STRUCTURED FINANCE ASSOCIATION

TARGETED CONSULTATION ON THE FUNCTIONING OF THE EU SECURITISATION FRAMEWORK

October 1, 2021

Firm name: Structured Finance Association

1.	**Effects of the regulation**					
1.1.	Has the Securitisation Regulation (SECR) been successful in achievingthe following objectives:					
	Fully agree	Somewhat agree	Neutral	Somewhat disagree	Fully disagree	No opinion
Improving access to credit for the real economy, in particular for SMEs						✓
Widening the investor base for securitisation products in the EU					✓	
Widening the issuer base for securitisation products					✓	
Providing a clear legal framework for the EU securitisation market				✓		
Facilitating the monitoring of possible risks						✓

Providing a high level of investor protection	✓					
Emergence of an integrated EU securitisation market						✓

Structured Finance Association (SFA) members are in general agreement with the below responses that we understand have been submitted by the Association for Financial Markets in Europe (AFME) to the Targeted Consultation on the Functioning of the EU Securitisation Framework (Consultation), with some variation given differences in the US and EU markets. In support of alignment across global securitization industries, SFA understands that the Australian Securitization Forum (ASF) is submitting a similar response.

Our answers to the matrix above vary slightly from those of AFME and ASF to account for the variations in each jurisdiction. Our selections of "fully disagree" concerning the widening of the issuer and investor base for securitisation products and "somewhat disagree" for providing a clear legal framework for the EU securitisation market are on the basis that the Article 5(1)(e) issue has potentially affected all of these areas for third country securitisations.

Our selection of "fully agree" concerning the providing of high level investor protection is based on our belief that EU investors are equipped with protection if they invest in a US deal, thus producing a proportionately reasonable and sufficient level of information.

We welcome the opportunity to respond to the Consultation and would be happy to answer any further questions that you may have.

1.2. If you answered 'somewhat disagree' or 'fully disagree' to any of the objectives listed in the previous question, please specify the main obstacles you see to the achievement of that objective.

<u>Market access</u>

We support the below AFME response on this point:

Another broad thematic challenge that needs to be addressed in the context of the Article 46 Review is that of market access. Consideration will need to be given to the fact that most publicly-placed EU securitisations will require access to investors in third countries such as the UK, US or those in the APAC region. The result is that public securitisations, even where the sell-side entities are entirely based in the EU, will often need to consider and (to some degree) comply with the requirements of those third countries.

That is not to say that the EU should necessarily seek alignment in all areas with the rules in those jurisdictions, but considerable weight should be attached to the interoperability of the regimes such that EU entities seeking access to investors in other markets will not have unnecessary burdens imposed on them by having to comply with multiple regulatory regimes.

Likewise, EU investors seeking to invest in third country securitisations need mirroring flexibility of their own.

The broader point is that consideration of EU rules cannot be done in a vacuum, because the reality of operating in a global capital market is that EU market participants will frequently have to consider third countries' regulations (mainly those of the UK and US) even where those regulations do not directly apply to them.

<u>Widening the investor base for securitisation products in the EU</u>

We support the below AFME response on this point:

The main effect of the SECR on investors in securitisation is to implement wide-ranging, detailed, and onerous due diligence requirements that require investors to verify a number of matters, some of which they would not otherwise be concerned with. These detailed diligence requirements, which are unique to securitisation (and for which there is no equivalent in respect of much riskier investments such as, for example, equity investment in emerging markets) represent significant barriers to entry. This partially explains the reduction in investor base for securitisation products over the years since the introduction of the SECR.

Not only are new investors discouraged from entering the market, but also some existing investors have exited the market or reduced their allocation to securitisation partly in response to both (i) the substantive outcomes of these new regulations; and (ii) the prudential regulatory incentives. We would also stress that the complexity of the regime has discouraged investors – and in particular small and mid-size investors – from entering the market, even where their sophistication would otherwise make securitisation investments appropriate. This concentrates the investor base even further.

The differences in attitudes of investors to, for example, ABCP between the EU and the US is remarkable and instructive on this point. AFME members report that this is linked to the relative attractiveness of the products in the two jurisdictions, which derives largely from their regulatory treatment in each jurisdiction – including the eligibility of ABCP for central bank liquidity operations, where unfortunately the treatment of ABCP under the ECB collateral framework is considerably less generous. This is despite the widening of such schemes recently to much more risky investments such as Additional Credit Claims.

We would also point out that in the context of EU investor access to third country securitisations, the uncertainty around the application of Article 5(1)(e) to third country securitisations has adversely impacted the availability of such products to the EU investor base. This point is discussed in more detail in our response to questions 3.1 and 4.4.

Widening the issuer base for securitisation products

The uncertainty around the application of Article 5(1)(e) to third country securitisations has adversely impacted the available third country issuer base for EU investors. This point is discussed in more detail in our response to questions 3.1 and 4.4.

Providing a clear legal framework for the EU securitisation market

We support the below AFME response on this point:

Significant legal questions remain unresolved and unclear or in a state of uncertainty. By way of example, these include the due diligence requirements on institutional investors under Article 5(1)(e) when investing in non-EU securitisations. This point is discussed in more detail in our response to questions 3.1 and 4.4.

Providing a high level of investor protection

We support the below AFME response on this point:

Undoubtedly the SECR regime provides a high level of investor protection for retail clients, because Article 3 SECR imposes significant limitations on the ability to sell securitisations to this investor base. We support the restrictions in Article 3 and are not aware of any securitisations being sold to retail clients in the EU in recent years.

The 5% risk retention requirement is a core aspect of the investor protection framework which we support.

The SECR regime also provides a high level of investor protection for institutional investors, but we consider that in some cases this level of protection is not appropriately calibrated in that it imposes costs that are disproportionate to the benefits of the protections conferred once account is taken of institutional investors' significantly greater potential to protect themselves via due diligence and independent credit analysis.

The requirements for extensive disclosure under Article 7, for risk retention under Article 6, relating to the choice of underlying assets (adverse selection rules in Article 6(2) and rules relating to credit granting criteria in Article 9) and the ban on re-securitisation under Article 8 all provide protection which as a whole reduces risk. The same is true with the detailed diligence requirements under Article 5.

However, we believe that these reductions in risk are not achieved in a proportionate manner. The purpose of financial markets is to allocate risk efficiently by appropriately remunerating those willing and able to take risks.

- In particular, we support AFME’s suggestion of a principles-based, proportionate approach to investor protections (rather than the current formal and prescriptive transparency and reporting requirements) such that: Ensuring investing in securitisation markets is limited to professional investors capable of understanding securitisation investments and absorbing credit losses to the extent that risks are realised. This is largely already achieved by the restrictions in Article 3 SECR.

- Ensuring EU sell-side (including third country originators, sponsors and issuers) entities supply appropriate information on the securitisation structure and underlying exposures (including asset selection criteria) to permit investors to undertake a well-informed analysis of their prospective investment at a level of granularity appropriate to the transaction and the underlying assets. Our view is that this point is particularly appropriate for third country transactions which already provide an appropriate and proportionate level of information to enable a sophisticated investor to carry out sufficient due diligence. We do not think it makes sense to prevent a sophisticated EU investor from investing in a third country transaction simply because that transaction does not provide the same level of reporting as the SECR Article 7 disclosure requirements and does not provide granular loan-by-loan level information. Investors are required to undertake a level of diligence appropriate to the size, jurisdiction, risk and tenor of their exposure, and document their due diligence process accordingly. In the context of third country (non-EU) securitisations, EU institutional investors should be able to carry out proportionate due diligence and should be able to give appropriate consideration to the information made available to them in compliance with applicable third country regulatory regime and/or applicable third country market practice. The imposition of stricter and less proportionate due diligence requirements, such as mandatory EU template-based loan-level data reporting, would prevent EU institutional investors from investing in well-developed and well-established third country securitisation markets which impacts the ability of the EU investors to diversity their investment portfolios, leading to geographical concentration risks and less liquid securitisation markets, ultimately pushing EU institutional investors' lending into less regulated forms of financing. In this regard we fully support the Capital Markets Union High Level Forum's (CMU HLF) report's recommendation to introduce more flexibility to the SECR framework as regards institutional investors' verifications. Specifically, we support the CMU HLF's recommendation to allow an EU-regulated investors in third country securitisations to determine whether it has received sufficient information to meet the requirements of Article 5 to carry out its due diligence obligation proportionate to the risk profile of such securitisation (we also refer you in this regard to the SFA feedback to the European Commission on the CMU HLF report, linked here). For example, the lack of loan-by-loan information on a third country securitisation with a highly granular pool (as would be the case in a U.S. credit card ABS) should not prohibit an EU investor from investing in such securitisation (in this regard we also refer you to the SFA letter with further details on existing loan-level disclosure practices in the U.S. ABS market, linked here).

3. Due diligence

The transparency regime in the SECR requires that the originator, sponsor and SSPE of a securitisation make a range of information available to the holders of the position, to competent authorities and, upon request, to potential investors. The information is provided via templates and is intended to enhance the transparency of

the securitisation market as well as to facilitate investors' due diligence and the supervision of the market. The following questions aim to find out whether the information that is currently provided to investors is appropriate, sufficient and proportionate for their due diligence purposes and whether any improvements can be made.

3.1. Do you consider the current due diligence and transparency regime proportionate?

Yes
No
No opinion

Please explain your answer.

We support the below AFME response on this point, particularly in relation to third country securitisations. We also support AFME submissions that identified concerns and issues that arise as a result of the lack of coordination between the application of the SECR regime and other EU regulatory regimes, such as the Prospectus Regulation in relation to the requirement that overlap with the SECR requirements relating to the disclosure of the core transaction documents.

There are some benefits, but for the reasons set out above, we do not believe that the regimes are proportionate. The disproportionality is much more acute for private securitisations than for public securitisations, but it exists in both cases. If Article 5(1)(e) were to be interpreted restrictively to require full EU-style disclosure from non-EU sell-side entities then that would be especially disproportionate. See our answer to question 4.4 below.

On public securitisations, the disproportionality comes mainly in these forms:

- Due diligence obligations in relation to third country securitisations: This is especially problematic with respect to Article 5(1)(e) and could be resolved by a more flexible and proportionate application of the requirement to conduct regulatory due diligence. This would ensure EU investors can invest on a level playing field with third country investors, and help them to optimise their risk:return ratio by diversifying geographically while ensuring they take appropriate measures to understand the investments they are making.

- Loan-level data: This data is not required in order to make a well-informed investment decision in respect of securitisations of highly granular and homogenous asset classes.

    - By way of example, for credit card securitisations pool-level characteristics, trends and statistics are far more useful than any information about the (very small) individual receivables making up the pool, as the former will help an investor understand the key parameters affecting their investment over time (e.g. excess spread and payment rate). The latter, on the other hand, will necessarily be out of date by the time data can be reported (due to the shortterm and revolving nature of the underlying receivables) and in any case data on any individual receivable does not materially affect the credit performance of the overall pool.

- Inappropriate templated data requirements: these are not only a problem for public securitisations, but the content of the disclosure templates is often not appropriate to the economics of the transactions.

    - We support the elimination of loan-level data requirements as noted above, but if the loan-level requirement is to be retained then we would support the implementation of this recommendation for new, simplified templates.

    - There are other instances where templates may simply not be sufficiently flexible to be meaningfully completed. For example, certain mortgage loans can be connected to both commercial and residential properties (e.g. a shopkeeper who lives above their shop). In this case, the originator would have to choose between the RMBS and CMBS template, but both are likely to include irrelevant information the originator would not otherwise collect (and where the fields may require information that may not make sense in the circumstances) and which would have limited availability of ND options to provide the required flexibility.

The benefits of current market practices (which are due only in part to the SECR regime) include ensuring that a broader range of investors conduct proper diligence both before investing and in an ongoing manner. In this sense it may have contributed to a more professional and robust securitisation market that is better able to price and manage credit risk. The first real test of this has been the COVID-19 pandemic, which has so far caused no widespread forced selling in the securitisation market and credit spreads have moved largely in line with other fixed income markets. However, these benefits have, we believe, been achieved at the cost of creating barriers to entry so high that the volume of transactions (and therefore the volume of finance provided to the real economy via securitisation) has been much lower than it otherwise could have been. It may thereby have pushed more funds into less regulated forms of financing such as direct lending from funds.

4. Jurisdictional scope

The Joint Committee of the ESAs issued an opinion to the Commission on the jurisdictional scope of the Securitisation Regulation, identifying some elements of the legal text that require clarification. This section of the questionnaire seek feedback on the issues identified by the Joint Committee.

4.2. Where non-EU entities are involved, should additional requirements (such as EU establishment/presence) for those entities be introduced to facilitate the supervision of the transaction?

Yes
No
No opinion

Please explain your answer.

We support the below AFME response on this point:

We feel strongly that additional requirements would be unnecessary and create additional costly and onerous barriers to participation in the market that are not justified by improvements to market functioning or safety. They would tend to reduce the number of non-EU securitisations sold to EU investors thereby increasing geographic concentration risk, reducing liquidity and market depth and creating conditions for increased volatility. EU investors in any case report all of their investments to their own supervisors, so the supervision of EU investors is already assured, regardless of the origin of the transaction.

4.4. Should the current verification duty for institutional investors laid out in Article 5(1)(e) of the SECR be revised to add more flexibility the framework?

Yes
No
No opinion

Please explain your answer.

We refer to our comments made in section 1.2 above, in particular our feedback (linked here) supporting the CMU HLF report's recommendation to introduce more flexibility to the SECR framework regarding institutional investors' verifications. Specifically, we support the CMU HLF's recommendation to allow an EU-regulated investors in third country securitisations to determine whether it has received sufficient information to meet the requirements of Article 5 to carry out its due diligence obligation proportionate to the risk profile of such securitisation.

We also support the below AFME response on this point, particularly in relation to third country securitizations:

Regarding section 1.2.2 of the JSA Opinion on Article 5(1)(e), we agree that either interpretative guidance or further legislation would be helpful here as this has caused some issues for the market. However, we have significant concerns about the impact of the conclusions reached in this section. The articulation of the law as it currently stands in the JSA Opinion is at variance with the understanding of many market participants and it is unclear how the ESAs have come to the conclusion they appear to have reached. It is disappointing that the JSA Opinion does not take account of the difficulty in interpreting and applying Article 5(1)(e) or the market practice developed over the more than two years since market participants first requested guidance on this point. Nor do they appear to have taken account of the considerable difficulties EU institutional investors have had obtaining Article 7 information when investing in third country securitisations. The JSA Opinion is also at odds with the recommendations of the High Level Forum on CMU that Article 5(1)(e) should not apply to third country transactions and that a "proportionate" approach should be considered instead.

This is necessary in particular for EU banks acting through their third country branches or subsidiaries as investors, originators or sponsors of securitisations (including sponsors of ABCP conduits) in connection with third country securitisations with, for example, non-EU originators and/or SSPEs to avoid creating an unlevel playing field when offering asset-backed lending solutions to their clients.

If EU banks are required to obtain SECR-style templated information from their clients, this will put them at a significant competitive disadvantage as compared to their non-EU competitors for those same clients' business.

EU banks and members of their corporate groups investing in third country securitisation lending transactions typically perform a prudent, risk-based assessment of the transactions they are entering into, and already typically receive asset-level data which is sufficient for determining whether their lending criteria have been satisfied before entering into a transaction and on an ongoing basis post-closing. However, this information may be in a format different from the templates prescribed under Art. 7 SECR, e.g. in the form of a loan tape. Providing the information specifically in the form of the Art. 7 SECR templates, or providing additional information or data fields which are not produced or used by that originator in its business (including due to the region specifics – e.g. lack of LEI or NACE codes for which such codes exist but are not typically used or required for non-EU entities/industries), would represent a considerable additional administrative and reporting burden for such originators. Non-EU originators are unlikely to make the significant investment in their information technology systems that would be required solely to satisfy an EU bank or its group member where funding is available from other investors, such as non-EU banks. If Art. 5(1)(e) were to be clarified to require receipt of reporting specifically in the form of the Art. 7 SECR templates, or to require receipt of information corresponding to all the data fields in those templates, this will clearly put EU banks and their group members at a significant competitive disadvantage and greatly diminish their ability to compete in and participate in this market.

It is also important to note that investors in these transactions are typically closely involved in structuring the transactions and would typically review and actively negotiate their terms. Each initial and subsequent investor may have the ability to carry out due diligence before investing in the transaction, receive requested information, both initially and on an ongoing basis, and ask questions from the originator's and/or the servicer's management, in each case either directly or through participation in a syndicate of investors via an agent. This is in contrast to a transaction where the initial information in relation to the transaction is limited to a "take it or leave it" form of offering memorandum or other disclosure document. The lenders generally have the opportunity to carry out due diligence, liaising directly with the originator or through an agent for the lenders, and to consider asset-level data. These transactions are typically structured to extremely high credit standards and monitored diligently.

While we are generally supportive of the availability and use of the equivalence mechanism in EU financial services legislation, we do not believe that a third country equivalence regime with the requirements suggested by the ESAs would provide meaningful flexibility; indeed it would almost certainly put EU institutional investors at a disadvantage by needlessly limiting their investment options. Even the most advanced securitisation markets outside the EU (other than possibly the UK) lack reporting requirements imposed by law that are comparable to those in the EU.

They would therefore likely fail to qualify as "equivalent" under the framework suggested by the ESAs – functionally eliminating the ability of EU investors to make appropriate, measured judgments designed to maximise and diversify their returns and those of their stakeholders.

It would be much more sensible to apply the concept of proportionality of due diligence (in line with the recommendation made in the Final Report of the High Level Forum on the Capital Markets Union of 10 June 2020) to permit EU investors to judge whether they had received sufficient information (including information contractually promised to be provided on an ongoing basis) to make an informed judgment about the risks of taking an investment decision, as they do with virtually every other asset class other than securitisation. This would permit EU investors to make a reasoned judgment in cases e.g. where it is simply not practically possible to provide the exact same information as required under the EU regime, due to jurisdiction-specific features of the assets, jurisdictional differences in legislation or terminology. Needless to say, we also do not believe that it is sensible or proportionate to require any disclosure in respect of third country securitisations to be reported via a securitisation repository, not least because this will often breach contractual obligations or local laws on confidentiality of information, and would therefore risk leading to exclusion of EU investors from transactions in order to avoid these outcomes. This policy position is already recognised by EU law, in the form of recital (13) and Article 7(2) of SECR.

Given the strong misgivings we have expressed above regarding the conclusions reached in the JSA Opinion we urge the Commission and the ESAs to reconsider. We and our members stand ready to engage constructively with the Commission and the ESAs to assist with this process, and to help resolve any underlying concerns. However, if the Commission and ESAs decide to proceed as outlined in the JSA Opinion (which we strongly oppose), then given the potentially significant implications for existing investments in third country securitisations, we stress that in advance of publication of any further commentary, interpretative guidance or legislative proposals, the ESAs should consider the implications and put in place any grandfathering required for EU investors with existing third country securitisation positions.

If you answered 'Yes' to question 4.4, how can it be ensured that the ultimate objective of protecting EU institutional investors remains intact?

We support the below AFME response on this point:

Even with our proposed revisions, we believe that the objective of protecting EU institutional investors would remain intact. We continue to support the policy objectives underlying the Article 5 legal obligation for institutional investors to undertake due diligence – an obligation which is unique to securitisation. It should also be noted that the overall framework also provides other safeguards which address lessons learned from the GFC such as avoiding over-reliance on credit ratings. Lastly it should be noted that, like life, all investment carries risk and the policy objective should not be to seek to exclude it altogether. The question is where the balance should be struck which is why we believe a more proportionate approach is appropriate.

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