diligence obligations set out in Article 17 of the AIFMD and Article 5 of the SECR with respect to those AIFs that they manage and/or market in the Union. The goal is to ensure an appropriate level of protection for EU investors investing in AIFs marketed by non-EU AIFMs."*

MFA disagrees with the ESAs' view and strongly encourages the Commission not to adopt the above view for the reasons set out below.

<u>REASON 1: OBLIGATIONS OF AUTHORISED, EU AIFMS VS. UNAUTHORISED, NON-EU AIFMS</u>

The securitisation due diligence requirement that is set out in Article 5 of the SECR was originally introduced into EU financial services legislation by the addition of a new Article 122a to the Capital Requirements Directive ("**CRD**") in 2010. The requirement was then extended to apply to AIFMs by the original Article 17 of the AIFMD; and later also to insurance and reinsurance undertakings pursuant to the Solvency II Directive ("**Solvency II**").

In this regard, we note that the AIFMD has been carefully crafted with a clear delineation between:

- rules that apply to authorised AIFMs – that is, AIFMs authorised in EU member states (prior to any activation of the AIFMD third country passport provisions); and
- rules that apply to unauthorised, non-EU AIFMs marketing AIFs into individual EU member

states under individual national private placement regimes ("**NPPRs**") pursuant to Article 42 of the AIFMD.

The careful balance above was struck so that authorised, EU AIFMs would have the ability to market their AIFs across the whole of the EU by using the AIFMD marketing passport, while non-EU AIFMs would not have that passport, and instead would have to rely on the NPPRs, which are available only in some EU member states, with varying degrees of accessibility.

In particular, under the above framework, unauthorised, non-EU AIFMs marketing AIFs into the EU under Article 42 of the AIFMD are subject only to the provisions of Articles 22-24, and 26-30 of the AIFMD.

Notably, Article 17 of the AIFMD – both in its original form and as amended by the SECR – applies only to authorised AIFMs; it does not apply to unauthorised, non-EU AIFMs marketing AIFs into the EU under Article 42 of the AIFMD.

Consequently, if Article 2(12)(d) of the SECR was interpreted to apply to unauthorised, non-EU AIFMs that market their AIFs into the EU, then the following would be the result:

- both authorised EU AIFMs and unauthorised EU AIFMs would need to observe the obligations outlined in Article 5 of the SECR; however
- an authorised EU AIFM would be required under Article 17 of the AIFMD to take corrective action where that AIFM is exposed to a securitisation that no longer meets the requirements provided for in the SECR; whereas
- an unauthorised, non-EU AIFM would ***not*** be required to take such corrective action.

The above result clearly indicates that the co-legislators did not intend for unauthorised, non-EU AIFMs to be brought within the institutional investor definition in Article 2(12)(d) of the SECR. We explore this intention further in Reason 2 below.

<u>REASON 2: ARTICLE 5 SECR and ARTICLE 17 AIFMD WERE NEVER INTENDED TO APPLY TO UNAUTHORISED, NON-EU AIFMS</u>

Question 4.5 asks if the SECR and the AIFMD should be amended to "clarify" that non-EU AIFMs should comply with the due diligence obligations. The question therefore suggests or implies that it was the co-legislators' intention in the SECR and AIFMD to impose the due diligence obligations on non-EU AIFMs that market their AIFs in the EU.

MFA is strongly of the view that there was no intention on the part of the co-legislators, either under the AIFMD or the SECR, to impose the due diligence obligations on non-EU AIFMs that market their AIFs in the EU.

In relation to Article 17 of the AIFMD, as noted in Reason 1 above, no clarification is required, since Article 42 of the AIFMD expressly does not apply Article 17 of the AIFMD to non-EU AIFMs that market their AIFs in the EU.

In relation to the SECR, MFA is of the view that it is clear the co-legislators did not intend to extend the due diligence obligation, which had been in existence in the AIFMD text since 2011, to non-EU AIFMs that market their AIFs in the EU.

To begin with, MFA notes the Commission's statement in the Introduction section of the Consultation

regarding "enhancing legal clarity via codifying the sectoral rules governing the EU securitisation market in a single regulation" *i.e.* codifying the sectoral rules in the SECR.

As noted in Reason 1 above, the sectoral rules governing the EU securitisation market were, prior to the introduction of the SECR, set out in the CRD (for authorised credit institutions and certain investment firms), Solvency II (for authorised insurance and reinsurance undertakings), and the AIFMD (for authorised AIFMs).

The purpose of the SECR was, as the Commission notes in the Consultation, to codify existing sectoral rules into a single EU regulation, the SECR. In particular, in relation to the Article 5 SECR due diligence requirement, the SECR was not intended to create a new set of obligations for non-EU AIFMs. That is evident from the fact that Article 29 (*Designation of competent authorities*) of the SECR, in providing for the supervision of compliance with the obligations set out in Article 5, refers back to the underpinning sectoral legislation, including the AIFMD for AIFMs. As noted in Reason 1 above, the penalty provision in the AIFMD was specifically set out in the amended Article 17 of the AIFMD, which clearly does not apply to non-EU AIFMs.

We note also that the transitional provision in Article 43(6) of the SECR provides that:

> "*alternative investment fund managers (AIFMs) as defined in point (b) of Article 4(1) of Directive 2011/61/EU* ***shall continue to apply*** *… Article 51 of Delegated Regulation (EU) No 231/2013*"; (Emphasis added)

The words "shall continue to apply" clearly indicate that there was no intention to change the scope of AIFMs that were caught by the SECR due diligence requirements.

Moreover, we note that, in the Explanatory Memorandum set out in the Commission Proposal for the SECR (2015/0226 (COD), the "**Commission Proposal**"), the Commission made clear that the policy intention of the SECR was simply to consolidate the various risk retention and due diligence requirements from the various pieces of legislation (CRD/CRR, AIFMD, Solvency II) into a single regulation. Specifically, the Explanatory Memorandum states:

> *"the EU securitisation framework is* ***drafted where relevant in line with the existing definitions and provisions in Union law on disclosure, due diligence and risk retention****. This will ensure that the market can continue to function on the basis of the existing legal framework where that framework is not amended…"* (At page 8; emphasis added)

> "*Whereas existing EU law provides in the credit institutions, asset management and insurance sector already for certain rules, these are scattered amongst different legal acts and they are not always consistent.* ***The first part of the proposal therefore puts the rules in one legal act, thus ensuring consistency and convergence across sectors****, while streamlining and simplifying the existing rules. As a consequence the sector-specific provisions on the same topic would be repealed."* (At page 13; emphasis added)

The Commission Proposal even contained a section on the "Third country dimension" of the SECR, where it is again clear that the SECR was intended to apply only to EU institutional investors:

> *"****EU*** *institutional investors can invest in non-EU securitisations and will have to perform the same due diligence as for EU securitisations…"* (At page 17; emphasis added)

Accordingly, MFA is of the view that it is clear there was never any intention for the SECR to extend

the due diligence obligation, which had been in existence in the AIFMD text since 2011, to non-EU AIFMs that market their AIFs in the EU.

REASON 3: THE SECR DEFINITION OF INSTITUTIONAL INVESTOR REFLECTS THE EXISTING SECTORAL SCOPE

Next, we note also that the intention simply to codify the existing sectoral rules is in fact reflected in the definition of "institutional investor."

The term "institutional investor" simply codifies in a single definition each of the types of financial institutions that were already subject to the pre-existing due diligence requirements imposed by the CRD/CRR, Solvency II and AIFMD (and then introducing new institutions into the definition, namely UCITS and institutions for occupational retirement provision).

For example, Article 2(12)(g) of the SECR refers to:

> *"a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013 for the purposes of that Regulation…"*

The term "credit institution" is not defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013 (the "**CRR**") by reference to any authorisation status or jurisdictional scope; rather, the definition simply refers to "an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account".

Yet it is accepted and clear that only authorised EU credit institutions would fall under the definition in Article 2(12)(g) of the SECR, and not also non-EU credit institutions. That is because, as discussed in Reason 2 above, the intention of the SECR was simply to codify into a single EU regulation the existing sectoral rules. There is no need to refer to "authorised" credit institutions in Article 2(12)(g) above, since the reference to credit institutions is clearly a reference to credit institutions that were already subject to the pre-existing due diligence requirements imposed by the CRD/CRR.

In the same way, the reference in Article 2(12)(d) of the SECR refers to *"an alternative investment fund manager (AIFM) … that manages and/or markets alternative investment funds in the Union"* is intended simply to refer to the pre-existing due diligence requirements imposed on authorised, EU AIFMs under the AIFMD.

MFA is thus of the view that, as a matter of legislative interpretation, unauthorised, non-EU AIFMs should not be considered to fall within the definition of "institutional investor" in the SECR.

REASON 4: POLICY OBJECTIVES

Since the SECR came into effect in January 2019, some of our members who are U.S. AIFMs have expressed concern that, despite all the reasons discussed above, one or more EU member state national competent authorities ("**NCAs**") might seek to interpret the SECR such that unauthorised, non-EU AIFMs fall within the definition of "institutional investor". That has resulted in some U.S. AIFMs deciding not to market their AIFs to EU investors.

In particular, U.S. AIFMs managing AIFs that invest in securitisation positions largely invest in U.S. securitisation transactions (and other non-EU transactions). Although the U.S. Securities and Exchange Commission has imposed securitisation risk retention rules directly on originators and sponsors, those U.S. risk retention rules do not satisfy the due diligence requirements in Article 5 of the SECR. In

addition, U.S. open market collateralised loan obligation (CLO) transactions are exempted from the U.S. risk retention obligation altogether and so also would not satisfy Article 5 of the SECR.

If a U.S. AIFM that markets its AIFs into the EU were to be subject to the SECR due diligence requirements, that U.S. AIFM would not be able to carry out its investment strategy, since it would not be able to invest in many securitisation transactions. This in turn would result in that U.S. AIFM not marketing such AIFs into the EU.

The result of the above is that EU professional investors who wish to obtain exposure to such U.S. (and other non-EU) securitisations will not be able properly to review all the opportunities available, since U.S. AIFMs would decline to present their funds to EU investors. That in turn would negatively affect the competitiveness of the EU's financial market, which would be contrary to the aims of the EU's Capital Markets Union project.

As a policy matter, MFA believes it is appropriate that – as contemplated by Article 42 AIFMD – a non-EU AIFM marketing its AIFs to EU investors should be required to comply with disclosure and reporting requirements to EU NCAs and to investors. However, operating conditions and other organizational matters such as regulatory capital, conflicts of interest, risk management, liquidity management, valuation, and investment restrictions such as the SECR due diligence requirements, should be a matter for the non-EU AIFM's home country regulator. Among other things, the non-EU AIFM's home country regulator would be in a better position to supervise and enforce such requirements.

CONCLUSION

For the above reasons, MFA is of the view that the Commission should clarify and confirm that non-EU AIFMs do ***not*** have to comply with the due diligence obligations set out in Article 17 of the AIFMD and Article 5 of the SECR with respect to those AIFs that they manage and/or market in the EU.

In this regard, we propose that Article 2(12)(d) of the SECR be amended so that it refers to:

> *"an alternative investment fund manager (AIFM) as defined in point (b) of Article 4(1) of Directive 2011/61/EU* ***that is authorised pursuant to Article 6 of Directive 2011/61/EU.****"*

From the perspective of U.S. AIFMs, this clarification would clear up the existing uncertainty discussed above, and have the resulting benefit of EU professional investors being able to invest in AIFs that invest in U.S./global securitisation and other structured finance transactions and therefore access a broad range of expertise and investment strategies. We believe it would also improve the overall integration and interoperability among the U.S. and EU markets for alternative credit investing.