STRUCTURED FINANCE ASSOCIATION

Policy Position Paper

in reaction to the proposed amendments to the European securitization framework

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FINANCE
ASSOCIATION

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General Overview and Broad Observations

The Structured Finance Association ("**SFA**") welcomes the European Commission's proposed package of regulatory reforms relating to the securitization market. This package includes proposals to amend the EU Securitization Regulation ("**SECR**"), the EU Capital Requirements Regulation ("**CRR**") and the Liquidity Coverage Ration Delegated Act ("**LCR DA**"), all published on 17 June 2025, as well as a proposal to amend the Solvency II Delegated Act ("**S2DA**") published on 17 July 2025.

As an association **representing participants across the full spectrum of the structured finance and securitization markets** – including lenders, dealers, securities issuers, institutional investors, financial intermediaries, credit rating agencies, law firms, accounting firms, technology firms, servicers and trustees – SFA plays a vital role in the development of market consensus solutions that support efficient and stable markets.[1] While our members often have conflicting views and interests, our governance structure requires consensus from all stakeholders.

While our focus has historically been on the U.S. markets, we have members around the world, including in many EU Member States, and we have been following the early stages of the proposed reforms of the European securitization framework with interest. We see **significant potential in the European securitization markets** and we are encouraged in general by the direction of the reforms. Our goal in participating in the debate on the progress of the reforms is to share our expertise and act as a resource to help develop and grow the European markets in a prudent way that takes account of the lessons learned over the years, including during the Global Financial Crisis ("**GFC**"). Growing, prudent and well-functioning markets accrue to the benefit of all, and SFA looks forward to cooperating with the Commission and the co-legislators to produce the best possible securitization framework to support that outcome while helping to meet Europe's funding needs as outlined in the Savings and Investments Union communication.

Part of the reason we are encouraged by the direction of the reforms is that we believe they represent **a serious step in the direction of simplification** and making the regulatory burden more proportionate. We are aware that, since the GFC, a number of U.S. institutions have limited their involvement in European markets (or avoided it entirely) because the heavy regulatory burdens imposed costs that were out of proportion with the volume of business over which those costs could be spread. We view the Commission's proposals as a serious package of reform that could potentially address these issues and lead to growth – coming in part from U.S. and other third country market participants returning to or increasing their investment in European

[1] SFA is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFA provides an inclusive network for securitization professionals to collaborate and, as industry leaders, to drive necessary changes, to be advocates for the securitization community, to share best practices and innovative ideas and to educate industry members through conferences and other programs. Further information can be found at www.structuredfinance.org.

securitization markets. This participation could come in the form of capital invested, but also in the application of expertise and the facilitation of capital formation.

This paper lays out SFA's views, which are informed by engagement with our membership, which is mainly U.S. institutions, but also includes European stakeholders of all kinds. These views are guided in part by the lessons learned in the U.S. from the GFC that have led to a vibrant, but prudentially sound, securitization market. Our full recommendations are set out in the rest of this paper, but in summary:

- The simplification of **due diligence** requirements proposed is helpful, but does not go far enough. In particular, it misses the opportunity to address Article 5(1)(e) SECR, which functionally prohibits EU institutional investors from investing in most non-EU securitizations, thereby shutting them out of a €2.5 trillion global market and putting them at a competitive disadvantage compared to their global peers. We are also alarmed at the proposal to double up on sanctions for institutional investors while simultaneously removing their ability to delegate their due diligence obligations. This will unquestionably have a chilling effect on a market these reforms are intending to help grow.

- Simplification of **transparency** requirements is a key positive step that SFA strongly supports. Transparency is a key requirement of a well-functioning market, but SFA is keen to ensure that flexibility remains for parties to agree disclosure packages that work for them, particularly where transactions are private in nature. We therefore recommend adjusting the proposed simplified regime by delegating greater discretion to level 2.

- We also recommend narrowing the definition of "**public securitization**" so that it captures only transactions intended to be widely distributed and strengthening confidentiality safeguards so parties can disclose information to public authorities and to each other without fear of wider dissemination of sensitive information.

- SFA supports the removal in respect of securitizations of the **10% limit on UCITS investments** in the debt securities of a single issuer. This is a meaningful barrier to UCITS investments in securitizations which should be removed as soon as possible.

- The moves to make the **bank prudential regime** for securitization more proportionate are welcome. However, we recommend certain adjustments in order to realize the potential of the European markets. In particular, eliminating the changes to the definition of "senior securitization position", capping risk-weight floors at their current levels and ensuring resilience is only tested at the outset of a transaction would all be advisable changes.

- SFA broadly supports the **adjustments to the S2DA**. We think the securitization measures represent a very significant step in the direction of reducing barriers to securitization investment by European insurers and reinsurers.

- We would be delighted to discuss this file further to help develop workable solutions that address the Commission's legitimate policy concerns.

Suggestions to optimize the Commission's proposed measures to revive the European securitization framework

<u>With respect to the Securitization Regulation</u>:

Transparency (Article 7)

- The principles-based approach proposed by the Commission is a very positive step and SFA strongly supports moving in that direction. The **highly prescriptive, detailed templated approach to securitization disclosure is one of the principal barriers** our members have mentioned when explaining reluctance to (further) invest in European securitization markets. Appropriate transparency that allows investors to independently assess a securitization investment is critical to a well-functioning market, but prescribing by legislation the minute detail of data fields which must be reported creates additional barriers to participation in the markets out of proportion to the benefits it creates.

- SFA therefore welcomes the proposal to **rationalize the detailed disclosure templates** so that the regulatory requirements are limited to that which is actually helpful for investors and sensible for originators to produce.

- In order to ensure the most is achieved by this proposal, SFA would recommend **leaving the details about the specific disclosure requirements to the Level 2 phase**. The Level 1 text should instead focus on providing clear guidance on both the powers to set specific disclosure requirements at Level 2 along with clear outcomes the Level 2 is expected to achieve. These could include the following principles:

    - disclosure requirements should be kept principles-based where this is consistent with investors and supervisors receiving necessary information

    - investors should be able to access sufficient information to make an independent assessment of the securitization

    - any requirement to provide a specific piece of information is only made where the utility of that information to investors outweighs the cost of capturing and reporting that information

    - where feasible, specific information requirements should be implemented on a "comply or explain" basis which allows authorities to closely monitor the market and adjust requirements where necessary, but reduces barriers to new and innovative types of securitization financing

    - the ESAs should take into account established market conventions when designing disclosure templates, especially where these are agreed in broad-based industry for a with input from both buy- and sell-side parties

- any standardization benefits are appropriately weighed against the loss of flexibility and disincentive to innovation imposed by that standardization

- prescriptive disclosure templates should be limited to established asset classes, with disclosure left more principles based for new and emerging asset classes

- Such disclosure regime would still require significant disclosure of specific loan level data and remain more prescriptive than the largely principles-based approach in the American market, and the UK is also looking like moving in this direction. A significant **narrowing of the gap between the EU and U.S. disclosure requirements** would be helpful in encouraging U.S. market participants to meaningfully re-engage with the EU securitization markets and help revitalize them. Likewise, avoiding the creation of a competitive disadvantage with the UK would also be helpful.

- An approach more consistent with the general goals set out above could also be considered for public securitizations.

Definition of Public Securitization (Article 2)

- The **proposed definition is too broad** and captures transactions that are not public in substance – which is to say they are neither intended for broad distribution nor for liquid trading. In particular:

    - The **listing criterion is problematic** because listing is often used for purposes of meeting the requirements of individual investors (even when they are buy-to-hold investors) and to gain parity of tax treatment with, e.g., loan finance. It is often not used for achieving wider distribution or greater liquidity of securitization bonds. This criterion would also have the effect of driving listings out of the EU altogether, leading to more difficulty with EU supervision. If a listing criterion is to be retained, it must be much narrower, such that it captures only listings requested by the originator, sponsor or SSPE which are designed to facilitate wide distribution or significant liquidity. The requirement that any listing be requested by the originator, sponsor or SSPE is because listings can be requested by others (e.g., investors) or done at the exchange's own initiative. It would be unworkable if third parties could change the nature and content of the sell side's disclosure obligations by requesting a listing the sell side did not want.

    - We understand what the Commission is getting at with the proposal to include **securitizations "marketed to investors and the terms and conditions are not negotiable among the parties", but it is too vague** to be applied in practice.

Otherwise, e.g. public deals with anchor investors would escape, but warehouses[2] with a very powerful lender (who is in a position to insist on its standard terms with no meaningful negotiation) that are genuinely private might be caught. Again, we would be delighted to discuss this further to come to a workable solution that addresses the genuine policy concerns of the Commission without causing such uncertainty.

- **Synthetic SRT transactions** are uniquely placed in the market in that they involve the communication of a bespoke disclosure package negotiated between the relevant bank and their investor(s), where onward communication of that information needs to be tightly controlled for competitive reasons. For this reason, synthetic securitizations are always done in "private" format and it is critical to the continued health of this section of the market that nothing should make synthetic SRT transactions "public", regardless of technical listing or certain terms remaining standard.

- A broader definition of "public securitization" would, of course, expand the universe of securitizations for which completing **loan-by-loan templates** is mandatory. SFA thinks appropriate transparency requirements are a cornerstone of a well-functioning securitization market and supports measures to ensure this remains the case. However, it is **critical that sufficient flexibility is retained so that barriers to entry created by prescribed disclosures are minimized**. Otherwise access to asset-backed finance for European enterprises and consumers would be affected. Compare US disclosure requirements (described broadly in Annex), where only SEC-registered public offerings are covered by Reg AB II so in practice most securities offerings are only covered by general disclosure obligations.

- A broader definition of public securitization also creates significant **confidentiality concerns** with some transactions that are currently private (e.g., CLO warehouses, all synthetic SRT trades). These confidentiality concerns need to be addressed to avoid pushing financing into other (often more expensive) formats that do not have the disclosure obligations associated with securitization. These confidentiality concerns cover a wide range of matters depending on the deal. They can include wanting the very fact of the financing arrangement's existence (or the parties to it) to remain private. They can also relate to very granular concerns about disclosure of certain data points indirectly revealing proprietary originator models or predictive analysis which are fine to disclose to known investors or the authorities, but would be very damaging and possibly anti-competitive if disclosed to competitors.

- A broader definition of public securitization risks bringing into scope **third country**

[2] Warehouses are private securitisation transactions done to provide financing to an originator who has not yet built up a sufficient volume of underlying assets to do a public securitisation. They are normally bilateral transactions between an originator and a single lending bank, with the bank providing flexible, asset-backed finance for assets as they are originated.

transactions (currently entirely out of scope), which in turn risks excluding EU investors from producing the best available risk-adjusted returns for their stakeholders. This is less of an issue if our suggestions on due diligence are adopted.

Securitization Repositories (Articles 10 and 17)

- Mandatory submission of templates to repositories for deals that are in substance private will raise **confidentiality issues** for many issuers that are not sufficiently addressed by the current Commission proposal drafting. It will also raise friction and **direct costs** for transactions. Where transactions are small (e.g. receivables-backed financing for SMEs), this increase in regulatory compliance requirements and costs will be material and potentially prohibitive. A number of remedies could be considered:

  - Impose the requirement to report to a repository only in respect of transactions over a certain amount in original principal amount outstanding. There is a certain level of arbitrariness inevitable in choosing such an amount but SFA would suggest that €100m might be an appropriate level to ensure that the compliance costs would not be a material barrier to structuring a transaction as a securitisation.

  - Clarify the language of the regulation to make explicit that access to repository information may not be provided to anyone other than public authorities on a confidential basis in respect of private transactions (it is currently silent on this point). Provide meaningful administrative sanctions and direct redress for harmed parties against securitization repositories who breach this obligation.

- Language should be clarified to **explicitly exclude non-EU securitizations** from the obligation to file templates with repositories. We understand this was the Commission's original intention but this should be made explicit.

Due Diligence (Article 5)

- SFA welcomes the proposals to facilitate simpler and more streamlined investment in European securitizations. We believe a **principles-based approach is key** to ensuring EU investors are empowered to make investment decisions in the best interests of their stakeholders.
- In particular, we believe that securitization investing is so diverse and bespoke[3], that prescribing specific items that investors should check before they invest is not practical, and any attempt to do so will inevitably miss the mark. We believe that there is a justification for due diligence requirements but that these must offer systemic safeguards

[3] Different matters will need to be verified based on differences in asset class (mortgages, consumer loans, auto loans, corporate loans etc.) transfer, securitisation technique (true sale or synthetic), transaction structure, jurisdictions of parties, seniority of investment (and, implicitly, level of credit enhancement), investor intention (hold to maturity vs. in the trading book), price at the intended time of investment and a large number of other factors.

while taking account of international competitiveness concerns and also taking account of the fact that the securitization market is an exclusively wholesale market. There are no retail investors in securitization.

- We would therefore propose to **allow EU institutional investors to compete on a more level playing field with their global peers** by more closely aligning the due diligence requirements for EU and non-EU securitizations. In particular:

  - As proposed by the Commission, in respect of EU securitizations, EU institutional investors could rely on the EU supervision of disclosure, risk retention and STS rules.

  - In respect of risk retention for third country securitizations, they must assess whether the structure of the transaction provides appropriate interest alignment between buy side and sell side. This could be by compliance with local risk retention rules or simply a function of the contractual structuring of the transaction.

  - In respect of disclosure for third country securitizations, EU institutional investors could be required to assess the disclosure they are receiving in respect of a securitization and satisfy themselves they are receiving sufficient information to enable them to form an independent assessment of the transaction.

  - In respect of STS for third country securitizations, the issue does not arise because of the requirements of SECR that only EU securitizations can be STS.

- This would help **ensure a broad range of investment opportunities are available to European investors** – who would then be competing on a more level playing field – while preventing a return to the pure ratings and rates buying practices that led to European investments in risky and opaque (re)securitizations pre-GFC.

- Separately, the proposal to make due diligence obligations proportionate in their application is a step in the right direction but **needs to be put in the operative text** in order to make it practically useful. At the moment, it is only in recitals (4), (6) and (8) of the Commission's proposal to amend SECR, which is not helpful to investors who wish to rely on proportionality rules where the situation makes clear the risk is mitigated (e.g., extremely low price, matching order to buy from a creditworthy client). The concept of proportionality must also **apply to the risks of the particular investment in the circumstances**, rather than to the "risks of the securitization", since many of the factors that might mitigate risk will be external to the securitization itself (e.g. familiarity with the originator, extremely low purchase price for the specific trade, matching order to buy the position from a creditworthy client).

Delegation of Due Diligence (Article 5(5))

- Delegation of due diligence is proposed to be aligned with other European legislation – where delegation of tasks does not transfer the legal responsibility. **The "alignment" argument is a red herring**, however, because no other product has the level of prescriptive diligence requirements imposed on securitizations.

- Compliance with the specific demands of the due diligence requirements imposed by the securitization framework require specialized knowledge and expertise, and that is what justifies allowing market participants the ability to delegate these tasks and transfer legal responsibility with such delegation.

- SFA recommends, therefore that the ability to delegate primary regulatory responsibility for due diligence obligations be preserved, but that it **should be conditioned on this being agreed in writing** between the institutional investor being exposed to the securitization and the institutional investor to whom delegation of investment authority has been made.

Sanctions (Article 32)

- It is proposed that the failure of institutional investors to comply with due diligence requirements be added to the list of situations where Article 32 SECR sanctions may be imposed. This seems to be as a result of a misapprehension that investors cannot currently be sanctioned for failure to comply with their Article 5 SECR due diligence obligations. In fact **they can be sanctioned under their respective sectoral regulatory regimes and/or under national law**. See examples in Annex B.

- Extending the application of SECR sanctions would therefore in fact mean a **doubling up of sanctions** which could have a chilling effect on the market. It would disincentivize new market entrants and may even encourage some existing market participants to exit, particularly when combined with the proposed changes to delegation rules.

- It would also be **disproportionate to impose the same level of sanctions on buy- and sell-side parties to a transaction**, these types of non-compliance are qualitatively different. When a sell-side party fails to comply, it affects the whole market (e.g. the whole market gets incorrect or incomplete information, or all investors are invested in a deal without risk retention). When buy-side party fails to comply, it affects only themselves. The particular effects will depend on the particular kind of investor as well, which is why it is appropriate that investor sanctions should remain a part of the sectoral frameworks for the investors. We therefore recommend that the proposed addition of Article 5 to the list of provisions for which a breach can be sanctioned under Article 32 of SECR be removed.

STS (Articles 20, 26b, 26c and 26e)

- SFA members support the changes to the **homogeneity rules for STS transactions**. The deemed homogeneity of transactions where at least 70% of exposures are to SMEs is a positive step that should help facilitate the use of the STS regime for SME financing transactions – and thereby the use of securitization to provide funding to the SME sector in line with the goals of the Commission proposal and the wider SIU initiative.

- In particular, we consider that the 70% threshold (which we are assuming is measured by principal amount outstanding of underlying exposures at origination – this could stand to be clarified) is an appropriate compromise, balancing the goals of the homogeneity requirement (largely, simplifying the financial analysis of the securitized portfolio for investors) with the need to provide flexibility to allow originators to meet the additional challenges associated with securitizing SME assets. It is important that the 30% flexibility "bucket" only applies with respect to homogeneity, rather than any of the STS criteria, thereby providing a sensible level of assurance that that 30% will not negatively affect the overall STS nature of the securitization. It might also be appropriate to consider some constraints on the content of the 30% "flexibility bucket" so that comparable financial analysis tools can be used to analyze those assets as well as the SME exposures.

- We also support the extension of STS eligibility to on-balance-sheet securitizations where **unfunded protection** is provided by certain classes of insurers. We would, however, recommend the clarification of this proposal. We understand that the current wording which refers to "assets under management" is causing a significant amount of confusion, partly because the size of an insurance or reinsurance undertaking is normally better measured by "total assets" (which is indeed the term used in recital (22) to the Commission's legislative proposal). The confusion also arises partly because it is not clear at what level the €20 billion would be measured. We would strongly recommend that this be measured at group level which is more reflective of the size of the business in any case. Finally, the requirement that the relevant undertaking uses an internal model approved in accordance with Solvency II (and complies with its Solvency II capital requirement) should be extended so that it includes third country entities who comply with their home jurisdictions' equivalent requirements so as to ensure a broader base of potential protection sellers and a more competitive market. This would be one helpful way of getting non-EU investment into EU securitization markets.

UCITS investments in securitization

- The UCITS Directive only allows UCITS funds to invest in **up to 10%** of the debt securities of a single issuer. In the case of securitizations, the concerns around excessive influence over an issuer and excessive concentration of risk in one credit either don't arise or are mitigated by the nature of the product. The issuers will generally be single transaction vehicles with no meaningful business other than that of running the transaction. Likewise, the credit of the portfolio is naturally diversified because securitizations generally have many underlying assets.

- The limit is also a meaningful **barrier to investment by UCITS funds** because UCITS funds typically need to make large investments in order to ensure the return on the investment outweighs the transaction costs (including due diligence) for making the investment. Portfolio sizes in the EU are typically small enough that it would not be unusual for a UCITS fund to need to buy more than 10% of a transaction in order to address these concerns.

- The Commission should **amend the issuer limit in the UCITS Directive** to address these issues. SFA's preference would be for this to happen as part of the securitization framework legislative package in order to speed up implementation and also to avoid a long deferral in case the UCITS Directive is not reopened.

With respect to the Capital Requirements Regulation:

***Resiliency* (Article 243)**

- The new concept of "resilient securitization" position layers on **added complexity** to an already complex regulatory framework. This may be necessary as a further safeguard, but SFA would encourage a reconsideration in the longer term to avoid unnecessary complexity while maintaining risk sensitivity. It is also important that resiliency be measured at the outset of a transaction, rather than as an ongoing test – see next bullet.

- **K_A is the wrong parameter** for this resilience concept, with its ongoing requirement, because K_A migrates over the life of a deal, meaning an initially resilient securitization position could lose that status based on the normal and expected evolution of defaults over time. One option to address this would be to use K_{SA}, but the important thing is to ensure that the normal and expected evolution of defaults over the life of a transaction does not lead to loss of favorable regulatory treatment.

- The current proposal of 1.5 * K_A (which we believe should refer to K_{SA} as per the above) to test resilience of the senior tranches leads to overly conservative outcome and will prevent making use of the resilient label for well-structured synthetic securitizations. **The multiplier of x1.5 should be reduced** to levels consistent with the IRB multiplier.

- The specific formulas introduced for calculating the minimum attachment point of the senior position appear to ignore credit enhancement such as overcollateralization and excess spread. **We would recommend against a minimum attachment point for a senior position at all**, but if it is to be retained, it should be by reference to K_{SA}, and not K_A. In any case, if a minimum attachment point for a senior tranche is to be retained, it is important that the normal and expected evolution of defaults over the life of a transaction does not cause loss of this status.

Risk Weight Floors and P-Factor (Articles 259-262)

- SFA in general supports the change to a formulaic risk weight floor ("**RWF**"). We view this as an elegant solution to navigate between the twin objectives of prudential conservatism and risk sensitivity. However, just as the RWF value is floored (at 5%, 7%, 10% or 12% depending on STS status, resilient status and investor vs. originator/sponsor position) it should also be capped. We would recommend **capping the RWF at current levels** (so 10% or 15%, as appropriate) to avoid this generally positive development inadvertently resulting in increased capital requirements – especially for transactions where the underlying assets are risk-weighted at over 100% (including many infrastructure securitizations). We also query the continuing appropriateness of the distinction between originator/sponsor positions on the one hand and investor positions on the other. Given the significant evolutions in disclosure standards since the GFC, the risk level for a bank investing as an investor vs. holding a position as an originator or sponsor have become much more closely aligned.

- SFA in general welcomes the proposal for a formulaic p-factor. However – as with the risk weight floor, and for the same reasons – we query the **appropriateness of having different p-factor for originator/sponsor positions vs. investor positions**. We also note that the reduced p-factors under the SEC-SA for the originator of 0.3 for STS and 0.6 for non-STS – while lower than those which apply generally – would risk erasing the currently available capital relief provided by the transitional arrangements in relation to the **output floor** (which use p-factors of 0.25 for STS and 0.5 for non-STS). If left unaddressed, we are concerned that this may prevent the recovery of the securitization markets desired and intended to be stimulated by this package of changes. Additional measures would therefore be helpful to address the impact of the output floor.

Significant Risk Transfer (Articles 244 and 245)

- We broadly welcome the inclusion of a mandate to formalize a fast-track process. We would encourage the co-legislators to design a mandate for it to be workable and as broadly inclusive as practical so that SRT can be approved promptly in more cases.

- We further are encouraged by the introduction of the new principles-based approach test for SRT more broadly and look forward to engaging with the EBA on the design of level 2 measures that are workable as regards the structural features, and the principles of the supervisory assessment process.

ANNEX A

American structured finance market reforms since the Global Financial Crisis

Part I: Post-Crisis Legal and Regulatory Changes in the United States

One reason securitization has still served as an engine of growth following the 2008 financial crisis is that in the ensuing years legal and regulatory actions brought new standards to the practice of securitization. The U.S. regulatory responses to the crisis were primarily embodied in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) of 2010 and in the implementation of the Basel III international framework. The major regulatory changes were to require certain minimum underwriting and documentation factors for mortgage originators, risk retention, increased disclosure, enhanced capital and liquidity requirements, and rating agency reform.

Ability to Repay

Poor underwriting in the mortgage market represented one of the most significant drivers of losses for securitized products. In the wake of the crisis, the U.S. Congress mandated, and the Consumer Financial Protection Bureau implemented, an ability to repay requirement for residential mortgage loans. This requirement specifies certain minimum underwriting and documentation factors for mortgage originators to use to determine a borrower's ability to repay a mortgage.

Risk retention

In 2014, pursuant to the requirements of Section 941 of Dodd-Frank, credit risk retention rules were adopted by the Securities and Exchange Commission (SEC) jointly with the federal banking regulators and housing agencies. These rules generally require an originator or sponsor of a securitization to retain an economic interest of at least 5% of the aggregate credit risk of the assets underlying an issuance, subject to certain limited exceptions deemed to be low-risk.

Increased disclosure and reporting

Section 942 of Dodd-Frank required the SEC to adopt disclosure requirements for asset-backed securities (ABS) in order that these securities include "asset-level or loan-level data, if such data is necessary for investors to independently perform due diligence." The SEC published these additional ABS disclosure requirements, referred to as Reg AB II, in 2014. In its final rules, the SEC extended loan-level disclosure requirements to ABS backed by residential mortgages, commercial mortgages, auto loans or leases, re-securitizations of these types of ABS, and securities backed by corporate debt, though not to other ABS.

Reg AB II was intended to provide an additional level of transparency to the market to address several perceived shortcomings of the pre-crisis securitization market, including that issuers had historically provided pool-level information rather than detailed asset-level information, and that neither a standardized format nor agreed-upon data points existed across issuances, even within the same asset class. Currently, the SEC is reviewing the required fields under Reg AB II to strike the right balance between disclosure requirements and efficient markets. The expectation is a modest reduction in the fields required for certain RMBS transactions. See [Asset-Backed Securities Registration and Disclosure Enhancements].

Capital requirements

In July 2013, U.S. banking regulators finalized rules implementing the Basel III capital framework and Sections 171 and 939A of Dodd-Frank, which prohibited reliance on credit ratings and required banking regulators to consider securitized products in establishing risk-based capital standards.

Federal banking regulators generally require banking institutions to derive a risk weight for securitization exposures based on a set of prescriptive factors, primarily through what is known as the simplified supervisory formula approach (SSFA). The SSFA considers risk factors such as the capital required of the underlying assets, delinquencies, and the attachment and detachment points of the exposure to determine an aggregate risk weight. The SSFA formula additionally imposes a supervisory surcharge, referred to as the p factor, which represents the multiple above the disaggregated loan capital charge assigned to hold the collateral as a securitization. Under the current capital regulation, p is specified at 0.5, which may be interpreted as a 50% surcharge on holding the underlying asset in securitized form. In addition, securitization exposures are subject to a risk-weight floor of 20%.

Under bank capital rules, risk-based capital for securitizations is required to be held against consolidated balance sheet assets, as determined by accounting treatment. Under generally accepted accounting principles implemented in 2010, a bank securitizer may be required to consolidate ABS trusts onto its balance sheet if it maintains a controlling financial interest in the vehicle. Thus, even when risk has been effectively sold or transferred to investors through the issuance of asset-backed securities, a sponsoring bank may still be required to hold capital against the underlying assets.

Liquidity requirements

U.S. federal banking regulators finalized Liquidity Coverage Ratio (LCR) rules in 2013. The LCR requires covered institutions to maintain a sufficient amount of unencumbered high-quality liquid assets (HQLA) to withstand cash outflows during a prospective 30-day period of economic stress. U.S. banking regulators elected to exclude all non-agency securitized products – even AAA-rated senior tranches of securitization – from counting toward a bank's HQLA.

Rating agency reform

Under Section 943 of the Dodd-Frank Act, the SEC adopted new requirements to improve credit-rating quality and agency accountability. Dodd-Frank included new requirements pertaining to internal controls, reporting, disclosure, and accountability of nationally recognized statistical ratings organizations, the U.S. equivalent to the concept of an ECAI in the EU. Information required as a result of implementation of the rules includes the main assumptions used in the methodologies; potential limitations of the credit rating; and information relating to conflicts of interest. In the case where a rating is assigned to an asset-backed security, the rules require that information on the representations, warranties and enforcement mechanisms be available to investors, and that the issuer or underwriter of the security make publicly available the findings of any third-party due-diligence report it obtains.

Restriction on speculative investments by banks

Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, prohibits banks from investing in what it classifies as "covered funds," which include hedge funds and private equity funds, as well as CLOs with a bond component. The intent of this rule is to ensure that broker-dealers' trading positions reflect client demand as opposed to speculative risk positions.

Part II: Brief Comparison with relevant Post-Crisis Legal and Regulatory Changes in Europe

In many respects, these legal and regulatory responses in the United States were similar to those adopted by European regulators. For example, on both sides of the Atlantic the relevant banking and securities regulators introduced increased capital requirements for securitized products, excluded many securitized assets from eligibility toward post-crisis liquidity standards, introduced expanded disclosure requirements in response to limited transparency of certain pre-crisis securitized assets, and imposed requirements for originators and sponsors to retain credit risk in securitizations to mitigate misalignment of incentives between securitizers and investors.

However, in general the regulatory regime governing securitization in the United States remains far less prescriptive than in Europe. Most notably, significant differences exist between the American and European regulatory regimes governing risk retention, disclosure and due diligence.

Risk Retention

U.S. law requires the sponsor of a securitization transaction to retain at least five percent of the credit risk on the securitized assets. The five percent can be retained as either a vertical slice of the securitization or as a horizontal (first loss) position, or a combination of both (an "L-shaped interest"). Other options are available for particular asset classes or securitization structures (including the seller share in a revolving pool). Retained credit risk exposure generally may not be transferred, hedged, or financed by nonrecourse debt. Most of these restrictions expire after a set period of time ranging from two to five years or when the unpaid balance of the assets or the securitization interests hits a threshold ranging from 25% to 33% of the unpaid balance on the closing date of the securitization. The practical result is that the risk retention obligation expires at the end of this sunset period. Retention pieces are permitted to be held by any majority-owned affiliate of the securitization sponsor.

There are also a number of significant exceptions to this credit risk retention requirement, however. It does not apply at all to government-backed securitizations, including Ginnie Mae and certain student loans. It also does not apply to Fannie Mae and Freddie Mac, which generally retain all credit risk, and which do not require the financial institutions that sell them mortgages to retain a share in the loans.

Certain asset classes are also exempt from the credit risk retention requirement even when there is no government backing. The retention requirement does not apply to securitizations of certain asset classes when the assets are "qualified", including commercial loans, commercial real estate loans, residential mortgages, or auto loans. In order to be qualified, these loans must meet certain underwriting standards, including verification of ability to pay, ensuring that there is high quality collateral in exempt transactions. CLOs are also exempt because a court decision from 2018 that interpreted CLO managers not to be securitizers. The rule has not since been changed to reimpose risk retention obligations on CLOs.

Consequently, generally what is subject to the risk retention requirements in the United States are credit card securitizations, some small classes of ABS, and securitizations of assets that do not meet the underwriting qualifications for exemption.

In Europe, an originator, sponsor or original lender must also retain at least a net economic interest of five percent in the securitization, and there are no sunset timeframes after which the risk retention obligation expires as there are in the United States. The five percent interest can be held as a vertical slice or as a horizontal first loss position (among other options), but not as an L-shaped interest as in the United States. Unlike the United States, the EU has no general rule permitting risk retention to be held by any majority-owned affiliate. The closest it gets is rules relating to holding risk retention on a consolidated basis that are restricted to authorized financial institutions and their groups.
The primary exceptions to this requirement are for securitizations where the underlying assets are guaranteed by governments, central banks, supranationals or institutions to which the standardized approach applies a risk weight of 50% or less under EU bank capital rules.

The EU also requires institutional investors to verify that the sponsor, originator, or original lender of a securitization retains at least a five percent material net economic interest in the securitization on an on-going basis. There is no analogous provision in the United States.

Disclosure

In the United States, Reg AB II imposes a number of disclosure requirements on offers and sales of asset-backed securities (ABS), including the requirement that issuers provide standardized loan-level information in the offering prospectus and in on-going reports. Reg AB II, however, applies only to securities offerings that are registered with the SEC, and not all securities offerings must be registered. Significantly, securities that are offered and sold only to "qualified institutional buyers" – and not to retail investors – are exempt from registration. Because so many ABS are sold only to institutional investors, a substantial percentage of ABS issuance in the United States is exempt from registration, including nearly all private-label mortgage-backed securities (i.e., those done without the backing of U.S. government-sponsored entities Fannie Mae or Freddie Mac, or U.S. government-owned corporation Ginnie Mae), putting these deals outside the scope of Reg AB II. Consequently, though the SEC does promulgate a standardized set of disclosures which is directly applicable to many transactions, and which serves as a baseline reference for the entire market, it has little direct impact on most of the American securitization market. Instead, the majority of the disclosure included in American securitization transactions is the product of negotiation between sell-side and buy-side parties, using Reg AB II as a baseline reference.

In Europe, EU securitization regulations require originators, sponsors, and securitization vehicles to make certain information available to investors, regulators, and potential investors, including quarterly performance information on the securitized assets, most of the legal documentation for the transaction, and, when applicable, a prospectus outlining the features of the transaction. These disclosures are known as "Article 7 reporting." The templates differ by the type of securitized assets, but all include a large number of mandatory data fields, including asset-level reporting. The Article 7 reporting regime is analogous to the approach taken in the US by Reg AB II, but Article 7 applies to all EU securitization transactions, while few non-agency transactions in the United States are subject to the U.S. disclosure regulation because virtually all private-label transactions are exempt from registration.

Due Diligence

In Europe, Article 5 of the EU Securitization Regulation requires institutional investors to perform a due diligence assessment before investing in and while holding a securitization position to understand and evaluate the associated risks. These assessments must cover the risk characteristics and structural features of the securitization and its underlying exposures. Investors also need to verify compliance with the risk retention and credit-granting requirements, and ensure that they will receive the necessary information under the Article 7 reporting obligations. Failure to comply with these due diligence requirements can lead to sanctions, including fines.

In contrast, there are no due diligence requirements imposed on investors in the United States that are similar to or analogous to those imposed on European investors by Article 5. Instead, investors in the United States have latitude to apply their professional judgment when deciding what due diligence is appropriate before making an investment decision, which is often determined by the context and characteristics of an investment opportunity, including the originator's track record, the investor's experience, the seniority of the exposure under consideration, and other similar factors.

ANNEX B
Existing Sanctions for Institutional Investors in Breach of Article 5 SECR

Sanctions in institutional investors for failure to comply with their Article 5 SECR obligations vary depending on the particular type of institutional investor concerned. Sanctions were quite deliberately never provided for in the original version of the SECR because there was a history of sanctions for failure to comply with due diligence rules already in place in sectoral legislation before the SECR was adopted. This was because the securitization (risk retention and due diligence) rules had historically been provided for in those pieces of historical legislation before the requirements were harmonized in the SECR. It was a deliberate choice not to completely harmonize sanctions for failure to comply because of the differing nature – and therefore differing appropriate sanctions – for each type of institutional investor. Nothing has changed since the original adoption of the SECR to justify a change this approach. We should also note that the EU-level sectoral regimes are also supplemented at national level (especially for categories of institutional investor that were not subject to securitization rules prior to the SECR – IORPs and UCITS funds – and where the EU-level legislation is a Directive). Below is a non-exhaustive summary organized by type of institutional investor giving examples of where the issue of sanctions for breaches of Article 5 is already dealt with in existing law:

	EU-level	CZ	DE	ES	FI	FR	IE	IT	NL
Insurance or reinsurance undertaking (Article 2(12)(a) and (b) SECR)	Article 257 of the Solvency II Delegated Act	Sections 136 and 182 of Act No. 256/2004 Coll., on Doing Business on the Capital Market, as amended (the "**DBCM Act**")	Article 298(1) of the Versicherungs-aufsichtsgesetz (the "**VAG**")	Art. 41 c) of Law 5/2015 of 27 April	Chapter 4 of the Act on the Financial Supervisory Authority (878/2008, as amended)	Article L. 612-39 of the Code monétaire et financier	Part 5 of the European Union (General Framework for Securitisation and Specific Framework for Simple, Transparent and Standardised Securitizations) Regulations 2018 (the "**Irish SECR SI**")	Article 190-bis.2 of Testo Unico dell'Inter-mediazione Finanziaria (Decreto legislativo n. 58/1998)	Annex 25 of the Decree implementing EU Regulations on Financial Markets (Bijlage 25 van het Besluit EU-verordeningen Wft)
IORP or IORP manger (Article 2(12)(c) SECR)	Articles 25(2)(c) and 48 of the IORP Directive	Sections 136 and 182 of the DBCM Act	Article 298(1) of the VAG	Art. 41 c) of Law 5/2015 of 27 April	Chapter 4 of the Act on the Financial Supervisory Authority (878/2008, as amended)	Article L. 612-39 of the Code monétaire et financier	Part 4 of the Irish SECR SI	Article 190-bis.2 of Testo Unico dell'Inter-mediazione Finanziaria (Decreto legislativo n. 58/1998)	Annex 25 of the Decree implementing EU Regulations on Financial Markets (Bijlage 25 van het Besluit EU-verordeningen Wft)
AIFM (Article 2(12)(d) SECR)	Articles 17 and 48 of AIFMD and Articles 50-54 of AIFMR	Sections 136 and 182 of the DBCM Act	Article 5(12) of the Kapitalanlagege-setzbuch ("**KAGB**")	Art. 41 c) of Law 5/2015 of 27 April	Chapter 4 of the Act on the Financial Supervisory Authority (878/2008, as amended)	Article L. 612-15 of the Code monétaire et financier	Part 5 of the Irish SECR SI	Article 190-bis.2 of Testo Unico dell'Inter-mediazione Finanziaria (Decreto legislativo n. 58/1998)	Annex 25 of the Decree implementing EU Regulations on Financial Markets (Bijlage 25 van het Besluit EU-verordeningen Wft)
UCITS management company or internally-managed UCITS (Article 12)(e) and (f) SECR)	Articles 50a and 99 of the UCITS Directive	Sections 136 and 182 of the DBCM Act	Article 5(12) of the KAGB	Art. 41 c) of Law 5/2015 of 27 April	Chapter 4 of the Act on the Financial Supervisory Authority (878/2008, as amended)	Article L. 612-15 of the Code monétaire et financier	Part 5 of the Irish SECR SI	Article 190-bis.2 of Testo Unico dell'Inter-mediazione Finanziaria (Decreto	Annex 25 of the Decree implementing EU Regulations on Financial Markets (Bijlage 25 van

								legislativo n. 58/1998)	het Besluit EU-verordeningen Wft)
Credit institution or investment firm (Article 2(12)(g) SECR)	Article 270a of CRR	Sections 136 and 182 of the DBCM Act	Article 6(3) of the Kreditwesen-gesetz for credit institutions Article 5(12) of the KAGB for investment firms	Art. 41 c) of Law 5/2015 of 27 April	Chapter 4 of the Act on the Financial Supervisory Authority (878/2008, as amended)	Article L. 612-39 of the Code monétaire et financier	Part 5 of the Irish SECR SI	Article 190-bis.2 of Testo Unico dell'Inter-mediazione Finanziaria (Decreto legislativo n. 58/1998)	Annex 25 of the Decree implementing EU Regulations on Financial Markets (Bijlage 25 van het Besluit EU-verordeningen Wft)

STRUCTURED FINANCE ASSOCIATION

SFA Staff Contact Listing

Michael Bright Chief Executive Officer Michael.Bright@StructuredFinance.org	Covell Adams Chief Operating Officer Covell.Adams@StructuredFinancre.org
Daniel Grattan Global Head of Advocacy Daniel.Grattan@StructuredFinance.org	David Dwyer General Counsel of Policy and Regulatory Affairs David.Dwyer@StructuredFinance.org