SQUARE THE CIRCLE
by iLS

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DOES THE MARKET NEED AIFMs TO ACT AS SPONSORS OF EU SECURITISATIONS?

Background

Between October and December 2024, the European Commission conducted a consultation on the functioning of the EU securitisation framework. Following the passing of Regulation (EU) 2017/2402, commonly known as the SECR, and a subsequent Commission report on the impact of the SECR in 2022, this consultation marked the latest attempt to reinvigorate the European securitisation market.

The European Commission was motivated by reports from Mario Draghi, Enrico Letta and Christian Noyer on the need to strengthen lending capacity and create deeper capital markets in the bloc to increase competitiveness. By contrast with the US, the securitisation market in the EU has been unable to return to pre-financial crisis levels.

In this context, market participants were asked to provide their views on a series of potential reforms to existing regulation. Among these, question no. 3.6 asked respondents to provide their view on potentially expanding the definition of "sponsor" in the SECR to include alternative investment firm managers established in the EU (the "**Question 3.6**").[1] Furthermore, respondents were encouraged to suggest whether the definition should be expanded to include additional market participants.

Introduction

Under the SECR, a net economic interest of 5% of tranched securitisation transactions has to be retained by certain entities acting in their qualified capacity as "originators", "sponsors" or "original lenders" to ensure that their interests and those of the investors are aligned. Question 3.6 focuses on the opportunity to expand the definition of "sponsor"[2] to include, not only EU and non-EU credit institutions and EU investments firms, but also EU alternative investment firm managers ("**AIFMs**").

Respondents included mainly banks, AIFMs, government bodies and industry bodies. Remarkably, compared to the AIFMs involved in the broader consultation, fewer of them provided their feedback on this matter which directly affects their business interests. Based on our review of a sample of answers from the most notable respondents,[3] no consensus seems to

[1] The full text of question 3.6 is: "Should the definition of a sponsor be expanded to include alternative investment firm managers established in the EU? Please explain your answer to question 3.6, including if the definition should be expanded to any other market participants".

[2] The definition of "sponsor" is outlined in Art 2(5) of the SECR as "a credit institution, whether located in the Union or not, as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013, or an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU other than an originator, that: (a) establishes and manages an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities, or (b) establishes an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities and delegates the day-to-day active portfolio manage."

[3] In alphabetical order: Amundi Asset Management, the Association for Financial Markets in Europe, Banco De España, BNP Paribas, the Danish Government, Deutsche Bank AG, the European Banking Federation, the Finnish Ministry of Finance, the ING Group, the International Association of Credit Portfolio Managers, the Italian Banking Association, the

have been reached in the market on whether the scope of the "sponsor" definition should be expanded.

Interestingly, a few respondents have taken this opportunity to suggest that non-EU investment firms should be allowed to act as "sponsors".[4]

Reasons of Those in Favour

The majority of AIFMs and their industry body expressed support for expanding the "sponsor" definition as they are believed to satisfy certain practical and legal conditions required to act as a retainer, and their direct involvement as "sponsor" would be beneficial to the market. In particular:

- **AIFMs satisfy the "sole purpose test"** – AIFMs are generally well-equipped to satisfy the related sponsor obligations under the SECR as they operate within the parameters of a business strategy and maintain governance arrangements to carry out their strategy and have access to a range of economic resources (including, for example, income sources based on management fees). In other words, AIFMs are expected to meet the "sole purpose test" set out in article 2(7) of the Regulatory Technical Standards[5] to assess whether an entity has been established or operates for the sole purpose of securitising exposures and, therefore, is not eligible to act as an "originator"[6] pursuant to article 6(1) of the SECR;[7]

- **AIFMs are regulated and subject to capital requirements** – AIFMs are highly supervised and subject to prescriptive safeguards under the AIFMD[8] regime, including initial capital and own fund requirements;[9]

- **AIFMs already acting as risk retainer** - AIFMD II[10] reforms already introduce a risk retention regime based on SECR requirements whereby AIFMs and entities that they

Managed Funds Association, the French Ministry of Economy, Finances and Industry, Paris Europlace, PGIM Fixed Income, PIMCO, Schroder Investment Management (Europe) S.A., UniCredit, and the Union de Creditos Immobiliarios EFC S.A.

[4] PIMCO, Schroder Investment Management (Europe) S.A.

[5] Reference is made to the Regulatory Technical Standards contained in Commission Delegated Regulation (EU) 2023/2175.

[6] Although the "sole purpose test" applies to originators, the implicit argument seems to be that AIFMs comply with a sort of *de minimis* operational, organisational and business requirements that need to be satisfied by any entity acting as a risk retainer.

[7] Managed Funds Association.

[8] That is Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

[9] PIMCO.

[10] That is Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds.

manage are permitted to originate loans and incorporate a requirement to retain 5% of any loans originated and subsequently sold;[11]

- **AIFMs acting as sponsors would be beneficial to the market** – should AIFMs be included in the definition of "sponsor", they would have direct access to the securitisation markets, and this could lead to the evolution and development of a new range of investment strategies, enabling AIFMs to structure and manage securitisations. AIFMs could use the securitisation structure to develop tailor-made investment structures to meet the needs of their investors. Additionally, acting as a sponsor would give the AIFM greater control over the securitisation process, allowing them to manage and structure portfolios more effectively. Conversely, under current circumstances, the SECR compels AIFMs to resort to artificial structuring arrangements if they wish to issue a securitisation[12] or simply not to issue a securitisation in the EU.[13]

Reasons of Those Against

Subject to exceptions, banks, banking and governmental authorities have expressed their disagreement with the proposal contained in Question 3.6. The arguments substantiating their position can be summarised as follows:

- **Lack of capital** – the capital requirements applicable to AIFMs are insufficient to ensure that they are suitable to satisfy the sponsor's support and guarantee requirements for ABCP securitisations,[14] and, in the absence of levels of prudential liquidity requirements comparable to those applicable to banks, AIFMs would be able to introduce more risky securitisations, which could potentially destabilize the ABCP market;[15]

- **Business model focused on management (as opposed to asset holding)** - from a commercial perspective, the main business of AIFMs is management, not holding assets directly. Although sponsors do not own the assets before they are securitised, a sponsor

[11] PIMCO. The rationale of this argument seems to be that, since the AIFMs can act as risk retainers under the AIFMD, they should be allowed to be sponsors for the purposes of the SEC. In fairness, this argument appears weak and not fully technically correct. Under Article 15(4i.) of the AIFMD (introduced by the AIFMD II), "*[a]n AIFM shall ensure that the AIF it manages retains 5% of the notional value of each loan that the AIF has originated and subsequently transferred to third parties.*". According to the above, the 5% economic interest has to be retained by the AIF (as opposed to the AIFM) in its capacity as "originator". Furthermore, although the retention requirements set out in the AIFMD and the SECR seems to share the same objective (i.e., counteract the "originate-to-distribute" strategy), they should be considered as two separate requirements altogether.

[12] For example, by setting up a separate EU MiFID investment firm, but this is a highly inefficient solution from a cost and timing perspective.

[13] Managed Funds Association.

[14] European Banking Federation, BNP Paribas and Paris Europlace. Similarly, the French Ministry of Economy, Finances and Industry (according to which, "*generally [AIFMs] do not have the capital necessary to directly hold the retention piece that comes with the status of originators of a securitisation transaction*").

[15] ING Group.

under these circumstances would still need to hold risk retention, which is not something most AIFMs are set up to do themselves;[16]

- **Conflicts of interest** – should the AIFMs be allowed to act as sponsors and, therefore, risk retainers in the AIFs managed by them, concerns may arise about how their duty to act in the best interests of their AIF investors would interact with their obligation to hold the risk retention for the life of the transaction;[17]

- **AIFMs already acting as risk retainers** - AIFMD II has clarified that EU AIFMs as originators can perform loan origination activities and as such, can act as retention holders under SECR.[18]

Final Considerations

We feel that the points raised by respondents both for and against the proposal set out in Question 3.6 are important in assessing the proposed change. However, they are not necessarily incompatible. In evaluating the proposed change, the first issue to consider is whether it satisfies a need that is truly perceived in the market. Based on the answers of AIFMs and their industry body, they believe that this change would help their business and, therefore, would be welcome. In particular, based on our understanding of the responses, AIFMs are only interested in acting as sponsors within specific boundaries, *i.e.* when issuing a securitisation on behalf of investors in AIFs managed by them (so-called captive securitisations).

In our view, this is a critical point: by excluding the possibility for AIFMs to act as sponsors of securitisations other than captive securitisations, the expansion of the definition of "sponsor" should not result in increased competition among sponsors in the non-captive securitisation market. The non-captive securitisation market remains dominated by banks, which may explain why they largely opposed the proposed change.

If the above is correct, the hypothetical new limb of the definition of "sponsor" dealing with AIFMs should be extremely clear about the limited scope of the transactions in which they can act as sponsors.

We believe that such a limb should also carve out so-called "fully supported" ABCP transactions and programmes (in which sponsors directly and fully provide support via liquidity facilities to

[16] Paris Europlace and Association for Financial Markets in Europe. The latter has noted on point that "*[a]t the moment, the capital requirements are set up to deal with the assets the AIFM has under management, but they do not provide for capital to be held in respect of assets held directly by the AIFM* [emphasis added]. *This situation would presumably need to be corrected if AIFMs were to sponsor securitisations and hold risk retention themselves.*"

[17] Paris Europlace and Association for Financial Markets in Europe.

[18] BNP Paribas. Interestingly, this is the same argument used by PIMCO to support the widening of the scope of the definition of "sponsor" to AIFMs (see footnote no. 11 above). In this case, the rationale seems to be that, since the AIFMs are able to act as originators, then it is not necessary to let them qualify as sponsor. We are under the impression that BNP Paribas has misconstrued the provisions of the AIFMD as they seem to conclude that the AIFMs can act as originators-risk retainers for SECR purposes in the context of securitisations of loans originated by the AIFs under management. Based on our interpretation of Article 15(4i.) of the AIFMD, the risk requirement set out there has to be satisfied by the AIF (as opposed to the AIFM) and only for the specific purposes of the AIFMD (and not necessarily also for the purposes of the SECR).

the SSPEs to cover liquidity and credit risk, material dilution risk, transaction and programme-level costs).[19] The argument that the capital requirements for AIFMs are too light when compared to banks is generally correct. However, it should be noted that such differences may appear less striking when comparing the capital requirements for AIFMs with those applicable to *e.g.* so-called "class 3" investment firms, *i.e.* those investment firms which under Investment Firms Regulation[20] are subject to lighter prudential requirements than banks but can nevertheless act as sponsors.[21]

On the other hand, the absence of levels of prudential liquidity requirements comparable to those applicable to banks seems to constitute a concrete obstacle for AIFMs to act as sponsors in the context of "fully supported" ABCP transactions and programmes, particularly with a view to avoiding that investors are misled about the solidity of the transaction or programme in which they invest.

As for the interplay between the definition of "sponsor" under the SECR and the new retention requirement introduced by the AIFMD II, we are under the impression that this has limited relevance to the question at hand. First of all, it should be reiterated that the new retention requirement applies only to AIFs acting as originators of the loans originated by them, as opposed to the AIFMs which manage those AIFs. The two retention regimes under Article 15(4i.) of the AIFMD, on the one hand, and, article 6 of the SECR, on the other hand, overlap only marginally. In order for an AIF to act as originator for SECR purposes, it would still have to meet the "sole purpose test", while, in case of failure of such test, the AIF will still have to retain 5% of the notional value of each loan that the AIF has originated and subsequently transferred to third parties. More importantly, we note that no efficient solution has been offered with respect to securitisations issued by an AIF involving loans which have not been originated by it, but have been acquired on the primary or secondary market (which is, for instance, a significant issue in the NPL securitisation market). Over the last few years, certain international law firms have proposed a construction under which AIFs may act as originators for SECR purposes even under these circumstances (including, in scenarios where the underlying assets were acquired directly by the SSPE).

[19] This approach is shared by the Association for Financial Markets in Europe.

[20] Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms.

[21] Until 25 June 2021, all investment firms were subject to the EU prudential framework which applies to banks, as set out in Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms, also known as the Capital Requirements Regulation (CRR), and Directive 2013/36/EU, also known as the Capital Requirements Directive (CRD). More recently, Regulation (EU) 2019/2033 set out, for certain categories of investment firms, new prudential requirements which are proportionate to a firm's size, nature, complexity, risk profile and business model. compared to the CRR/CRD framework, providing for simpler and more bespoke capital requirements for smaller investment firms. Despite the relevant changes within the investment firms' regulatory framework based on their size, however, the securitisation regulation did not seem to take into account those changes and it is still not differentiating between investiment firms when permitting them to act as sponsor.

Such construction combines the limb (b) of the definition of "originator" in the SECR[22], pursuant to which 'originator' may also be "*an entity* […] *which purchases a third-party's exposure on its own account and then securitises them*", with the consideration that in-scope securitisations under the SECR include arrangements where the credit risk is transferred but title to the assets is not. On that basis, following such an approach, an AIF could qualify as a "limb (b) originator" if the credit risk in the assets to be securitised were transferred to it prior to the assets being securitised, by funding/guaranteeing the purchase of those assets by a SSPE which in turn would issue notes to the AIF. Through such a mechanism, the AIF would be deemed to have purchased the exposures "for its own account" through the SSPE which would then (after a meaningful timespan) issue senior notes to a lender, leveraging the AIF's equity position. However, no official position has publicly been taken by the European authorities as to whether this approach is viable.

Should this be the case, the proposed expansion of the definition of "sponsor" to allow the AIFMs to act as sponsors in captive securitisations could still be beneficial to the market to avoid unnecessary costs for their investors in all those scenarios where the relevant AIF fails the "sole purpose test" set out in article 2(7) of the Regulatory Technical Standards and, therefore, is not able to act as risk retainer.

[22] "Originator" is defined by article 2(1)(3) of the Securitisation Regulation as "an entity which: (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or (b) purchases a third-party's exposure on its own account and then securitises them.".

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