167 Fleet Street, London EC4A 2EA, UK
+44 (0)20 7822 8380
info@aima.org

aima.org

Submitted via email to: SecuritisationReview@hmtreasury.gov.uk

2 September 2021

Dear Basia,

Securitisation Regulation: call for evidence

The Alternative Credit Council (ACC)[1] and the Alternative Investment Management Association (AIMA)[2] welcome the opportunity to respond to HM Treasury's (HMT) call for evidence on the Securitisation (Amendment) (EU Exit) Regulations 2019 ("the Securitisation Regulation").

Over the past decade, securitisation has played a crucial role in the financing of SMEs and midmarket businesses in the UK when compared to other jurisdictions with less developed securitisation markets. The extensive reforms introduced via the Securitisation Regulation and Capital Requirements legislation have supported investor confidence in the securitisation framework but there is still more to be done.

We would encourage UK policymakers to be ambitious when reviewing the Securitisation Regulation and how it supports a robust and efficient market. A reformed securitisation framework will help further reduce the UK economy's dependence on bank funding while also expanding the range of banks' asset and capital management options to absorb market and regulatory pressures. This will enhance their resilience by providing them with another tool for the management of their non-performing exposures and support effective risk management

[1] The ACC represents over 200 members that manage more than $450 billion of private credit assets. ACC members provide an important source of funding to the economy by providing finance to mid-market corporates, small and mid-sized enterprises, commercial and residential real estate developments, infrastructure, as well the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

[2] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org

across the financial system. In addition, investors will experience a broadening of investment opportunities and cross-border investments will be encouraged.

An efficient securitisation market is an essential feature of a well-functioning business finance market, and we welcome HMT's consideration of how the UK securitisation framework can be enhanced. We have provided more detailed comments in response to this call for evidence in the annex to this letter but would highlight the following key areas:

- **Scope of the regulation:** The application of the 'Institutional investor' definition within the Securitisation Regulation for non-EU Alternative Investment Fund Managers (Non-EU AIFMs) is a source of uncertainty for our members and other market participants. Amending the scope of this definition to remove this uncertainty will help promote a successful and sustainable securitisation market. This could be achieved by amending Article 2(12)(d) to the text below:

"a full-scope UK AIFM (as defined in regulation 2(1) of the Alternative Investment Fund Managers Regulations 2013)"

- We would encourage HMT to make this amendment to the Regulation at the earliest possible opportunity.

- **Simple, Transparent and Standardised (STS) certification for Collateralised Loan Obligations (CLO):** The CLO market is a key source of financing for UK businesses and a key means by which capital markets are connected to the non-financial economy. CLOs fall within the remit of the Securitisation Regulation but are ineligible for STS certification. The exclusion of CLOs from the STS framework acts as a brake on the provision of finance to borrowers. This would be particularly beneficial for insurers seeking income generating assets with higher returns than are currently available in a low-yield environment, while also allowing them to become a more prominent source of finance for the real economy than they are currently. Developing an approach to STS certification for CLOs that is consistent with global regulatory standards would also demonstrate the UK's commitment to the development of regulatory best practice, promotion of efficient markets and being a leading global financial centre.

- **ESG and securitisation:** Our members recognise that ESG and climate related disclosures are necessary for investors to make informed decisions when allocating capital. The asset management sector is currently subject to multiple regulatory requirements in relation to the identification, assessment and disclosure of ESG risk factors. These requirements meet the Government's stated objectives regarding climate-related disclosures in the securitisation market. It is unclear what benefit additional ESG requirements within the securitisation framework would provide and why specific ESG disclosure requirements for securitisation are being considered when there are no equivalent proposals for other capital raising investment structures. We would also highlight that there are substantial challenges around ESG data collection that remain outside the scope of the Securitisation Regulation.

- **Disclosure of private securitisations:** We do not believe that extending the disclosure requirements for public securitisations to private securitisation would be appropriate. Our response summarises the factors which have influenced the volume of private securitisations following the introduction of the Securitisation Regulation. We are not aware of any evidence that suggests these factors may contribute towards investor detriment or increased financial stability risks which would necessitate changes to or the extension of disclosure requirements.

- **Risk retention modalities:** We would encourage HMT to reconsider the current approach to risk retention calculation for non-performing exposures so that this is assessed on the transaction price rather than the nominal amount. This would better align with the actual economics of the transaction and support a more efficient secondary market for non-performing exposures. We would also invite the Government to introduce the option for 'L-shaped' risk retention modalities alongside the horizontal and vertical approaches. This option would provide more flexibility for transactions to be structured to meet the needs of investors without compromising the alignment of interests promoted by risk retention more generally.

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact Nicholas Smith, Director, Private Credit (nsmith@aima.org).

Yours sincerely,

Jiří Król
Deputy CEO, Global Head of Government Affairs, AIMA
Global Head of the ACC

Annex – ACC and AIMA comments in response to the Securitisation Regulation: call for evidence

Scope of the Regulation:

The application of the "institutional investor" definition within the Securitisation Regulation for non-EU Alternative Investment Fund Managers (Non-EU AIFMs) is a source of uncertainty for our members and other market participants.

Article 5 of the Securitisation Regulation imposes certain due diligence requirements on "institutional investors" investing in securitisation positions issued from 1 January 2019. "Institutional investor" is defined in Article 2(12)(d) of the Securitisation Regulation to include:

an AIFM (as defined in regulation 4(1) of the Alternative Investment Fund Managers Regulations 2013) which markets or manages AIFs (as defined in regulation 3 of those Regulations) in the United Kingdom;

Amending the scope of this definition will help promote a successful and sustainable securitisation market. This could be achieved by amending Article 2(12)(d) to the text below:

"a full-scope UK AIFM (as defined in regulation 2(1) of the Alternative Investment Fund Managers Regulations 2013)"

We would encourage HMT to make this amendment to the Regulation at the earliest possible opportunity.

This view is supported by considerations related to the scope of the AIFMD, principles of legislative interpretation, and evidence of the policy intent of the Securitisation Regulation. Specifically:

- The Securitisation Regulation implies clearly that the AIFMs within its scope are those which are currently subject to Article 17 of the AIFMD, as amended (as implemented in the UK under FUND 3.5.4R and 3.5.5R of the FCA Handbook) ("Article 17 of the AIFMD"), which applies only to full-scope UK AIFMs. Third country AIFMs are not subject to Article 17 of the AIFMD.
- Article 17 of the AIFMD will complement and reflect the due diligence requirements set out in Article 5 of the Securitisation Regulation by placing an obligation on AIFMs to consider taking remedial action in respect of non-compliant securitisations to which their AIFs are exposed. However, as set out above, Article 17 of the AIFMD only applies to full-scope UK AIFMs. The intention cannot have been to apply the Article 5 due diligence requirements to both authorised AIFMs and Third Country AIFMs, but the Article 17 of the AIFMD obligation regarding remedial action only to authorised AIFMs. Therefore, Article 5 of the Securitisation Regulation was not intended to apply to Third Country AIFMs.
- The Securitisation Regulation does not provide for a competent authority to supervise compliance of Third Country AIFMs with Article 17 of the AIFMD or Article 5 of the Securitisation Regulation, further making clear that these provisions are not intended to apply to Third Country AIFMs.
- As a matter of legislative interpretation, as applied to the definition of an "institutional investor", the definition should only be interpreted as including AIFMs authorised under the AIFMD as it applied in the UK post-Brexit, which would exclude Third Country AIFMs.

- The reference to “and/or markets” in the definition of “institutional investor” as it relates to AIFMs points to the extension of the definition to Third Country AIFMs only upon the activation of Article 37 of the AIFMD.
- At no stage in the legislative process was there any stated intention to widen the scope of the existing rules on risk retention so that they should apply to Third Country AIFMs. Any such intention would have been expressed in the EU Commission Proposal, in the Recitals of the Securitisation Regulation or elsewhere given that this would be a significant expansion of the scope of the existing rules by applying them to Third Country AIFMs.

We enclosed a copy of our letter to ESMA requesting a Q&A to clarify the scope of the Securitisation Regulation alongside this response. This letter provides additional information on each of these points.

The position under the EU regime remains uncertain, but recent publications by EU supervisory bodies indicate that this topic will be considered as part of the upcoming review of the EU Securitisation Regulation due to commence next year. We also note that publication of any reforms in the EU relating to the AIFMD are also likely to take place in either Q4 2021 or Q1 2022. We would therefore encourage the UK Government to address this matter at the earliest opportunity to provide UK securitisation managers with greater certainty ahead of what is likely to be a long period of policy deliberation within the EU.

STS for Collateralised Loan Obligations (CLOs)

The CLO market is a key source of financing for UK businesses and a key means by which capital markets are connected to the non-financial economy. Due to the tranching involved, CLOs fall within the remit of the Securitisation Regulation, but they are ineligible for Simple, Transparent and Standardised (STS) certification as they are deemed to be “actively managed” for the purposes of the Securitisation Regulation.

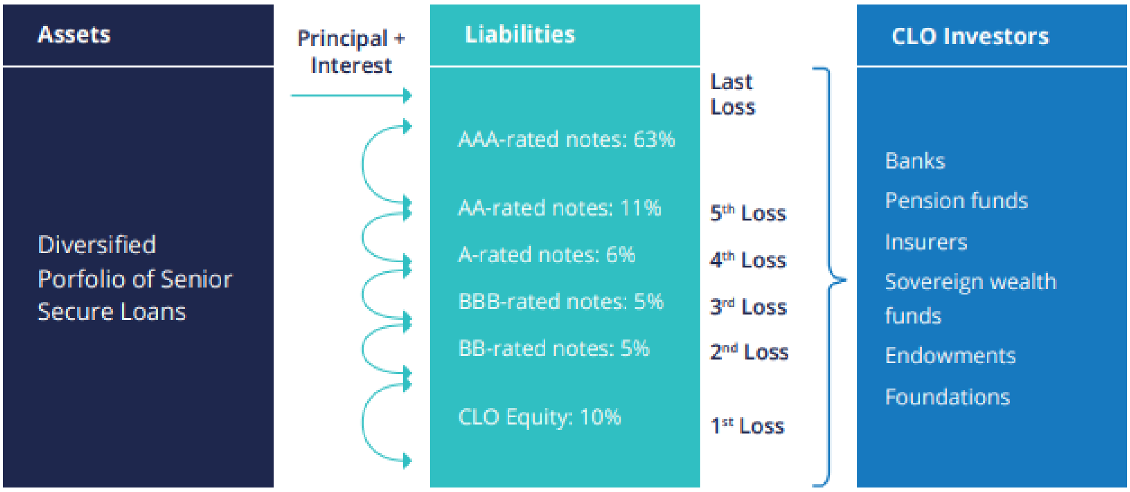
The exclusion of CLOs from the STS framework acts as a brake on the provision of finance to borrowers, while also limiting the ability of banks to de-leverage their balance sheets. Developing a new approach that would allow CLOs to achieve STS certification would help attract investor capital and support the availability of finance for UK businesses. This would be particularly beneficial for insurers seeking income generating assets with higher returns than are currently available in a low-yield environment. Such a reform would also allow them to become a more prominent source of finance for the real economy than they are currently. Diversifying the sources of finance available to corporates will also encourage a more resilient economy by reducing the dependency on bank financing as a driver of investment and growth.

Developing an approach to STS certification for CLOs that is consistent with global regulatory standards would also demonstrate the UK’s ongoing commitment to the development of regulatory best practice, promote effective markets and be a leading global financial centre. We recognise from our discussions with HMT that alignment with the Basel framework, particularly with regard to rules for the banking sector, remains a policy priority for the Government. It may be therefore more appropriate to consider targeted changes that would focus on the insurance sector and improve their access to the CLO market.

What are CLOs?

CLOs raise capital from institutional investors and lend this to businesses across a range of industry sectors. This allows investors to invest in assets they would not be able to invest in on an individual loan basis, while also diversifying their exposure to different segments of the economy. A CLO generates returns for investors by returning the interest and principal payments they receive from borrowers. Around two-thirds of global CLOs are held by non-bank investors such as pension funds, insurers and investment funds.[3]

Figure 1: Typical CLO Structure



CLOs and STS certification

CLOs are unique in that a CLO manager can "manage", within a set of well-defined constraints, the pool of underlying loans to optimise returns for their investors. In practice this means that the CLO manager seeks to identify better performing borrowers and loans rather than simply "buying the market".

The strict contractual requirements that limit the discretion of the CLO manager when managing the underlying pool of loans have been central to the success of the CLO market. In most deals, the manager can only turn over a limited portion of the collateral, generally around 20%, each year. CLO managers can only replace the loans in the portfolio with loans that meet the eligibility criteria of the CLO structure used to structure the initial pool of the securitisation. Such eligibility criteria are typically determined by external ratings agencies rather than the asset manager. This practice helps ensure investors' interests are being protected, promotes consistency across the market while also supporting the efficient allocation of capital across the economy.

[3] https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/november-2018.pdf?la=en&hash=A9AE16F96F1F4C01B9ECF1C2B4D902E9472085B3

Due to the tranching involved, CLOs fall within the remit of the Securitisation Regulation, but they are not eligible for STS certification as they are deemed to be ”actively managed” for the purposes of the Securitisation Regulation. We support the policy objective of the STS framework to ensure transparency and support good investor outcomes and believe that typical CLO structures are consistent with this objective for several reasons:

- CLO managers are required to comply with standardised tests and criteria (see Figure 2) prescribing how the CLO should be managed rather than on a solely discretionary basis;
- CLO managers typically report details of trading of underlying exposures in the context of the CLO manager’s management responsibilities, providing investors with transparency;
- The subordination of a proportion of the CLO manager’s fees incentivises strong performance of the CLO transaction and aligns the CLO manager’s interest with their investors; and
- The strong performance of highly rated European-managed CLOs during the past decade demonstrates the resilience of the structure.

Figure 2: CLO structural protections

Test	Description
Over Collateralisation (OC)	The OC tests protect noteholders against a deterioration in the value of the portfolio collateral. This is tested by comparing the value of outstanding notes versus collateral and ensuring it is sufficiently over collateralised.
Interest Coverage (IC)	The IC tests protect noteholders against a deterioration in interest income from the portfolio. This is tested by comparing the interest income received versus the liabilities due to ensure there is sufficient coverage.
Weighted Average Life (WAL)	The weighted average life of all the loans in the portfolio. Designed to prevent the total risk horizon of the portfolio from exceeding a covenanted level.
Weighted Average Spread (WAS)	The average effective interest rate spread for the loan portfolio over an index rate such as LIBOR. This test ensures a minimum level of income from the underlying portfolio that should be sufficient to pay interest on the liabilities.
Weighted Average Rating	A measure of the average credit rating of the portfolio, which is an indicator of the portfolio’s average credit risk.

As noted above, any discretion afforded to the CLO manager is subject to investor oversight and recourse via the standardised tests and criteria that the CLO manager is required to meet. Furthermore, we would highlight how comparing pre and post trade positions demonstrates how almost all the reinvestment criteria of CLOs support better portfolio management and incentivise good investor outcomes.

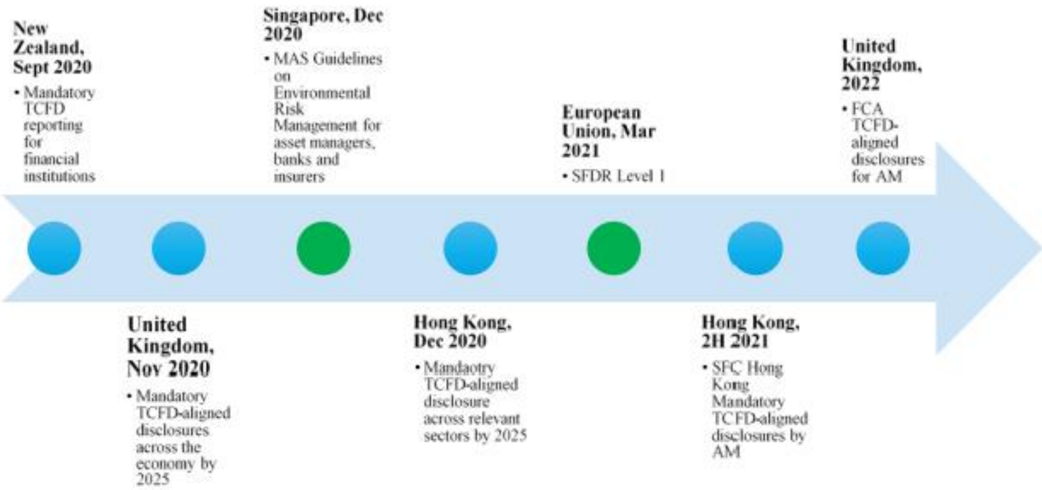
We would therefore ask the UK Government to consider amending the UK STS criteria to encompass transactions where active management can only occur within the portfolio criteria established by the CLO manager and their investors. This would align with the Securitisation

Regulation's existing requirements for new exposures into revolving pools to meet the initial eligibility criteria and for proven servicer experience level.

ESG and securitisation

Our members recognise that ESG and climate related disclosures are necessary for investors to make informed decisions when allocating capital. The asset management sector is currently subject to multiple requirements in relation to the identification, assessment and disclosure of ESG risk factors. These are being introduced by policymakers across the globe in ways which often overlap and create material differences in the requirements firms are required to meet across their global operations. Figures 3 and 4 below[4] provide an illustration of the timeline of announcements and upcoming changes by various governments and regulators that refer to the TCFD Framework, as well as the different levels of compulsion adopted by policymakers with respect to this agenda.

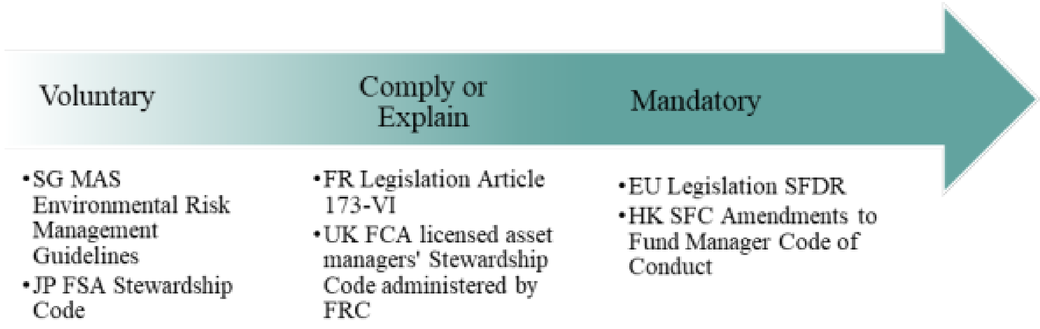
Figure 3: Timeline of announcements and upcoming changes by various governments and regulators that refer to the TCFD Framework.



Note: Green circles represent policies that are currently in force.

[4] Taken from IOSCO Consultation Report Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management https://www.iosco.org/library/pubdocs/pdf/IOSCOPD679.pdf

Figure 4: Different levels of compulsion taken by jurisdictions with respect to sustainability-specific rules.



The timetable by which firms need to meet these regulatory requirements poses challenges for asset managers of all shapes and sizes. We believe that these requirements will meet the Government's stated objectives regarding climate-related disclosures in the securitisation market and that no additional ESG requirements within the securitisation framework are required. The impact of these requirements is already starting to be seen in the securitisation market. For example, investors asking CLO managers for disclosures to help them meet their own obligations under the Sustainable Finance Disclosure Regulation (SFDR) has resulted in some recent deals including a qualified obligation to provide Potential Adverse Impact reporting. We would also question the necessity and value of specific ESG disclosure requirements for securitisation when there are no equivalent proposals being considered for other capital raising investment structures.

If there are areas where HMT believes that these reforms do not meet their policy objectives we would welcome further discussion on these points to better understand HMT's concerns.

In addition to our comments on the necessity of additional disclosure requirements we would also highlight that there are substantial challenges around ESG data collection for many participants in the securitisation markets that are material when it comes to disclosure. This is most pronounced in instances where such data was not collected on the underlying assets at origination. In such instances it is extremely challenging to go back and collect such data.

In some instances the challenges around ESG data collection also remain outside the scope of the Securitisation Regulation and may require policy changes in areas of non-financial sectors. Our members' experience in other areas of their investment management activity confirms that any ESG-related disclosure with respect to securitisation will remain challenging without corresponding requirements on corporates to report this data. Any approach to improving transparency and promoting investor choice with respect to ESG and securitisation should first focus on improving the quality and availability of the underlying assets at origination, rather by imposing requirements on participants in the securitisation market who were not involved in the origination of the assets and are less able to collect such data.

We understand from our discussions with HMT and the FCA that ESG and sustainability are priority matters across Government. The FCA is currently consulting on enhancing climate-related disclosures (CP21/17) across the financial sector. We would encourage HMT to review the responses to that consultation as part of their considerations of ESG disclosure requirements within the Securitisation Regulation.

Disclosure of private securitisations

We do not believe that extending the disclosure requirements for public securitisations to private securitisation would bring any additional benefits and we are not aware of any evidence of investor detriment or risk to financial stability which would justify such an approach.

It is legitimate for investors to invest in private securitisations where they feel this best meets their needs and private securitisations should not be seen as posing greater investor protection risks simply by virtue of being private. Whether a securitisation is private or public, investors will apply a robust approach to risk analysis as part of their investment and in any negotiations with counterparties. While private securitisations by definition do not include the same level of public disclosures as public transactions, the disclosures involved in these transactions are typically negotiated to the level required by the investor(s) in that private financing transaction. Under the Securitisation Regulation private securitisations are already subject to highly prescriptive transparency requirements including onerous template-based loan-level and investor reporting. It is therefore unclear what additional benefits would accrue to investors by extending the Securitisation Regulation disclosure requirements (which will bring in application of Annex XIV template and UK securitisation repository reporting) from public securitisations to private securitisations or any other measures which would mandate increased reporting or disclosure obligations for private securitisation.

We would also caution against the application of the mandatory UK securitisation repository reporting to private securitisations, like managed CLOs, without a thorough assessment of interoperability with the EU regime. This is because managed CLOs in-scope of the Securitisation Regulation regime in the UK with sell side parties in the EU may also be subject to the direct application of the EU Securitisation Regulation regime. Even in instances where all sell-side parties are in the UK, indirect application of the EU regime will need to be considered and complied with where they are seeking to raise capital from EU investors. HMT will be aware that the European Commission is also undertaking its own review of the EU Securitisation Regulation regime and intends to report in early 2022. Any legislative proposals and further changes to the EU regime following this consultation will take time to finalise and become applicable, meaning that any assessment of interoperability is unlikely to be meaningful until such processes have concluded. We would therefore urge HMT to engage in dialogue with the EU Commission to ensure that both regimes support cross border investment, consistent approaches to compliance with the regime while also widening the issuer and investor base.

We also understand from our discussions with HMT and the FCA that the Government would like to know more about the private securitisation market and why there appears to have been an increase in private CLO transactions since the introduction of the Securitisation Regulation. We believe that the following factors are relevant in this respect:

- Whether a securitisation is considered public or private is predicated on whether a prospectus (within the meaning of the UK Prospectus Regulation) is prepared.

- Certain CLOs, such as warehouse facilities/arrangements, are historically unlisted and may not even involve the creation of an instrument that can be listed, therefore, such deals are "private" for the purposes of the Securitisation Regulation.

- The majority of listed European CLOs (including UK CLOs) would historically seek admission to trading in Ireland, with a mix of listings on the regulated market and the Global Exchange Market (GEM), which is an Irish MTF. This trend has continued post-2019, which (in the absence of listings on the London regulated market, that was largely non-existent pre-2019 and continued to be so post-2019) makes all of CLOs "private" securitisations for the purposes of the Securitisation Regulation regimes in the UK. For example:

  (i) between 1 January 2009 and the end of 2018, there were approximately 377 listed European (including UK) CLOs issued, 340 of which were listed in Ireland with 2 deals listed in London;

  (ii) between 1 January 2019 and August 2021, there were approximately 241 listed European (including UK) CLOs, one was listed in London while the rest were listed in Ireland.

- Listing in Ireland is therefore a well-established practice for European CLOs that predates the Securitisation Regulation and means there is a high level of familiarity among investors and CLO managers with Irish listing. The increased use of Irish MTF during the past 10 years is driven by the fact that GEM listing entails a simpler process, including quicker timelines for the review and approval of the listing particulars and lower listing cost compared to the regulated market in Ireland. GEM disclosure rules are largely modelled on the EU Prospectus Regulation wholesale debt standards and the EU Market Abuse Regulation regime applies to GEM listings, with CLO listing particulars typically made available on the website of the Euronext Dublin.

- Listing on the GEM market also allows the CLO notes to qualify for the "quoted Eurobond" treatment which is important from a tax neutrality perspective.

Our members' experience with the securitisation framework has highlighted some existing challenges with respect to the differentiation of public and private securitisations through reference to whether a prospectus has been prepared in connection with that transaction. This approach is not viewed as appropriate in all circumstances by our members. For example, in private warehouse transactions, the structure and transaction documentation is tailored to the specific lenders and other parties involved, meaning that compliance with standardised disclosure, transparency and template-based reporting requirements adds cost and administrative burden to all parties without any commensurate benefits for investor protection or encouraging the creation of a wider issuer or investor base.

We would therefore encourage HMT to consider alternative means by which to differentiate securitisation transactions in a more proportionate manner to enhance the efficiency of the UK securitisation framework.

Risk retention modalities

We would encourage HMT to reconsider the current approach to risk retention calculation for non-performing exposures so that this is assessed on the transaction price rather than the nominal amount. This would better align with the actual economics of the transaction and support a more efficient secondary market for non-performing exposures. We would also invite the Government to introduce the option for 'L-shaped' risk retention modalities alongside the horizontal and vertical approaches.