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ESAs' Opinion to the European Commission on the Jurisdictional Scope of Application of the Securitisation Regulation

Introduction and legal basis

1. The ESAs' competence to deliver this opinion is based on Articles 16a of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010¹ as the jurisdictional scope of application of the obligations under Regulation (EU) 2017/2402² (the "Securitisation Regulation" or "SECR") relates to the area of competence of the Joint Committee Securitisation Committee ("JCSC").
2. The Boards of Supervisors of the ESAs have adopted this opinion, which is addressed to the European Commission. A copy of this opinion has been sent to the European Parliament and the Council.
3. This document lays down the opinion of the ESAs on the jurisdictional scope of application ("JSA") of the SECR and the compliance challenges that such JSA poses for market participants.
4. This opinion comprises two parts:
 - a) Part 1 deals with the application of Articles 5 to 7 and 9 of the SECR to third country-based entities;
 - b) Part 2 deals with the application of the SECR's provisions to investment fund managers.

¹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48); and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

² Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35).

JSA of the SECR: rationale and challenges

5. The SECR was implemented as a response to the 2008-09 financial crisis, which originated in the global market for asset-backed securities, namely in the US subprime mortgage part of it, and eventually spread to European markets.
6. The SECR's main objective is to "restart high-quality securitisation markets, without repeating the mistakes made before the 2008 financial crisis"³. To that end, the SECR allocates to each of the securitisation parties certain structural and quality obligations in relation to the transaction. Competent authorities in each Member State must be designated to monitor compliance with the different SECR requirements and, accordingly, those authorities must have administrative and sanctioning powers on the securitisation parties to enforce compliance. For ease of reference, the securitisation's originator, original lender, sponsor and special purpose entity issuer (the "SSPE") will be referred to as the "sell-side parties" and the institutional investors as the "buy-side parties".
7. The SECR's definition of "securitisation" does not set out its jurisdictional scope and the definitions of the various parties and certain other provisions do not expressly require that these parties be established in the EU. For instance:
 - a) the definition of sponsor's referring to a credit institution "located in the Union or not" (Article 2 (5) of the SECR);
 - b) the express ban on establishing SSPEs in certain third countries as per Article 4 of the SECR, which means that the SECR allows establishing the SSPE in other third countries;
 - c) the references to sell-side parties "being established in the Union" or "in a third country" in points (a) to (d) of Article 5 (1) of SECR on due diligence requirements.
8. Thus, the SECR does not prevent entities located in a third country from being party to a securitisation. However, securitisations with a third country party on either the buy side or the sell side may give rise to difficulties in the interpretation of Articles 5 to 7 and 9 of the SECR that hamper the effective functioning of the market.
9. This document seeks to address those difficulties by setting out the ESAs' opinion on the JSA of the SECR in relation to securitisations with a third country party on either the buy side or the sell side. Where there are matters that can be clarified within the current SECR text, the ESAs' view is that the European Commission should issue a statement with interpretative guidance. Where there are matters that cannot be dealt with through interpretation of the current SECR text, the ESAs' opinion includes concrete proposals to amend the SECR where appropriate.

³ Recital 2 of the Securitisation Regulation 2017/2402

ESAs' opinion on the jurisdictional scope of the SECR

- The European Commission should issue a statement to provide interpretative guidance on the application of Articles 5 to 7 and 9 of the SECR to securitisations with third country-located party(ies) and on the application of Article 5 of the SECR to third country-located institutional investors.
- Without prejudice to the above, Articles 5 to 7 and 9 of the SECR should be amended insofar as necessary to address the issues concerning the jurisdictional scope of application referred to in this Opinion. The European Commission may want to use the upcoming review of the securitisation framework as an opportunity to propose the necessary amendments.

Part 1 – Application of Articles 5 to 7 and 9 to a securitisation with third country parties

1.1. The “sell-side” parties’ obligations (Articles 6, 7 and 9 of the SECR)

10. The sell-side parties are subject to specific obligations to ensure that the securitisation meets certain structural and quality requirements as laid out in Articles 6, 7 and 9 of the SECR. These obligations are, in turn, mirrored by the obligation on institutional investors to verify the matters referred to in paragraphs (1) and (2) of Article 5 in relation to the sell-side parties referred to therein before investing in the securitisation. More concretely, an explicit reference to a securitisation party being “established in a third country” in points (b) and (d) of Article 5(1) acts to impose specific verification duties on EU-located institutional investors as regards third country-located sell-side parties. Articles 6, 7 and 9 of the SECR are, however, silent on the location of the securitisation’s sell-side parties.
11. Where a securitisation features all its sell-side parties in a third country (a “third country securitisation”), Articles 6, 7 and 9 of the SECR do not apply directly to that securitisation but indirectly through the investor verification laid out in paragraphs (1) and (2) of Article 5 of the SECR. Where the investor verifies that the sell-side party in the third country has failed to comply with any applicable requirement therein (or where the institutional investor fails to carry out the required verification), it may not invest in that securitisation.
12. However, where a securitisation features a mix of sell-side parties located inside and outside the EU, the question is raised as to how those transactions would comply with Articles 6, 7 and 9 of the SECR, taking into account that the designated competent authority would have no powers to enforce compliance of these Articles on the parties to the securitisation located outside the EU. This inability to hold direct accountability on some of the securitisation’s sell-side parties would appear at odds

with the SECR's objective of ensuring that the transaction complies with certain minimum standards (see paragraph 10).

13. The ESAs are of the opinion that the SECR does not require that all the securitisation's sell-side parties be located in the EU for the transaction to comply with Articles 6, 7 and 9 of the SECR. However, in order to clarify how transactions with a mix of sell-side parties located inside and outside the EU would meet these Articles, the ESAs envisage two possible interpretations:

- (a) Option 1: similarly to third country securitisations (see paragraph 11), Articles 6, 7 and 9 of the SECR do not apply directly to the securitisation's sell-side party in the third country but indirectly through the investor verification laid out in paragraphs (1) and (2) of Article 5 of the SECR. Any breach of those Articles by the sell-side party in the third country that remained uncured would simply render the securitisation non-compliant with the SECR, as a result of which institutional investors in the EU would be unable to invest in it (or where the breach had occurred subsequently to the securitisation issuance, the investor in the EU should sell the notes);
- (b) Option 2: without prejudice (and in addition) to the investor verification duty as applicable to the relevant case, the securitisation's sell-side party located in the EU should be directly responsible for complying:
 - with the obligations laid down in Articles 6 and 9 of the SECR, provided in the latter case that the securitisation sell-side party located in the EU has overall responsibility for setting or applying the credit-granting criteria in relation to exposures to be securitised (see section 1.1.3); and
 - with the main disclosure obligation under Article 7 (see section 1.1.2) in respect of the relevant securitisation.

In the event of breaching any of those obligations, the sell-side party in the EU could be held accountable under those Articles, notwithstanding the eventual non-compliance of the securitisation as a whole with the SECR that would, in any event, result from an uncured breach.

14. As doubts on the manner to comply with Articles 6, 7 and 9 of the SECR operate to dissuade market participants from engaging in securitisations, the ESAs are of the view that the Commission should clarify through interpretative guidance which interpretation of those Articles should be upheld between the two envisaged in paragraph 13. For these purposes, the ESAs would advise the Commission to adopt the interpretation referred to as option 2 for the following reasons:

- (a) the inability to hold third country-located parties accountable under the SECR poses practical challenges on the ability of the ESAs and the competent authorities to effectively supervise that securitisations comply with the Regulation;

- (b) the overall purpose sought by the SECR to uphold certain minimum structural and quality standards would be better served if a sell-side party could be held accountable in the EU for the breach in respect of a securitisation, alongside the checks that institutional investors in the EU would have to carry out in accordance with Article 5.

ESAs' opinion on the interpretation of Art. 6, 7 and 9 where a securitisation features sell-side parties in a third country

- The European Commission should issue interpretative guidance to clarify under which circumstances securitisations featuring one or more (but not all) of its sell-side parties in a third country should be regarded as compliant with Articles 6, 7 and 9 of the SECR.
- For these purposes, the ESAs invite the European Commission to have regard to the suggested interpretation of Articles 6, 7 and 9 of the SECR referred to as option 2 in paragraph 13 of this Opinion and in subsections 1.1.1 to 1.1.3 for the reasons laid out in paragraph 14
- Notwithstanding the foregoing, should the European Commission take the view that the above-referred option 2 interpretation may not be upheld under the current SECR, the ESAs invite the Commission to take the opportunity provided by the upcoming securitisation framework review to propose all the necessary amendments in Articles 6, 7 and 9 of the SECR to implement that option 2 interpretation as a legal requirement.

15. The following subsections will examine how option 2 would operate in practice and other relevant issues for each of Articles 6, 7 and 9 of the SECR.

1.1.1. The risk retention obligation (Art. 6 of the SECR)

16. The SECR requires the originator, the original lender or the sponsor to retain at least 5 per cent of the material net economic interest in the securitisation transaction for the life of the transaction.
17. The purpose of this requirement is to ensure a proper alignment of interests between those parties and the institutional investor in the securitisation.

18. As Article 6 of the SECR clearly provides, the risk retention obligation may be met *alternatively* by either of the securitisation's originator, original lender or sponsor, so it suffices that one of them retains the material net economic interest for this obligation to be met in relation to a securitisation.

19. In line with the preferred interpretation of Article 6 of the SECR referred to in paragraph 13(b), where one or more of the securitisation's originator, original lender or sponsor are located in a third country, the party or parties among them located in the EU should be the sole responsible for retaining the net economic interest in the transaction. In this scenario, there would be no obligations under Article 6 that the transaction's relevant sell-side party(ies) in the third country would need to comply with.

1.1.2. The transparency obligation (Art. 7 of the SECR)

20. The originator, the sponsor and the SSPE of a securitisation must make available to current and prospective institutional investor and to the competent authorities the information referred to in Article 7 of the SECR.

21. These parties must comply with the transparency obligation by providing information at different intervals and on an ad hoc basis. The disclosures must be made in accordance with the templates set out in the Commission Delegated Regulation (EU) 2020/1224⁴ and Commission Implementing Regulation (EU) 2020/1225⁵.

22. As it is noteworthy and unlike the risk retention obligation, the transparency obligation is imposed *jointly* on the securitisation's originator, sponsor and SSPE, which must designate one among them to make the required disclosures. The party so designated is referred to as "*the entity responsible for reporting the information*" in para. 2 of Article 7 of the SECR.

23. In line with the preferred interpretation of Article 7 of the SECR referred to in paragraph 13(b), where one or more of the securitisation's originator, sponsor or SSPE are located in a third country, they should designate either party among those that is located in the EU as the "*entity responsible for reporting the information*". Hence, the main obligation of making disclosures should be carried out by one of the sell-side parties in the EU, subject to all the other sell-side parties (including those in the third country) making the designation referred to in paragraph (2) of Article 7 of the SECR.

24. Furthermore, the transaction parties should set up appropriate arrangements in the securitisation contractual documents to ensure compliance with Article 7 of the SECR where one or more of those sell-side parties is located in a third country. In particular, the transaction's sell-side party(ies) located in a third country should be subject to explicit obligations under the securitisation contractual

⁴ Commission Delegated Regulation (EU) 2020/1224 of 16 October 2019 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards specifying the information and the details of a securitisation to be made available by the originator, sponsor and SSPE (OJ L 289, 3.9.2020, p. 1).

⁵ Commission Implementing Regulation (EU) 2020/1225 of 29 October 2019 laying down implementing technical standards with regard to the format and standardised templates for making available the information and details of a securitisation by the originator, sponsor and SSPE (OJ L 289, 3.9.2020, p. 217).

arrangements to provide the necessary information and documents to the “entity responsible for reporting the information” for this entity to make the required disclosures under Article 7 of the SECR.

1.1.3. The credit-granting criteria obligation (Art. 9 of the SECR)

25. Originators, sponsors and original lenders must apply to “*exposures to be securitised*”:

- a) “*the same sound and well-defined criteria for credit granting which they apply to non-securitised exposures*” and
- b) “*the same clearly established processes for approving and where relevant amending, renewing and refinancing credits*”.

26. In line with the preferred interpretation of Article 9 of the SECR referred to in paragraph 13(b), where one or more of the securitisation’s sponsor, originator or original lender are located in a third country, the party or parties located in the EU should be responsible for ensuring that the “*exposures to be securitised*” are applied the credit-granting criteria and subject to the same processes for approving and renewing credits as non-securitised exposures in accordance with that article, provided that the securitisation sell-side party located in the EU has overall responsibility for setting or applying the credit-granting criteria on the exposures to be securitised. Examples of such securitisation parties could include the sponsor of an ABCP programme, insofar as party responsible for setting and/or verifying the asset purchase criteria of the ABCP programme, or an originator or original lender that is also a parent undertaking in relation to the securitised exposures of its subsidiaries.

27. Without prejudice to the above, it should be noted that the securitisation sponsor is referred to in Article 9 but not in Article 5(1)(b) of the SECR. This leads to an apparent gap in the current framework, whereby the sponsor of a securitisation must comply with Article 9 but, where it is not located in the EU, it is not subject to the verification by the institutional investor in accordance with Article 5(1)(b) of the SECR. It is, however, unclear whether there are good grounds to include a reference to the sponsor in Article 5(1)(b) as well.

28. For instance, given that the purpose of this requirement is to provide a safeguard against the originate to distribute model, the sponsor’s interests in this regard are already more closely aligned with those of the institutional investor than the originator’s. Hence, imposing a duty on the institutional investor to verify that the sponsor complies with this requirement may be burdensome and an inefficient use of institutional investor’s resources.

ESAs' opinion on amending Art. 5(1)(b) of the SECR to include a reference to sponsors located in third countries

- The ESAs advise the European Commission to investigate the convenience and appropriateness of including a reference to sponsors located in a third country in Article 5(1)(b) of the SECR.

1.2. The “buy-side” parties’ obligations: Due diligence requirements (Art. 5 of the SECR)

1.2.1. Scope of “Institutional investors” and potential scenarios

29. The due diligence requirements fall on “institutional investors” as defined in Article 2(12) of the SECR.

30. By virtue of Article 5 of the SECR, institutional investors must verify that the transaction’s sell-side parties have complied with their respective credit granting criteria, risk retention and transparency requirements and certain other specifically-defined due diligence requirements on securitisation positions prior to investing in them.

31. In particular in relation to the transparency requirements, point (e) of Article 5(1) of the SECR obliges institutional investors to verify that the originator, sponsor or SSPE has “where applicable, made available the information required by Article 7 of the SECR in accordance with the frequency and modalities provided for in that Article”.

32. For the purposes of this Opinion, the following two scenarios involving parties in a third country should be considered in connection with Art 5 of the SECR:

- a) institutional investors established in the EU that invest in securitisations with a third country nexus; and
- b) subsidiaries of EU institutional investors located in third countries where they fall within the perimeter of regulatory consolidation, even if they invest in a securitisation with no EU link, by operation of Article 14 of Regulation 575/2013 (the “CRR”), as amended by Regulation 2019/876, where it applies to their parent.

1.2.2. Verification duties (paras. 1 and 2 of Art. 5 of the SECR)

33. We noted in previous section 1.1 that the verification duties on the buy-side parties referred to in points (b) and (d) of Article 5(1) of the SECR in relation to sell-side parties located in a third country

mirror the respective risk retention and credit granting criteria requirements on the sell-side parties located in the EU as per Articles 6 and 9 of the SECR. .

34. Article 5(1)(e) of the SECR similarly mirrors Article 7. While it is noticeable that Article 5(1)(e) is silent on the location of the transaction parties, the obligation to verify that the originator, sponsor or SSPE has complied with Article 7 of the SECR may be understood as including third country securitisations, where the party responsible for making the disclosures would be located outside the EU.
35. While the SECR's approach for points (b), (d) and (e) of Article 5(1) is identical, the practical implications vary greatly. For instance, it may be relatively straightforward for a third country sell-side party to comply with obligations under third country law that are equivalent to the risk retention and credit granting criteria obligations and, accordingly, it would also be fairly straightforward for EU-located institutional investors to verify the matters referred to in points (b) and (d) of Article 5(1) of the SECR.
36. By contrast, transparency requirements are a far more complex set of obligations. The third country law governing the relevant securitisation is very unlikely to set out transparency requirements matching line by line those laid down in Article 7 of the SECR. In particular, given the reference to complying with the "frequency and modalities" of disclosure referred to in Article 7 of the SECR, it seems that the third country securitisation would have to use ESMA templates or, at a minimum, templates with the same content, and that those be disclosed with the same frequency as that of ESMA's. However, the use of ESMA templates would most likely not be required for any such third country securitisation and would not be envisaged unless institutional investor in the EU were specifically targeted. Furthermore, there is no flexibility within Article 5(1)(e) of the SECR to waive or modify generally for a third country, or on an ad hoc basis for a transaction, concrete transparency requirements.
37. Accordingly, it seems very unlikely, or at least very challenging, that EU-located institutional investors would currently be able to discharge the requirement set out in Article 5(1)(e) of the SECR in relation to third country securitisations, as a result of which they will not be able to invest in them.
38. While the SECR's preeminent objective of protecting EU institutional investor investing in third country securitisations is well understood and should be upheld in all cases, the ESAs are of the view that the current verification duty laid out in Article 5(1)(e) of the SECR may be overly inflexible for third country securitisations and should be reassessed to determine whether more flexibility could be added to the framework without undermining its ultimate objective.

ESAs' opinion on a third country equivalence regime for transparency requirements

- The European Commission should assess the feasibility of incorporating a third country equivalence regime for transparency requirements in relation to third country securitisations, as part of the review envisaged in Article 46(e) of the SECR.
- For a third country law to be regarded as equivalent to Article 7 of the SECR, it should impose a requirement on the securitisation's sell-side parties to make available to institutional investors or potential institutional investors:
 - a) the same or substantially the same information as that required by Article 7 of the SECR;
 - b) with sufficient "frequency" even if the exact frequency of disclosure is not exactly the same as that required under Article 7 of the SECR;
 - c) in a "modality" of disclosure in the form of disclosure templates of similar quality and granularity as those set out in the Commission Delegated Regulation (EU) 2020/1224 and Commission Implementing Regulation (EU) 2020/1225.
- Third countries would be declared as equivalent for these purposes by a decision of the European Commission, having regard to advice provided by ESMA.
- Where a third country's securitisation transparency requirements have been assessed as equivalent, the institutional investors' duty laid down in Article 5(1)(e) of the SECR (in combination with the obligations laid down in Article 5(3) and (4)) of the SECR would be discharged by verifying that either of the originator, sponsor or SSPE in the third country has made available the information required in accordance with those transparency requirements and with the frequency and in the modalities provided for therein.

1.2.3. Third country-based subsidiaries of EU-based institutional investors

39. These subsidiaries are third country-based investors but they are indirectly captured by Article 5 of the SECR through the obligation of their EU-based parent company to ensure the consolidated application of this Article in accordance with Article 14 of Regulation 575/2013, as amended by Regulation 2019/876 (the Capital Requirements Regulation or CRR). The parent company is obliged to ensure that their subsidiaries "which do not fall under the CRR implement arrangements, processes and mechanisms to ensure compliance" with Article 5 of the SECR.

40. The extent of the obligation on the EU parent and the consequences of a breach are not precisely defined, which leads to uncertainty as to whether the subsidiary in the third country must in practice comply on a line-by-line basis with Article 5 as if it were an EU-based investor. Hence, the third country subsidiaries of EU parents subject to the SECR face the same challenges as EU institutional investor investing in third country securitisations referred to above, in particular as regards the compliance of disclosures in the third country with Article 7 of the SECR. However, those challenges are compounded by the much weaker link of these subsidiaries with the EU and create a significant compliance burden on and competitive disadvantage for EU-headed groups with operations in third countries vis-à-vis local players.
41. Without prejudice to potential third country equivalence assessments, ad hoc arrangements for these groups should be considered as well to cater to their distinctive features compared to institutional investors “genuinely” located in the EU. For instance, it should be noted that the specific purpose of this requirement in Article 14 of the CRR is not to protect the subsidiary in the third country itself, but the soundness of the EU parent and its safety from contagion risk. The ESAs are of the view that this purpose could be met not only through the subsidiary’s complying with Article 5 of the SECR, but also through certain other alternatives for those cases where the parent in the EU is unable to ensure the subsidiary’s compliance with that Article or where such compliance is deemed as unduly burdensome. Article 14 of the CRR, therefore, should be amended to provide for such alternatives.

ESAs’ opinion on amending Art. 14 of the CRR, in connection with Art. 5(1) to (4) of the SECR, to provide for alternatives to compliance with the latter Article

- Article 14 of the CRR should be amended to allow the EU parent undertaking to ring-fence the third country subsidiary investing in a securitisation from the EU group, where the subsidiary’s complying with Article 5(1) to (4) could not be ensured or where it was unduly burdensome for the EU parent.
- The ring-fencing of the relevant subsidiary would be done through the structural separation of the third country-based subsidiary from the core EU group to prevent or mitigate any potential contagion risk, subject to the satisfaction of the parent’s competent authority.
- Where the EU parent may not ring fence its subsidiary in a third country for these purposes or where the ring-fencing is unduly burdensome, the competent authority should be able to impose proportionate investment limits on the subsidiary’s investments in third country securitisations by reference to the consolidated situation of the EU parent.
- The power to assess the appropriateness of the alternatives to the third country-based subsidiary’s compliance with Article 5(1) to (4) of the SECR should rest with the consolidated prudential supervisor of the group, in consultation with the resolution authority.

Part 2 – Application of the SECR’s provisions to investment fund managers

2.1 The application of the definition of institutional investors under Article 2(12)(d) of the SECR to non-EU Alternative Investment Fund Managers (AIFMs)⁶

42. The definition of ‘institutional investors’ in Article 2(12)(d) of the SECR encompasses alternative investment fund managers (AIFMs) that manage and/or market alternative investment funds (AIFs) in the Union and includes a cross-reference to the AIFM definition in Article 4(1)(b) of the AIFMD.

43. The wording of Article 2(12)(d) of the SECR might create uncertainties concerning the application of Article 5 of the SECR (the due diligence obligations) to non-EU AIFMs.

44. A literal reading of the Article 2(12)(d) of the SECR might suggest that if an AIFM (as defined in Article 4(1)(b) the AIFMD⁷) manages and/or markets one or more AIFs in the EU, it will qualify as an ‘institutional investor’ for the purposes of the SECR. Therefore, in principle, non-EU AIFMs that market AIFs under the AIFMD national private placement regimes (NPPR) fall within the definition of institutional investors, even where the marketing activities in the EU are limited.

45. By contrast, the application of Article 2(12)(d) of the SECR in this way seems to be inconsistent with the specific requirements set out in Article 17 AIFMD⁸ as regards AIFMs exposed to a securitisation. Also, questions arise in relation to the supervisory requirements under the SECR, which neither sets out in detail which CA has to supervise compliance of non-EU AIFMs with Article 17 of the AIFMD, nor with Article 5 of the SECR, whereas clearly defined supervisory responsibilities and enforceability are a prerequisite for an effective supervision of the obligations under the SECR.

ESA’s opinion on the application of the SECR’s provisions to non-EU AIFMs and amending Articles 2(12)(d) and 5 of SECR and Article 42 of the AIFMD

- The application of the SECR to non-EU AIFMs should be clarified to avoid divergences in the application of existing requirements.
- The SECR and AIFMD should be amended to ensure that non-EU AIFMs comply with the due diligence obligations set out in Article 17 of the AIFMD and Article 5 of the SECR with respect to those AIFs that they manage and/or market in the Union. The goal is to ensure an appropriate level of protection for EU investors investing in AIFs marketed by non-EU AIFMs.

⁶ The recommendations contained in this opinion are without prejudice to the views expressed in the ESMA letter to the European Commission on the AIFMD review dated 18 August 2020:

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

⁷ Article 4(1)(b) of the AIFMD defines AIFMs as “legal persons whose regular business is managing one or more AIFs”.

⁸ Article 17 of AIFMD has been replaced by the following: “Where AIFMs are exposed to a securitisation that no longer meets the requirements provided for in Regulation (EU) 2402/2017 (...), they shall, in the best of interest of investors in the relevant AIFs, act and take corrective actions, if appropriate.

- These amendments should further clarify:
 - a) the wording of Article 2(12)(d) and/or Article 5 of the SECR on whether non-EU AIFMs marketing and/or managing AIFs in the Union are to be considered as ‘institutional investors’ and therefore, subject to the due diligence obligations under Article 5 of the SECR;
 - b) the application of securitisation-related rules set out in SECR and AIFMD, in particular by including in Article 42 of the AIFMD⁹ a cross-reference to Article 17 of the AIFMD and to the SECR.
- Finally, the legal text should also be amended to clarify in detail the relevant CAs and ensure they have the required supervisory and administrative powers to enforce the applicable obligations under the SECR vis-à-vis non-EU AIFMs.

2.2 The application of the definition of institutional investors under Article 2(12)(d) of the SECR to sub-threshold AIFMs

46. The definition of ‘institutional investors’ in Article 2(12)(d) of the SECR generally refers to alternative investment fund managers (AIFMs), as defined in Article 4(1) (b) of the AIFMD, that manage and/or market alternative investment funds (AIFs) in the Union without any reference to the different types of EU AIFMs.

47. The wording of Article 2(12)(d) of the SECR might create inconsistencies in supervision concerning the application of the SECR to both “authorised AIFMs”¹⁰ and “sub-threshold AIFMs”¹¹ considering that only specific provisions of the AIFMD are to be applied to sub-threshold AIFMs¹². Should sub-threshold AIFMs be subject to the due diligence obligations set out in the SECR, this would provide for stronger investor protection since investors would in those cases benefit from higher regulatory standards

⁹ Article 42 of the AIFMD provides for minimum requirements that must be met by third country AIFMs marketing via NPPRs, where available. However, Article 42 does not include a cross-reference to Article 17 of the AIFMD or the SECR.

¹⁰ Assets under management exceed EUR 100m or EUR 500m where the portfolios of AIFs consist of AIFs that are unleveraged and where investors cannot redeem their interest in the first five years following the initial investment. AIFMs above these thresholds are required to seek authorisation under the AIFMD comply with all aspect of the AIFMD, whereas sub-threshold AIFMs are merely subject to a registration process and certain reporting requirements. Pursuant to Article 3(5) of the AIFMD, AIFMs below these thresholds may choose to opt in and to seek authorisation under the AIFMD.

¹¹ “Sub-threshold AIFMs” are EU AIFMs below the thresholds set out Article 3(2) of the AIFMD and therefore, largely exempted from the AIFMD requirements.

¹² In addition, legislative clarifications as to whether the exempted AIFMs referred to in Article 3(1) and 61(3) of the AIFMD are to be considered as ‘institutional investors’ in accordance with Article 2(12)(d) of the SECR would be complementary in order to provide clarity for NCAs and market participants.

although further consideration should be given to clarifying the supervisory responsibilities and powers of NCA with regard to sub-threshold AIFMs.

ESAs' Opinion on the application of the SECR's provisions to sub-threshold AIFMs¹³ and amendments to the SECR

- Article 2(12)(d) of the SECR does not explicitly exclude sub-threshold AIFMs from the definition of institutional investor.
- Article 2(12)(d) of the SECR should be amended to clarify whether sub-thresholds AIFMs fall within the definition of institutional investor thereby requiring them to comply with the due diligence requirements under Article 5 of the SECR.
- As the question concerning the appropriate regulation and supervision of sub-threshold AIFMs is currently being analysed in the context of the AIFMD review, the ESAs take the view, as set out in ESMA's letter to the Commission on the AIFMD review, that consideration should be given to the power of Member States to apply additional requirements under their national law to sub-threshold AIFMs¹⁴ while ensuring coherence between AIFMD and SECR.

2.3 The application of Article 5(5) of the SECR to investment fund managers

48. Article 5(5) of the SECR provides that where institutional investors have given to a third party¹⁵ the authority to make investment management decisions that might result in an exposure to securitisation, the institutional investor may instruct that third party to fulfil its due diligence requirements arising under the SECR. According to Article 5(5) of the SECR, this third party becomes subject to the applicable sanctions and/or remedial measures which may be imposed by the relevant CA in the relevant Member States in accordance with Article 32 and 33 of the SECR if it fails to fulfil such obligations, instead of the delegating institutional investor itself.

49. As set out above, Article 5(5) of the SECR in connection with the definition of AIFMs might raise uncertainties as to whether an institutional investor may give a non-EU AIFM or sub-threshold AIFM the authority to make investment management decisions that might expose it to a securitisation and instruct that managing party to fulfil its obligations under this Article in respect of any exposure to a securitisation arising from those decisions. Moreover, it is not set out in detail which supervisory powers CAs would have to enforce the obligations under the SECR on them.

¹³ Please refer to the ESMA letter on the AIFMD review (as cited above) which recommends that "the Commission should consider further clarifying the power of Member States to apply additional requirements under their national law to sub-threshold AIFMs".

¹⁴ See the ESMA letter to COM on the AIFMD review (as cited above).

¹⁵ Meaning the portfolio manager to which the delegator has given the authority to make investment management decisions.

50. Permitting a sub-threshold or non-EU AIFM to act as ‘managing party’ pursuant to Article 5(5) of the SECR seems to be inconsistent with the fact that Article 6(4)(a) of the AIFMD requires that external authorised AIFMs need to obtain an additional license to perform individual portfolio management (so-called discretionary portfolio management). However, the AIFMD provisions do not foresee such a possibility for sub-threshold or non-EU AIFMs. It should also be noted that there are divergent NCAs interpretations where investment management functions for an AIF/UCITS are performed by an AIFM or UCITS management company on a delegation basis. While some NCAs considered these cases as discretionary portfolio management and therefore took the view that MiFID rules would need to be applied, other NCAs argued that the management of AIFs/UCITS on a delegation basis would not be discretionary portfolio management and the relevant AIFM or UCITS management company performing functions on a delegation basis would be subject to AIFMD/UCITS rules. This issue has been already raised in the ESMA letter on the AIFMD review¹⁶ and the Commission is asked to ensure consistent outcomes. Moreover, sub-threshold and non-EU AIFMs are largely exempted from the scope of the AIFMD. Hence, sub-threshold and non-EU AIFMs acting as ‘managing party’ pursuant to Article 5(5) of the SECR could raise investor protection concerns.
51. Moreover, the Article 5(5) regime whereby any sanction under Articles 32 and 33 of the SECR may be imposed on the managing party and not on the institutional investor who is exposed to the securitisation, raises questions as to whether it has an impact on the responsibilities under the AIFMD delegation regime, where the AIFM (or the “delegator”) – not the delegate – always retains the ultimate responsibility for the delegated function. As a result of this, AIFMs are subject to due diligence and delegation monitoring obligations to ensure the delegate complies with the applicable rules. In case of non-compliance with these obligations, CAs may then sanction the AIFMs.
52. Similar to the AIFMD, the delegation regime of the UCITS Directive specifies that UCITS management companies always retain the ultimate responsibility for the delegated functions. Equally, only UCITS management companies authorised in accordance with Article 6(3)(a) of the UCITS Directive may perform individual portfolio management services.

ESAs’ opinion on the application of Article 5(5) of SECR to investment fund managers and amendments to the SECR

- Article 5(5) of the SECR would benefit from further legislative amendments to ensure consistent application and avoid a potential conflict with the AIFMD and UCITS delegation regimes.
- Amendments should clarify that the possibility provided in Article 5(5) of the SECR to instruct third parties to fulfil the due diligence requirements arising under the SECR is without prejudice to:

¹⁶ See ESMA letter on the AIFMD review (as cited above), p. 5.

- the AIFMD and UCITS Directive requiring that only AIFMs authorised in accordance with Article 6(4)(a) of the AIFMD and UCITS management companies authorised in accordance with Article 6(3)(a) of the UCITS Directive may perform individual portfolio management services.
- the responsibilities of authorised AIFMs and UCITS management companies, to ensure compliance with the AIFMD and UCITS Directive even where portfolio management functions are delegated to third parties.
- Finally, in case of cross-border delegation, there would be merit in amendments to further clarify the allocation of supervisory responsibilities of the home and the host CAs including on the question which NCA is responsible for the administrative sanctions procedure vis-à-vis the managing party referred to in Article 5(5) of the SECR.

2.4 Delegation of day-to-day active portfolio management by sponsors to non-EU AIFMs

53. Article 2(5)(b) of the SECR includes in the definition of sponsor credit institutions or investment firms (other than the originator) that establish an ABCP programme or other securitisation that purchases exposures from third party entities and delegates the day-to-day active portfolio management involved in that securitisation to an entity authorised to perform this activity in accordance with MiFID II, UCITS Directive and AIFMD.

54. Article 2(5)(b) of the SECR seems to raise uncertainties as to whether sponsors may only delegate to EU AIFMs, MiFID II investment firms and UCITS management companies authorised in accordance with the AIFMD, MiFID II or the UCITS Directive to perform the specific tasks set out in this Article.

ESAs' opinion on the application of the SECR's provisions regarding delegation of day-to-day active portfolio management by sponsors and amendments to Article 2(5) of the SECR

- As regards the application of Article 2(5) of the SECR, Recital 7¹⁷ of the SECR sets out that sponsors may only delegate the day-to-day active portfolio management of the securitised pool of assets to MiFID investment firms, UCITS management companies and AIFMs authorised to perform such activities (i.e. excluding non-EU AIFMs or sub-threshold AIFMs).

¹⁷ Recital 7 states: "A sponsor should be able to delegate tasks to a servicer but should remain responsible for risk management. In particular, a sponsor should not transfer the risk-retention requirement to his servicer. The servicer should be a regulated asset manager such as an undertaking for the collective investment in transferable securities (UCITS) management company, an alternative investment fund manager (AIFM) or an entity referred to in Directive 2014/65/EU of the European Parliament and of the Council (1) (MiFID entity)". Article 2(5) of the SECR states: [...] "and delegates the day-to-day active portfolio management involved in that securitisation to an entity authorised to perform such activity in accordance with Directive 2009/65/EC, Directive 2011/61/EU or Directive 2014/65/EU".

- For the avoidance of doubt, in the case of investment fund managers, Article 2(5)(b) of the SECR should be amended to clarify that sponsors may only delegate to AIFMs authorised in accordance with Article 6(4)(a) of the AIFMD and to UCITS management companies authorised in accordance with Article 6(3)(a) of the UCITS Directive.
- Finally, in case of cross-border delegation, there would be merit in amendments to further clarify the allocation of supervisory responsibilities of the home and the host CAs.