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Commissioner Lord Hill
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By Post and by Email

Dear Sir

Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (the "Proposed Regulation")

Introduction

We refer to the Proposed Regulation published on 30 September 2015, and to our letter to the European Commission and the EBA dated 9 September 2015 regarding an earlier draft of the Proposed Regulation that was posted on the "*Financial Times*" website on the 25 August 2015.

The Loan Market Association[1] is pleased that the Proposed Regulation has addressed many of the issues raised in our letter dated 9 September 2015. We welcome the Commission's initiative to restart the European securitisation markets and agree that securitisation can play an important role in growing the European economy.

We are, however, disappointed that managed Collateralised Loan Obligations ("**CLOs**") will not qualify for a lower regulatory capital charge under the regime for "simple, transparent and standardised" ("**STS**") securitisations, which is contained in the Proposed Regulation and in the accompanying proposed amending regulation for the Capital Requirements Regulation ("**CRR**"). We would reiterate our view that CLOs are of significant value in diversifying and increasing the sources of finance available to European corporates. Such an increased availability of finance, in turn, facilitates economic growth and the creation of employment opportunities.

[1] Please see the description in the Appendix.

In addition, we still have some legal and practical concerns with the Proposed Regulation, which we have set out below (many of which relate to the provisions applying to both STS and non-STS securitisations). Where applicable, we have proposed amendments to the drafting of the Proposed Regulation.

1 Article 4(1) of the Proposed Regulation (Risk Retention Rules)

Article 4(1) of the Proposed Regulation includes a "direct" retention obligation on originators, sponsors and original lenders (in the same terms as in the earlier draft):

"The originator, sponsor or original lender of a securitisation shall retain on an ongoing basis a material net economic interest of not less than 5%",

As we mentioned in our letter dated 9 September 2015, this appears to mean that an entity who is an originator or original lender of a loan who transfers or sells such loan to a securitisation entity, or to another entity which then securitises that loan, should be required to hold a retention even if such originator or original lender is not the party who is establishing or managing the securitisation.

As we noted, there may, for example, be circumstances in which neither the originator nor the sponsor is in the EU, in which case it would appear that the retention obligation would fall on the original lender (although the jurisdictional scope of the obligation is still not entirely clear - please see below). It would appear that the original lender may have a retention obligation in such circumstances even if they no longer own the loan that is securitised and even where the loan is resold a number of times before it is securitised.

Article 4(1) goes on to provide that where the originator, sponsor or the original lender have not agreed between them who will retain the material net economic interest, the originator shall retain. This could be very problematic, particularly in transactions where there is more than one originator (i.e., where the securitisation has purchased assets from multiple parties).

It is our view that the Proposed Regulation should clarify that the direct obligation applies to originators, sponsors and original lenders who are directly involved in the securitisation. We would reiterate our view that it should be the originator, sponsor or original lender who is actually establishing or managing the securitisation that securitises the asset who should be required to retain. The first sentence of this article could make this clear by incorporating wording such as that below:

The originator, sponsor or the original lender of a securitisation ***who is directly involved in such securitisation*** *shall retain on an ongoing basis a material net economic interest of not less than 5%* ***in such securitisation****.*

2 Article 28 of the Proposed Regulation - Transitional Arrangements and the new Regulatory Technical Standards

We are pleased that our concerns relating to the retrospective application of the retention provisions in earlier drafts have been addressed in the latest version of the Proposed Regulation.

We note that regulatory technical standards will need to be developed in respect of various aspects of the Proposed Regulation. Although the transitional arrangements in the published draft are an improvement on those in earlier drafts, there is still scope for market uncertainty in the period between the date on which the Proposed Regulation enters into force (the "**Effective Date**") and the date on which the regulatory technical standards are to be adopted. It would be better if the market understood the full extent of all the new requirements in the Proposed Regulation prior to it coming into force. This period of uncertainty following the Effective Date until the date on which new regulatory technical standards are to be adopted may have an adverse effect on new securitisations in the EU. We expect that, during this period, market participants will find it difficult to issue new securitisations given the uncertainty as to what the new regulatory technical standards will provide. If it is not possible to delay the date on which the Proposed Regulation enters into force, we would request that the European Supervisory Authorities be encouraged to produce draft regulatory technical standards without delay.

3 <u>Article 2(5) of the Proposed Regulation - Definition of "Sponsor"</u>

Unfortunately, the Proposed Regulation has not widened the definition of "sponsor". The definition of "sponsor" remains the same as that in the CRR; it is a credit institution, or investment firm (as defined in the CRR), other than an originator that establishes and manages an asset-backed commercial paper programme or other securitisation transaction or scheme

As we noted in our September letter, the CRR definition of "investment firm" is overly narrow in that it unnecessarily excludes certain regulated EU firms, as well as non-EU firms (such as US Investment Advisers) that are entities suitable to hold the retention and which would ensure the correct alignment of interests with investors.

Such a restriction is also at odds with the Commission's desire to encourage investment into the EU from outside Europe, and can easily be addressed as the restrictions as to who can act as 'sponsor' are unrelated to risk retention requirements and do not serve to identify those entities that are suitable to hold the retention from an alignment of interest perspective.

As a result of the use of this limited CRR definition of "investment firm", certain MIFID investment firms (which lack authorisation to perform certain specified investment services) cannot act as "sponsor" despite the fact that they are in fact regulated under MIFID and despite the fact that they are managing securitisations. We can see no meaningful purpose behind such restrictions which limit the use of regulated EU entities which would otherwise be appropriate to hold the retention. We would therefore reiterate our proposals to remove the inability of certain MIFID investment firms to act as sponsor. In our September letter we proposed that one way to achieve this would be to add wording such as that below to Article 4 of the Proposed Regulation (to apply solely as regards the definition for risk retention purposes):

"For the purposes of the application of this article (risk retention), an entity shall also be considered to be a sponsor if it is an investment firm as defined in article 4(2) of [the Capital Requirements Regulation] disregarding the exclusion set out in sub-paragraph (c) of that article and it establishes and manages an asset-backed

commercial paper programme or other securitisation transaction or scheme that purchases exposures from third-party entities."

Similarly, the restriction on suitable regulated entities established outside the EU from acting as sponsor, does not serve a meaningful purpose. Indeed, such a restriction could encourage non-EU jurisdictions to take protectionist measures so as to exclude EU entities from participating in similar finance-raising activities in their jurisdictions.

We therefore also proposed in our 9 September letter that a "recognised third-country investment firm" should be recognised as "sponsor" (to the extent that the EU retention requirements will apply in the context of non-EU transactions based on the "indirect" approach), and suggested that wording such as that below could be used for this purpose:

"For the purpose of the application of [this article], an entity shall also be considered to be a sponsor if it satisfies conditions (a) and (b) of the definition of 'recognised third-country investment firm' in article 4(25) of [the Capital Requirements Regulation] and it establishes and manages an asset-backed commercial paper programme or other securitisation transaction or scheme that purchases exposures from third-party entities."

A key component of growth for European capital markets will be investment from countries such as the United States. The current definition of sponsor makes it very difficult for entities regulated outside of Europe, such as US registered Investment Advisers to comply with the current retention regime. This situation has not been remedied by the Proposed Regulation. This could have the effect of dis-incentivising US participants from investing into the EU. Restricting the ability of US participants to issue into the EU could have a detrimental effect on the in-flow of capital to Europe from the US. We do understand the concerns regulators would have with expanding the definition of sponsor to unregulated entities. Our suggested amendment would only extend the definition of sponsor to asset managers who are regulated, such as those regulated in the United States under the Investment Advisers Act of 1940. Allowing US registered Investment Advisers to act as sponsors also ensures the correct alignment of interests, as these are the entities that are establishing and managing US securitisations such as CLOs.

The expansion of the sponsor definition, for the purposes of risk retention, to all MIFID investment firms and to entities who are regulated as "recognised third-country investment firms", such as US Registered Investment Advisers, ensures a correct alignment of interest between the entities establishing and managing securitisations and the investors investing in such securitisations, whilst ensuring that all sponsor entities are subject to appropriate regulation.

4 Jurisdictional Scope of the Proposed Regulation

We noted in our September letter that the Proposed Regulation should clearly set out its jurisdictional scope. In particular, the Proposed Regulation does not include any jurisdictional scope on the application of the "direct obligation" (please see above).

As it is currently drafted, Article 4(1) could be construed as applying to retention holders established outside the EU. Article 4(1) is silent as to its jurisdictional scope. However, the Explanatory Memorandum states:

"For securitisations notably in situations where the originator, sponsor nor original lender is not established in the EU the indirect approach will continue to fully apply."

This would indicate that the intention of the Commission is to limit the "direct" approach to EU originators, sponsors or original lenders only. However there is no specific reference to its jurisdictional scope in the body of the Proposed Regulation.

We also think that it needs to be made clear whether or not the retention requirement applies to branches of firms which operate across EU and non-EU jurisdictions. It should be made clear whether the retention requirement applies to non-EU branches of EU established institutions (e.g. to a US branch of a UK investment bank) and that it does not apply to an EU branch of a non-EU entity (e.g. a UK branch of a US investment bank) (if that, is indeed, the intention). Such issues have significant practical implications and should be made free from doubt.

The Proposed Regulation could, for example, specify that the Article 4 retention requirement applies only to an originator, sponsor or original lender that is "established" (and for that purpose has its "statutory seat") in the EU. By way of analogy, there is a precedent in Recital (2) of Commission Delegated Regulation (EU) 2015/3 (the delegated regulation on CRA III), which states:

"This Regulation should apply to all financial instruments or other assets resulting from a securitisation transaction or scheme referred to in Article 4(1)(61) of Regulation (EU) No 575/2013 of the European Parliament and of the Council on condition that the issuer, originator or sponsor, is established, and for that purpose has its statutory seat, in the Union".

A similar sort of provision in the Proposed Regulation would be sensible. Given the consequences of failing to comply with the "direct" approach to retention, the Proposed Regulation should clearly set out its jurisdictional scope.

In line with the comment in the Explanatory Memorandum (please see above), we also presume that the Commission does not wish to impose the regulation of retention requirements in relation to securitisation activities taking place wholly outside the EU. Requiring US branches of European banks to comply with the Proposed Regulation will make EU banks far less competitive outside Europe, when compared with the position of non-EU banks. We would therefore propose that the Proposed Regulation includes a provision to the effect that the retention requirements do not apply to an originator, sponsor or original lender whose activities take place wholly outside the EU. An extra sentence could be added to Article 4(1) to this effect. The wording could be along the lines below:

"This Article shall not apply to an originator, sponsor or original lender whose activities in relation to the securitisation are carried on wholly outside the European Union".

In short, the Proposed Regulation should clearly define the jurisdictional scope as regards the parties subject to its provisions.

5 Article 3 - Due Diligence Requirements for Institutional Investors

The Proposed Regulation sets out due diligence requirements that apply to EU institutional investors assuming exposure to securitisation exposures. The requirements encompass actions to be undertaken prior to assuming exposure to a securitisation and actions to be undertaken on an on-going basis thereafter.

A problematic aspect of the Proposed Regulation is that an EU institutional investor that assumes exposure to a securitisation designated as an STS securitisation is obliged to carry out a due diligence assessment of whether the securitisation in fact satisfies the STS securitisation requirements. The Proposed Regulation states that such EU institutional investor may place appropriate reliance on the fact that notification has been made to ESMA that a securitisation complies with the STS securitisation requirements and on the disclosure by the originator, sponsor and issuer regarding such compliance. However, the Proposed Regulation does not indicate what constitutes appropriate reliance as distinct from inappropriate reliance. The requirement for each EU institutional investor to separately assess, in the case of a securitisation, whether the STS securitisation requirements are satisfied imposes a cost burden on EU institutional investors that seek to benefit from the more favourable capital treatment applicable to exposures to STS securitisations. Furthermore, an EU institutional investor that makes its own assessment of whether the STS securitisation requirements are satisfied is subject to the risk of significant administrative sanctions and remedial measures under the Proposed Regulation in the case that such assessment is incorrect, which is likely to deter it from relying upon a securitisation being an STS securitisation. These issues may reduce the likelihood of EU institutional investors relying in practice upon the lower capital requirements that apply to STS securitisation exposures with the result that the usefulness of STS securitisation as a concept is negated.

Instead of EU institutional investors bearing the full burden of determining whether a securitisation satisfies the STS securitisation requirements, we would suggest that ESMA, national regulators in EU member states, or third parties designated and supervised by ESMA, could assess whether a securitisation satisfies the STS securitisation requirements with an EU institutional investor able to rely on the outcome of such assessment in the absence of some level of knowledge or notice on the part of such investor that the STS securitisation requirements were not satisfied.

We would like to thank you for continuing to engage on these issues. We would be pleased to answer any questions you may have and to meet if you wish or to discuss any questions regarding the amendments proposed.

If you would like to do so, please contact Nicholas Voisey of the Loan Markets Association (nicholas.voisey@lma.eu.com) or David Quirolo (david.quirolo@cwt.com) of Cadwalader, Wickersham & Taft LLP.

Yours faithfully

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APPENDIX

The Loan Market Association

The Loan Market Association ("**LMA**") is the trade body for the European syndicated loan market founded by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice which are widely used and adopted.

Since the establishment of the LMA in 1996, membership has grown to over 600 organisations, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the European loan market *vis à vis* lenders, borrowers, regulators and other interested parties.