

FINANCING EUROPEAN BUSINESS

Non-bank Lending and the Economic Recovery



ALTERNATIVE
CREDIT COUNCIL

LENDING
FOR GROWTH



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Non-bank lending in Europe

Better access to finance for European SMEs and mid-market businesses

Helps banks de-leverage their balance sheets and support the flow of credit in the economy



Supports the post COVID recovery by connecting capital markets to the real economy

Promotes a resilient economy and a stable financial system

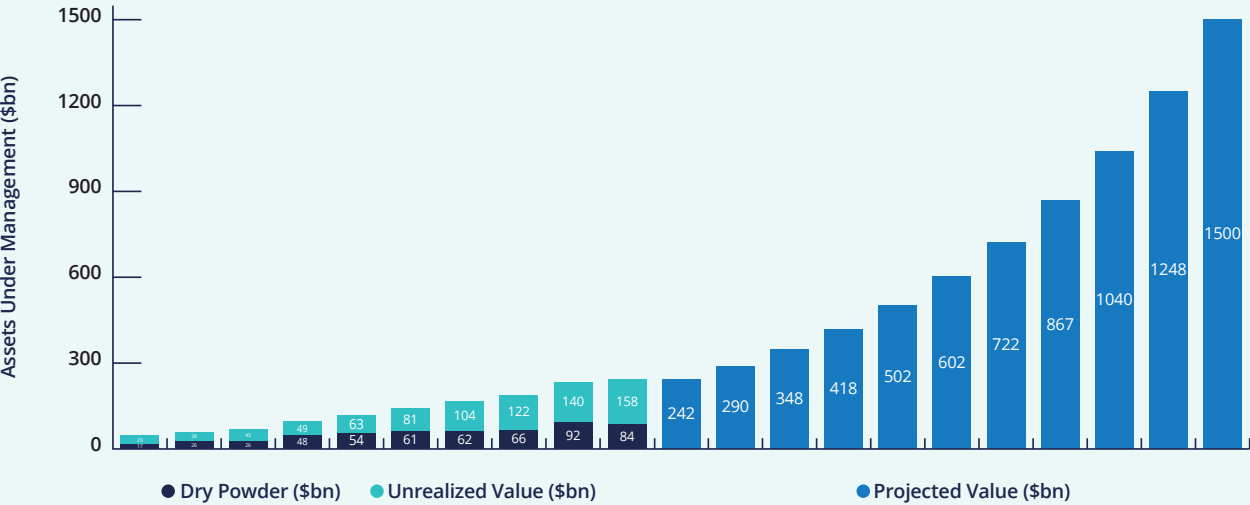
Around 50% of business debt financing in Europe is provided by non-bank lenders. The disintermediation of the banking sector and growth of non-bank lenders is one of the single biggest trends in the European economy during the last decade.

In the so-called 'direct lending' space, non-bank lenders are currently providing \$242bn of finance to more than 4,000 European businesses¹. This lending activity has grown from only \$39bn 10 years ago, with the market growing at a compound annual growth rate of 20% during that time. Maintaining this growth rate would see non-bank lenders investing over \$600bn in the European economy within five years and \$1.5tn by the end of the decade. This growth would benefit 10,000 European businesses within five years and up to 25,000 by 2030.

50%
of business debt financing in Europe is provided by non-bank lenders

non-bank lenders are currently providing \$242bn of finance to more than 4,000 European businesses

Europe-Focused Private Debt Assets under Management, 2000 - 2019



Source: <https://www.preqin.com/insights/global-reports/2020-preqin-global-private-debt-report>

¹ See Preqin market data and ACC data on average deal sizes - Figure 12 page 15 <https://www.aima.org/static/uploaded/12558e4c-cbc3-4418-9fc6e86d67cc8e3d.pdf>

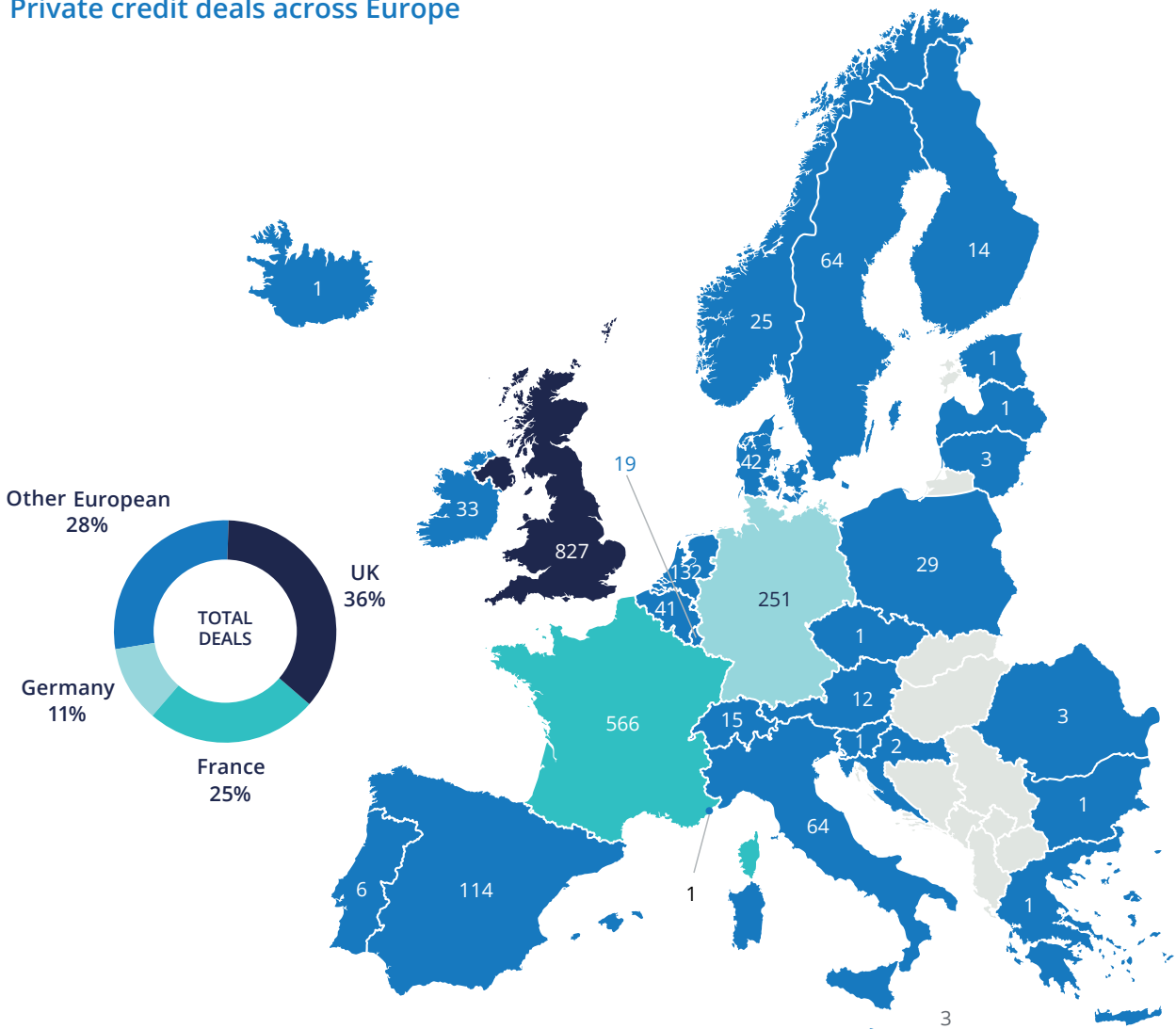
Non-bank lending in Europe

SMEs and mid-market companies are the main beneficiaries of the growth in non-bank lending, which allows them to access new sources of investment capital. Many of these borrowers have financing needs that fall outside the typical risk appetite of the banking sector, despite being viable businesses. Lenders with more tailored underwriting procedures, or who specialise in certain business sectors, provide these borrowers with a new way to access capital.

This allows these businesses to invest in their future, create jobs and compete in a global marketplace.

Despite the growth of non-bank lending, European businesses still suffer from a lack of access to finance. The European SME finance gap is estimated to be €400bn², but this is now likely to be much higher due to the impact of the COVID-19 pandemic. Access to finance remains one of the most critical issues facing businesses as they adapt to public health restrictions and invest in their future.

Private credit deals across Europe



Source: Deloitte Alternative Deal Tracker

² See https://www.allianz.com/content/dam/onemarketing/azcom/Allianz.com/economic-research/publications/specials/en/2019/20190409-TheView-EuropeanSMEs_COMPRESSED.pdf

Our research shows that almost half of all non-bank lenders plan to grow the amount of capital they invest in Europe over the next three years³, however Europe has some of the highest barriers to non-bank lending in the world⁴. This means that the amount of finance available to European businesses is currently below its real potential and significant gains can be made through policy reform.

Reducing the financing gap will require policymakers to act decisively and employ all tools at their disposal. The need for co-operation and co-ordinated action to reform capital markets within Europe is more urgent than ever. The Alternative Credit Council (ACC) supports the ongoing work of all European stakeholders to improve the performance of the European capital markets.

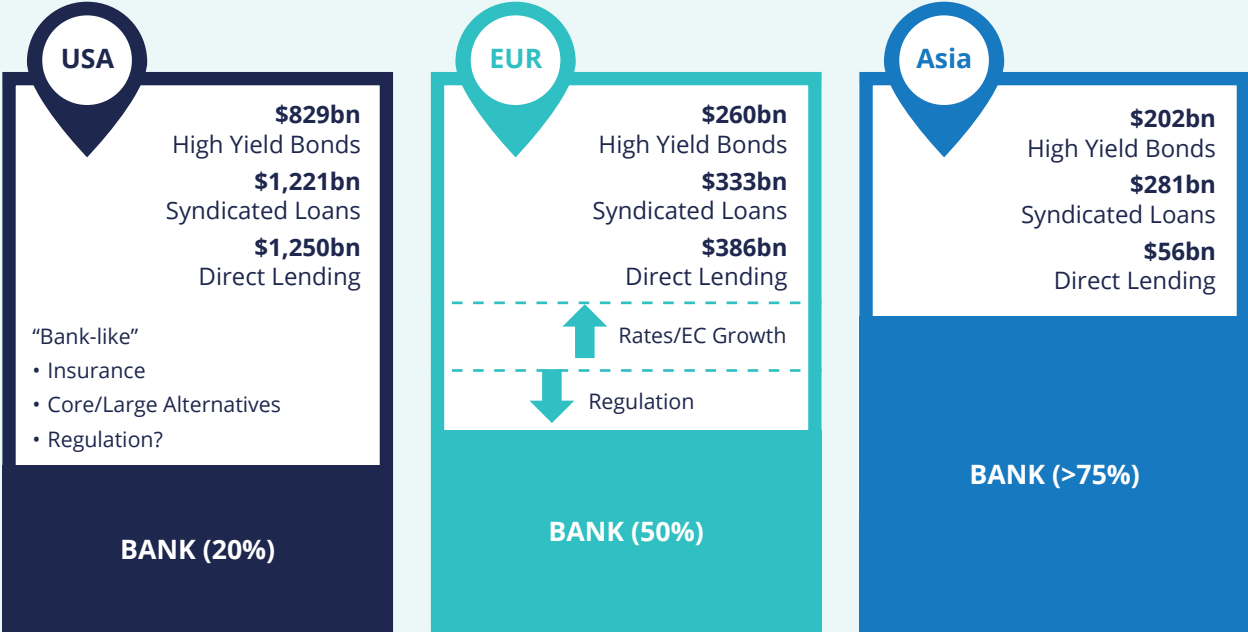
SMEs and mid-market companies

benefit most from the growth in non-bank lending

€400bn

estimated SME finance gap in Europe

Bank retrenchment globally is creating the opportunity for non bank-lenders



Source: StepStone Private Debt, COVID-19 Market Survey May 2020; Reuters, Credit Suisse, Bloomberg; Barclays Asia High Yield Index. Source: <https://www.stepstoneglobal.com/market-intelligence/stepstone-private-markets-intelligence/>

3 See <https://acc.aima.org/resources/research/financing-the-economy.html>
 4 See <https://www.aima.org/educate/aima-research/non-bank-lending-in-the-european-union.html>

Non-bank lending in Europe

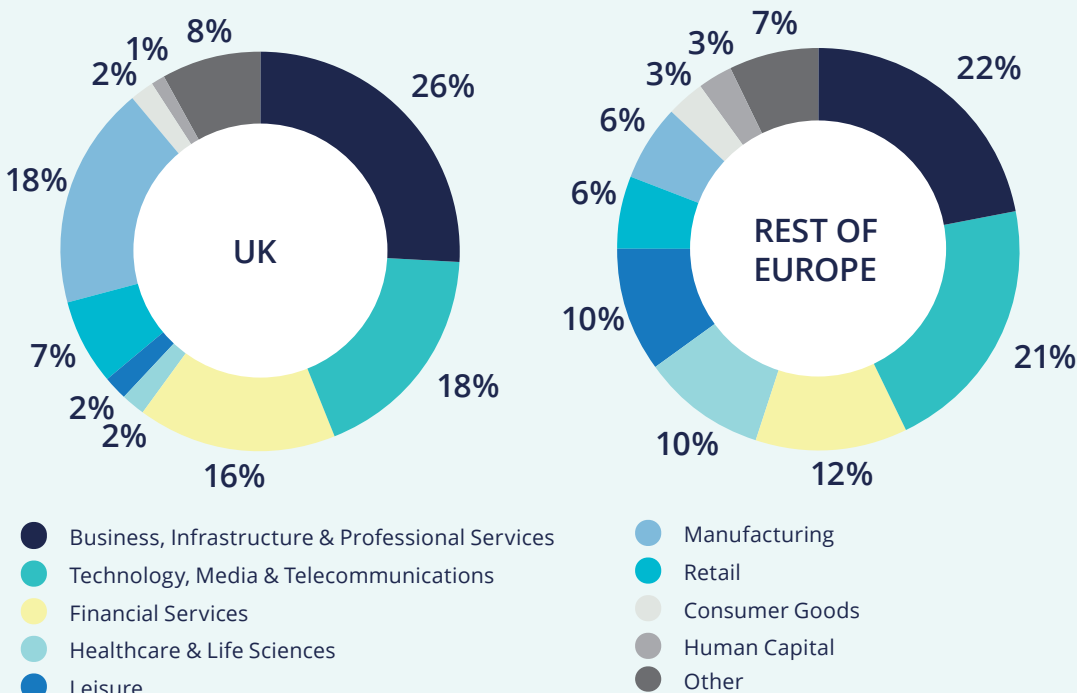
We welcome the European Commission High Level Forum’s final report *A new vision for Europe’s capital markets* and the subsequent *CMU action plan* to deliver this ambitious agenda. We also welcome the European Parliament’s own initiative report on the Capital Markets Union (CMU)⁵ and the contribution of other stakeholders to the reform agenda.

These reports underline that the European banking system, although better capitalised and more resilient, is not able to provide the credit needed to revitalise the European economy. European businesses often lack access to the capital needed to finance innovation and growth, despite the strong bank presence in many markets.

These businesses also require significant long-term investment as they transition to more sustainable models and compete with their international counterparts. A strengthened non-bank lending sector is therefore vital to any recovery efforts.

Non-bank lenders are already subject to regulatory oversight – including authorisation and ongoing supervision – via the Alternative Investment Fund Managers Directive (AIFMD) which sets the policy framework for alternative asset management in Europe. The AIFMD is currently under review to ensure that it provides the right basis for Europe’s alternative asset management industry to grow.

Private credit deals across Europe (2019)



Source: Deloitte Alternative Deal Tracker

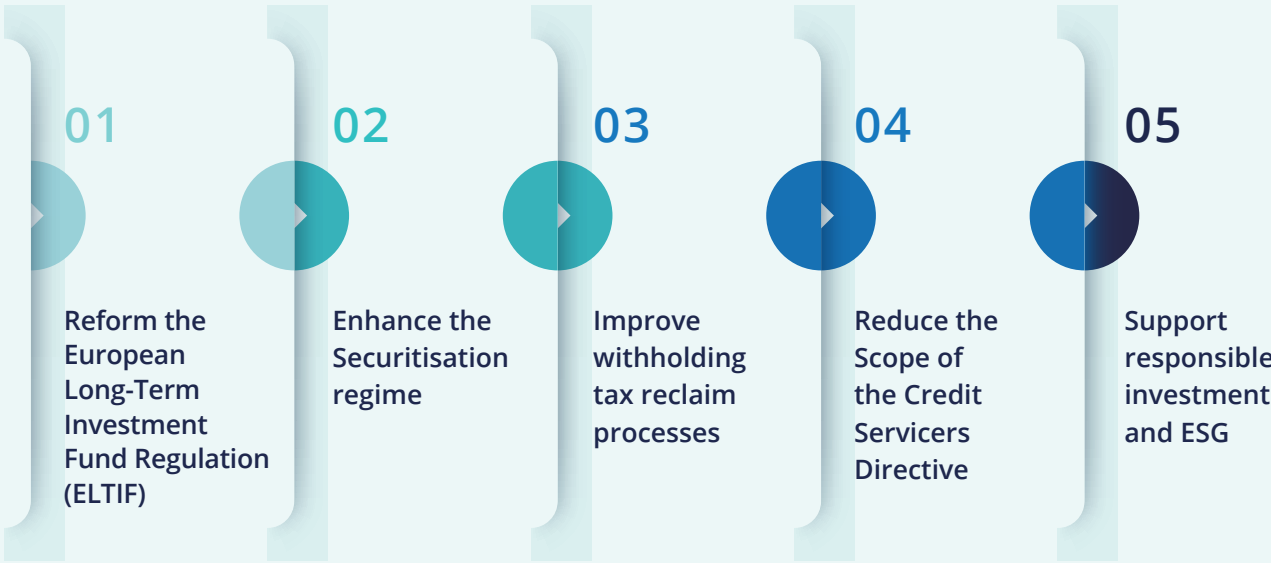
⁵ https://www.europarl.europa.eu/doceo/document/A-9-2020-0155_EN.pdf

The AIFMD recognises that the most appropriate means to regulate and supervise the sector remains at the level of the *asset manager* instead of focussing on specific strategies or investment structures. This ensures there is a consistent approach for different types of alternative investment strategies and limits the potential for nominal definitions to create regulatory arbitrage and affect investment decisions. While there have been some calls to introduce specific provisions for non-bank lenders into AIFMD⁶, we would urge policymakers to resist this approach. Undermining the basis of the AIFMD by introducing product level regulation would add significant complexity to the legislation and reduce confidence in the stability and effectiveness of the EU asset management policy framework.

Policymakers should instead focus on reducing the barriers that currently prevent the non-bank lending sector from playing a full role in the financing of the European economy. Many of the barriers to a deeper CMU also restrict the growth of non-bank lending in Europe. It is essential that the CMU reform agenda also addresses these challenges if it is to have a real impact and boost non-bank lending in Europe.

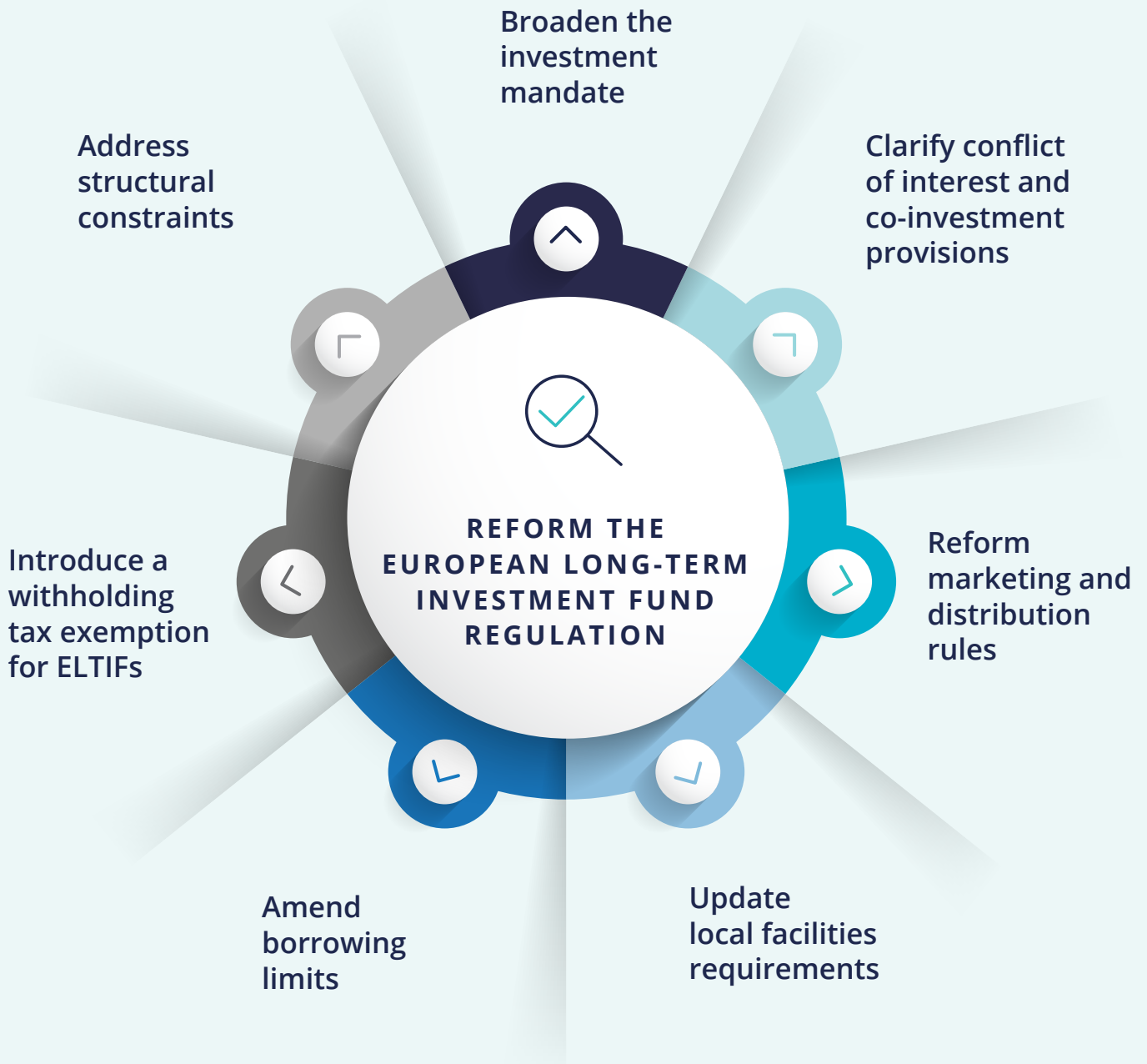
This paper provides policymakers with a series of recommendations that we believe will stimulate the non-bank lending market in Europe and support a sustainable and resilient economy.

How to boost non-bank lending in Europe



6 https://www.esma.europa.eu/sites/default/files/library/esma34-32-551_esma_letter_on_aifmd_review.pdf

Reform the ELTIF Regulation



There are currently only 27 active ELTIFs

providing less than €10bn equity and debt finance to SMEs across Europe.

The ELTIF Regulation was established in 2015 to support greater debt and equity investments in non-listed European businesses and reduce the SME finance gap. Typically, many illiquid or non-traditional assets have been the sole preserve of larger institutional investors such as pension and insurance funds.

The ELTIF offers retail investors and smaller institutional investors a way to access these investment opportunities and potentially realise higher returns, while also diversifying their exposure. This is particularly important for many investors in the current low interest rate environment. These investors also represent a new source of capital for European businesses.



WHAT ARE ELTIFs?

European Long-Term Investment Funds (ELTIFs) were introduced in 2015 to increase the amount of non-bank finance available for companies investing in the real economy. ELTIFs are collective investment vehicles that can raise capital from both retail and institutional investors who are willing to invest in smaller and mid-sized businesses (defined primarily as non-listed companies). ELTIFs are a form of Alternative Investment Fund (AIF) and must therefore be managed by an Alternative Investment Fund Manager (AIFM). This means that ELTIFs and ELTIF managers are subject to a robust EU regulatory and supervisory regime.

ELTIF OFFERS RETAIL INVESTORS AND SMALLER INSTITUTIONAL INVESTORS A WAY TO ACCESS THESE INVESTMENT OPPORTUNITIES AND POTENTIALLY REALISE HIGHER RETURNS, WHILE ALSO DIVERSIFYING THEIR EXPOSURE.

Reform the ELTIF Regulation

Despite the substantial growth of capital allocated to European based lending strategies by asset managers and their investors during the last decade, ELTIFs have not been the vehicle of choice to invest this capital. There are currently only 27 active ELTIFs providing less than €10bn equity and debt finance to SMEs across Europe⁷. This is despite some positive elements of the ELTIF, most notably the ability to originate loans on a cross-border basis. ELTIFs have therefore fallen short of expectations and the European Commission's High Level Forum is right to highlight the need for reform.

The primary challenge limiting greater take-up of ELTIF by asset managers and investors lies in the restrictive operating requirements that the ELTIF Regulation prescribes. These include the fund maturity, eligible assets, liquidity profile and leverage of the fund. In addition, safeguards that accompany the distribution of ELTIFs to retail investors – for example, suitability investments and marketing requirements – have diminished the attractiveness of ELTIF to its target market.

The final factor limiting the take up of ELTIF is how the vehicle attracts Withholding Tax (WHT). This makes it harder for an asset manager to achieve 'tax neutrality' for their investors. This simply means that the investors would pay no more tax than they would if they were to invest directly, rather than through a fund or other investment entity. These limiting factors make ELTIFs inefficient for investors seeking exposure to longer-term or illiquid assets such as SME loans or infrastructure investments.

Despite these challenges, the potential ceiling for ELTIFs to be a vehicle for SME finance is extremely high. In the United States, investment fund vehicles known as Business Development Companies (BDC) are providing more than \$100bn worth of finance to SMEs with an estimated 12,500 businesses benefitting from this capital.⁸ ELTIFs currently provide only a fraction of that amount in Europe, despite BDCs having many similarities with ELTIFs. A reformed and well-functioning ELTIF regime has the potential to achieve similar success to BDCs within 5-10 years. Unlocking this potential will make a material difference to European SMEs and support European citizens looking to save and invest.

Why have ELTIFs failed to succeed?

01

Too prescriptive for investors looking to lend in Europe

02

Retail investor requirements not conducive to attracting capital

03

Lack of certainty for investors on withholding tax treatment

⁷ See <https://www.esma.europa.eu/document/register-authorized-european-long-term-investment-funds-eltifs>

⁸ See Houlihan Lokey, Direct Lending Update, Summer 2019 – <https://hl.com/about-us/insights/insights-article/?id=17179871313>

HOW TO MAKE ELTIFS WORK FOR EUROPEAN SMES

A reformed and a well-functioning ELTIF regime, aligned with the needs of investors, has the potential to address many of the current challenges facing the European economy. Our key recommendations on how to enhance the effectiveness of ELTIF as a pan-European lending vehicle are summarised below:

- **Address structural constraints:**
The ELTIF Regulation requires an ELTIF to be established as a closed-ended structure and for it to have a fixed maturity. A practical consequence of these requirements is that they restrict the assets an ELTIF will consider for investment and increases the proportion of investor capital that is not fully invested. Allowing ELTIFs to also operate as permanent capital or evergreen vehicles will allow ELTIFs to better align with investor preferences, while also aligning with the long-term investment envisaged via ELTIF.
- **Broaden the investment mandate:**
The evidence of the last five years suggests that the current conditions imposed by the ELTIF Regulation on the ELTIF investment strategy require a re-assessment to determine whether they are unnecessarily inhibiting the growth of the vehicle. Expanding the types of assets ELTIFs can invest in will make the ELTIF a more efficient vehicle to deploy capital. ELTIFs should also be able to invest in ELTIF fund of funds structures to support portfolio diversification and make some assets more accessible to investors.
- **Clarify conflict of interest and co-investment provisions:**
Alternative Investment Fund Managers (AIFMs) typically invest capital in their own funds. This helps ensure an alignment of interest between the AIFM and their investors. Article 12 of the ELTIF Regulation creates uncertainty regarding this practice, which acts as a disincentive to establishing an ELTIF.
- **Reform marketing and distribution rules:**
MiFID investor definitions and target market rules should be reformed to enable ELTIF to fulfil its potential as a retail or semi-professional investment vehicle. The ELTIF Regulation should be reformed to permit the establishment of publicly listed and private ELTIFs.
- **Update local facilities requirements:**
ELTIF managers are required to set up local facilities in each Member State where it intends to market units or shares in the ELTIF. This requirement is anachronistic at a time when investors expect these facilities to be provided via online channels that do not require a local presence in each individual Member State.
- **Borrowing limits:**
Borrowing by ELTIFs is currently restricted to 30% of their assets. This compares unfavourably with other retail funds such as UCITS, which can borrow up to 100% of their assets. This restriction limits the ability of ELTIFs to produce the investment return needed by investors to make allocating capital to ELTIFs viable. Borrowing by ELTIFs to support the financing of assets will enhance their ability to finance SMEs, while also allowing the banking sector to play an important role as a financing partner.
- **Introduce a withholding tax exemption for ELTIFs:**
Investment by ELTIFs into private and unlisted SMEs creates more complexity regarding the withholding tax treatment of the investment, than investment in traditional asset classes such as stocks or bonds. This makes it harder for ELTIF managers to ensure tax neutrality for their investors, which ensures they are in no worse a position than if they invested directly rather than through the ELTIF. An exemption from WHT alongside an effective and swift clearance procedure would address this issue.

Enhance the Securitisation Regime

A reformed securitisation framework will help reduce the EU's over-reliance on bank funding.

Over the past decade, securitisation has played a limited role in the financing of SMEs and mid-market businesses in Europe when compared to other countries such as the US and UK. The extensive reforms introduced via the Securitisation Regulation and Capital Requirements legislation have helped restore confidence in securitisation, but there is still more to be done.

A reformed securitisation framework will help reduce the EU's over-reliance on bank funding, while preserving the financing of the European economy. Expanding the range of banks' asset and capital management options to absorb market and regulatory pressure will also enhance their resilience by providing them with another tool for the management of their non-performing exposures, thus contributing to the de-risking of the European banking system. In addition, investors will experience a broadening of investment opportunities and cross-border investments will be encouraged.



WHAT IS SECURITISATION?

Securitisation is a core feature of capital markets. It provides a mechanism by which illiquid loans originated by banks and finance companies are transferred to capital market investors. Securitisation solves two key problems in the financial system. It allows investors to access asset classes such as real estate mortgages, auto loans and corporate loans (including those of SMEs) that would not be otherwise investible on an individual basis. Securitisation also frees up the balance sheets of banks, allowing them to originate new loans and continue providing finance to the real economy.

SECURITISATION ONLY REPRESENTS 3% OF THE GDP IN THE EU-27, WHEREAS IT TAKES UP 12.5% OF GDP IN THE US AND 12% IN THE UK⁹

⁹ Source: HLF on Capital Markets Union report

Enhancing the role of Securitisation in the European Economy

The ACC welcomes the initiative of the CMU HLF to make the securitisation framework more efficient and better aligned with established industry practices. The ACC supports the seven key recommendations proposed by the HLF, in particular the recommendation regarding reducing the cost of SME financing and differentiating between disclosure and due diligence requirements for public and private securitisations. We also support the [Securities quick fix package](#) issued by the EU Commission as part of the COVID-19 recovery efforts, specifically the proposals to support on-balance-sheet synthetic securitisation and incentivise securitisation of NPEs.



HLF PROPOSALS TO ENHANCE THE SECURITISATION FRAMEWORK

- Unlock the Significant Risk Transfer Assessment process
- Recalibrate capital charges for senior tranches under CRR2
- Recalibrate capital treatment for securitisation tranches under Solvency II
- Reduce the costs of SME financing by: (i) including credit information within the scope of the European Single Access Point (ESAP); and (ii) continuing to improve credit underwriting standards and NPL reduction
- Apply equivalent treatment to cash and synthetic securitisations of all asset classes by: (i) expanding the scope of STS synthetic securitisations; and (ii) applying the same regulatory and capital treatment to synthetic and cash securitisation
- Upgrade eligibility of senior STS and non-STS tranches in the LCR ratio
- Differentiate the disclosure and due diligence requirements for public and private securitisations
- Allow EU-regulated investors in third-country securitisations to determine whether they have received sufficient information to meet the requirements of Article 5 of Securitisation Regulation
- Facilitate the securitisation of legacy portfolios and allow the development of an active market for buying and selling pool of assets in Europe, notably by explicitly allowing the practice of re-underwriting the loans in cases where an entity acquires legacy and NPE pools.

Enhance the Securitisation Regime

Extend the STS regime to on-balance-sheet synthetic securitisations

Introduce of a definition non-performing exposures (NPEs) securitisation



Re-calibrate capital requirements for NPE securitisations

Amend the computation of expected losses related to NPE securitisations net of credit risk adjustments



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 uses the interest and principal payments they receive from borrowers to return the principal and interest payments they return to investors. Around two-thirds of global CLOs are held by non-bank investors such as pension funds, insurers and investment funds.¹⁰

¹⁰ <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/november-2018.pdf?la=en&hash=A9AE16F96F1F4C01B9ECF1C2B4D902E9472085B3>

The implementation of the HLF recommendations and the Securities quick fix package are necessary and important steps that will support the ability of securitisation to support the flow of capital to European businesses and consumers.

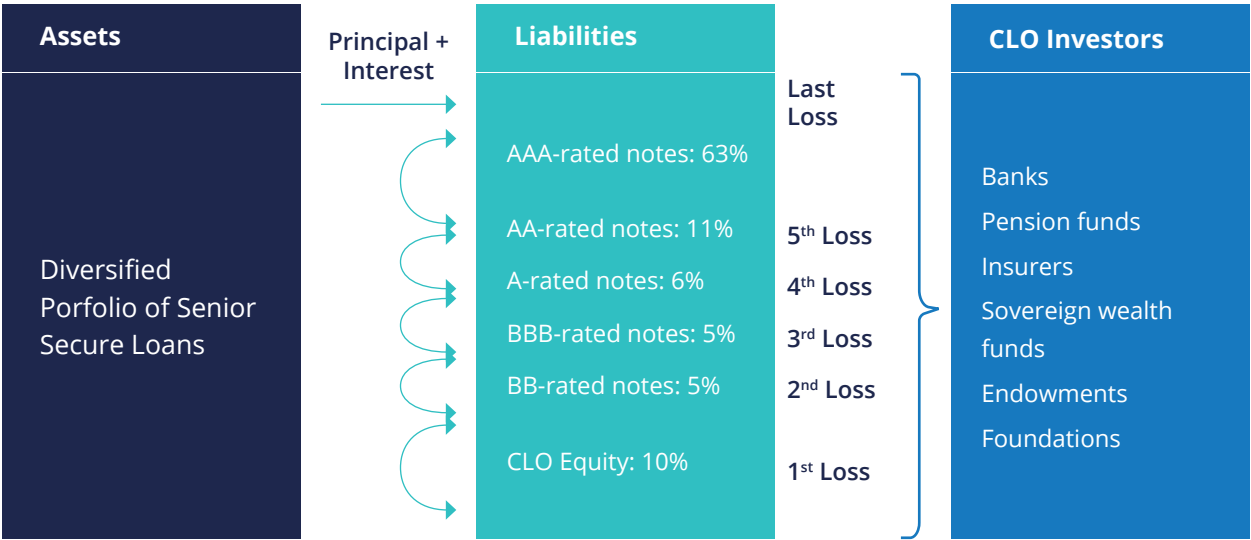
The ACC would however urge policymakers to consider additional reforms to address other fundamental issues holding back the European securitisation market, particularly those which affect Collateralised Loan Obligations (CLOs).

Focus on 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. This practice helps ensure investors’ interests are being protected, while also supporting the efficient allocation of capital across the economy.

Typical CLO structure



Enhance the Securitisation Regime

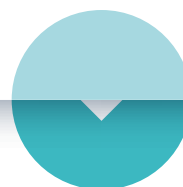
Due to the tranching involved, CLOs fall within the remit of the Securitisation Regulation, but they are not eligible for STS certification as they are deemed to be 'actively managed' for the purposes of the Regulation. CLOs should, however, be considered eligible for STS certification for several reasons:

- CLO managers are required to comply with standardised tests and criteria 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.

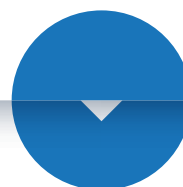
The exclusion of CLOs from the STS framework acts as a brake on the provision of finance to European borrowers, while also limiting the ability of banks to de-leverage their balance sheets. We would urge policymakers to amend the STS criteria to encompass transactions where active management can only 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.

Securitisation reforms to support the flow of finance in the EU economy

01 Implement the HLF recommendations



02 Implement the Securities quick fix package



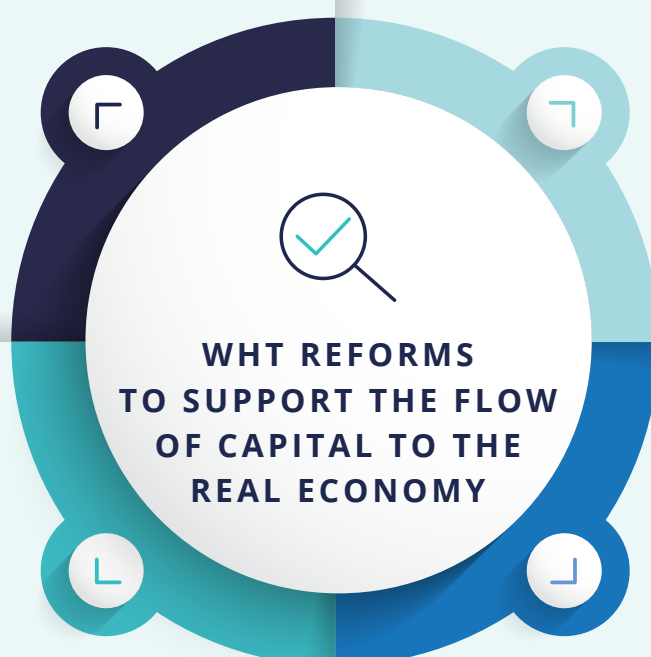
03 Allow CLOs to obtain STS certification where appropriate to increase the flow of finance to European borrowers and allowing banks to de-leverage their balance sheets



Improve Withholding Tax Reclaim Processes

Use existing reporting mechanisms and anti-avoidance rules rather than seeking to implement new laws

Better adoption of TRACE in Europe



Remove entirely Withholding Tax on interest and dividends (and equivalent payments) paid to (i) finance providers in an EU (or EEA) member state and (ii) qualifying finance providers outside the EU / EEA

Implement the HLF recommendations to set out common definitions, common processes, and a single form for WHT reclaim processes and a standardised system for relief at source of Withholding Tax

58% OF PRIVATE CREDIT MANAGERS CITE TAX AND FUND STRUCTURING AS THE BIGGEST REGULATORY CHALLENGE FACING THE ASSET CLASS¹¹

Improve Withholding Tax Reclaim Processes

In Europe, the current Withholding Tax (WHT) regime undermines the principle of tax neutrality by placing additional cost on investors who use funds or collective investment schemes to invest. This tax ultimately falls on investors, reducing their returns and diminishing their appetite to invest in the European economy. Whilst WHT can often be reclaimed where it has wrongly been levied on the investor, there are no common EU-wide rules regarding applicable time limits and reclaim processes which increases administrative and compliance costs.

The OECD Treaty Relief and Compliance Enhancement (TRACE) initiative has developed the Authorised Intermediary (AI) system. This standardised system allows the claiming of WHT relief at source on portfolio investments. It removes the administrative barriers that affect the ability of portfolio investors to effectively claim the reduced rates of WHT to which they are entitled, pursuant to tax treaties or to domestic law of the country of investment. It minimises administrative costs for all stakeholders and enhances the ability of both source and residence countries to ensure proper compliance with tax obligations. The ACC has expressed its support for this initiative and would encourage the adoption of TRACE across Europe.

In its report, the HLF invited the European Commission to set out in EU law common definitions, processes and a single form relating to WHT relief at source procedures, and to introduce a standardised system for relief at source of WHT through an EU Directive. We support these recommendations and would call on policymakers to go further by removing WHT on interest and dividends (and equivalent payments) paid to: (i) finance providers in an EU (or EEA) Member State; and (ii) qualifying finance providers outside the EU / EEA. Existing reporting mechanisms, coupled with an anti-avoidance rule, would provide adequate protection against abuse or fraud and Member States should be discouraged from imposing additional reporting or filing requirements that would ameliorate the benefits of this.



WHAT IS TAX NEUTRALITY?

Tax neutrality is an essential component of all investment strategies. Investors such as pension funds, insurers, not-for-profit organisations, foundations, endowments and other similar entities invest a small proportion of their funds in the alternatives market to diversify their portfolio and maximise returns. Such funds are designed to preserve so far as possible the attributes that an investor would have if they were investing directly in assets rather than using a fund. A tax neutral regime also ensures that tax treatment does not influence investors' choices between investing directly or through a fund in the same underlying investments.

Reduce the Scope of the Credit Servicers Directive

The volume of NPLs in Europe is likely to grow significantly

due to the economic impact of the COVID-19 pandemic

The ACC welcomes policymaker' efforts to address the high levels of non-performing loans ('NPLs') and promote a resilient financial system. However, the proposed Credit Servicers Directive is unlikely to materially support these objectives in its current form. The volume of NPLs in Europe is likely to grow significantly due to the economic impact of the COVID-19 pandemic and it is therefore necessary to re-assess whether the proposed Directive is the right means by which to address this new challenge.



WHAT IS THE CREDIT SERVICERS DIRECTIVE?

The proposed Directive of the European Parliament and of the European Council on credit servicers, credit purchasers and the recovery of collateral seeks to: (i) promote a healthy secondary market for NPLs; and (ii) tackle undue obstacles to credit servicing and the transfer of bank loans to third parties across the EU. The proposal provides for a definition of the activities of credit servicers, establishes common standards for authorisation and supervision and imposes conduct rules across the EU.

WHY THE CREDIT SERVICERS DIRECTIVE WILL NOT WORK

Lack of exclusion for the syndicated loan market from types of loans covered under the proposal

Disproportionate reporting and procedural requirements imposing undue administrative burden on credit institutions, credit servicers and credit purchasers

Lack of exemption for MiFID entities from the definition of credit servicer

Discretion of Member States to introduce additional requirements on credit purchasers

Disproportionate levels of forbearance measures and rules of conduct

Reduce the Scope of the Credit Servicers Directive

While we commend the work that has been undertaken to enhance the effectiveness of the proposed Directive, the delay in finalising the legislation should be taken as an opportunity to rethink the proposals to better align them with current circumstances and reduce the operational burden on market participants.

It is the ACC's view that the proposed Directive must be fundamentally reconsidered in light of the current environment, to ensure that the regulatory architecture supports the economic recovery of Europe.

At a minimum, any reforms should prevent Member States from introducing additional requirements on NPL purchasers and should focus solely on authorisation requirements on credit servicers. This will support the transfer of loans (both performing and non-performing) to non-bank financial institutions. Financial institutions subject to existing European regulation – AIFMs,

UCITS management companies and MiFID entities - should also be excluded from the definition of credit servicer and the Directive should only apply to consumer loans.

In addition, reporting obligations and procedural requirements on credit institutions, credit servicers and credit purchasers regarding the transfer of non-performing credit agreements should be aligned with existing market practice. As currently envisaged, these requirements will only hinder the market for NPLs by introducing additional cost and operational burdens to credit institutions, credit servicers and credit purchasers with no commensurate benefit. It is unclear how the disclosure of this additional information to national competent authorities will support greater investment by market participants in the European NPL market.

Reform the Credit Servicers Directive to reduce European NPLs

01

Re-introduce Article 15(2) from the original proposal to support a truly European market for NPLs and reduce barriers to investors

02

Limit the scope of the Directive to consumer loans

03

Ensure that financial institutions subject to existing European regulation are excluded from the definition of credit servicer

04

Align all reporting and disclosure requirements with market practices to reduce operational costs for banks and credit purchasers

Support Responsible Investment & ESG

Provide SMEs with the tools and guidance needed to calculate and report ESG data

Cooperate and coordinate with other financial centres when issuing guidance related to ESG and RI



Acknowledge and address the lack of reliable ESG data

Recognise the heterogeneity of alternative investment strategies in future policy initiatives

Support Responsible Investment & ESG

Meaningful engagement with environmental, social and governance factors (ESG) and Responsible Investment (RI) are no longer a 'nice to have' option for investment managers. Investors increasingly expect private credit managers incorporate ESG/RI considerations as part of the investment process, whether in the firms they lend to or the way in which they analyse risk. The ACC and its members recognise that this is not simply a temporary trend but a firm shift in attitude.

Despite this acknowledgment of the importance of ESG and RI to the private credit industry, our [Financing the Economy](#) research has highlighted that managers face multiple challenges when it comes to the practical incorporation of ESG/RI into the lending process. The chief obstacle is the absence of standardised data and reporting against ESG factors.. The ACC supports ongoing efforts within the financial services sector to disseminate best practice and improve investors' access to data.

68%

of private credit managers incorporate Responsible Investment and ESG factors into their investments¹¹

WHAT ARE THE BIGGEST OBSTACLES MANAGERS FACE WHEN ADOPTING RI/ESG FACTORS INTO A PRIVATE CREDIT STRATEGY?¹²

1.

Lack of standardisation across the data/reporting of RI/ESG factors

2.

Lack of relevant disclosures from borrowers

3.

Lack of exclusion for the syndicated loan market from types of loans covered under the proposa

¹¹ Source: ACC Financing the Economy research
¹² Source: ACC Financing the Economy research

We would highlight the following areas where regulatory support is needed to achieve the shared objectives of meaningful incorporation of ESG/ RI into the lending and investing process:

- **Assistance to SMEs and mid-market companies:**

When lending to SMEs, private credit firms often face difficulty in obtaining sufficient data to assess ESG/ RI factors. Such businesses are often too small to incorporate dedicated ESG/ RI functions within their business. The EU could support SMEs by developing materials – such as voluntary reporting templates, guidance and access to technical assistance – to help SMEs calculate and assess ESG-related metrics in a standardised manner. This would allow SMEs to provide these metrics to their stakeholders, including private credit lenders. When combined with the HLF proposal for a European database of financial information on issuers, this would provide investors with unparalleled access to ESG-related data to support their investment decisions.

- **Acknowledge and address the lack of reliable ESG data:**

Any further ESG-related policy initiatives should address this and provide flexibility to market participants when the data is not available. In addition, policymakers should be mindful of the sequencing of the various regulations they put forward and ensure consistency.

- **Recognise the heterogeneity of alternative investment strategies:** Private credit and the alternative investment management sector more generally encompasses a number of different investment strategies. This diversity has not been sufficiently reflected in the current regulatory actions in conjunction with ESG/ RI, notably the Sustainable Finance Disclosure. We recommend that any further policy initiatives are flexible and proportionate enough to accommodate our members' investment strategies.

These suggestions seek to ensure that investors and market players have the necessary tools and data to fulfil their obligations and service their ultimate beneficiaries - institutional investors such as pension and insurance funds.

Summary of Recommendations

01

Reform the ELTIF

- Address structural constraints
- Broaden the investment mandate
- Clarify conflict of interest and co-investment provisions
- Reform marketing and distribution rules
- Update local facilities requirements
- Update borrowing limits
- Introduce a withholding tax exemption for ELTIFs

02

Enhance the Securitisation regime

- Implement the HLF recommendations
- Implement the Securities quick fix package
- Allow CLOs to obtain STS certification

03

Reduce the scope of the Credit Servicers Directive

- Re-introduce Article 15(2) to support a pan-EU market
- Limit the scope of the Directive to consumer loans
- Exclude regulated financial institutions from the definition of credit servicer
- Align reporting and disclosure requirements with market practices

04

Support responsible investment and ESG

- Provide SMEs with tools and guidance to identify ESG data
- Acknowledge and address the current lack of reliable ESG data
- Recognise the heterogeneity of investment strategies in policy formulation

05

Improve withholding tax reclaim processes

- Better adoption of TRACE in Europe
- Implement HLF recommendations to standardise WHT reclaim and relief at source
- Remove WHT Tax on interest and dividends for EU/EEA and other qualifying finance providers
- Use existing reporting and anti-avoidance rules rather than introduce new laws

The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 170 members that manage over \$400bn of private credit assets.

The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council.

ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business.

The ACC's core objectives are to provide guidance 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.

Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

