



**Financial Services
Commission**

Information page

**Alternative Investment Fund Managers Directive
Operating conditions – Investment in
securitisation positions**

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Any advice or interpretation covered in this information page represents the views of the FSC as to its expectations of how the requirements of the AIFMD are to be complied with and/or how it fails to be applied. This however is not intended as a definitive interpretation of the AIFMD which is ultimately a matter for the courts to determine. The FSC does not provide, or purport to offer, legal advice.



1. Introduction

- 1.1 In this information page, reference is made to the Alternative Investment Fund Managers Directive 2011/61/EU (“AIFMD”) and to the supplementing Level 2 Delegated Regulation (“Level 2”).
- 1.2 The AIFMD requires Alternative Investment Fund Managers (“AIFMs”) to operate in accordance with conditions set out in the AIFMD and Level 2. The purpose of this information page is to provide AIFMs with clear information, based on the information on the AIFMD and Level 2, on what requirements and conditions they must comply with in relation to investments in securitisation positions.

2. Definitions

Article 50 of Level 2

- 2.1 For the purposes of this information page:

'securitisation'	means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranced, having the following characteristics: <ul style="list-style-type: none"> (a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and (b) the subordination of tranches determines the distribution of losses during the on-going life of the transaction or scheme.
'securitisation position'	means an exposure to a securitisation.
'sponsor'	means a credit institution other than an originator credit institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities.
'tranche'	means a contractually established segment of the credit risk associated with an exposure or number of exposures, where a position in the segment entails the risk of credit loss greater than or less than a position of the same amount in each other such segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments.

3. Investment in securitisation positions

Article 17 of the AIFMD

- 3.1 AIFMs must comply with:
- (a) the requirements that need to be met by the originator, the sponsor or the original lender, in order for an AIFM to be allowed to invest in securities or other financial instruments of this type issued after 1 January 2011 on behalf of AIFs, or
 - (b) qualitative requirements that must be met by AIFMs which invest in these securities or other financial instruments on behalf of one or more AIFs.

4. Requirements for retained interest

Article 51 of Level 2

- 4.1 AIFMs shall assume exposure to the credit risk of a securitisation on behalf of one or more AIFs it manages only if the originator, sponsor or original lender has explicitly disclosed to the AIFM that it retains, on an on-going basis, a material net economic interest, which in any event shall not be less than 5%.

Only any of the following shall qualify as retention of a material net economic interest of not less than 5%:

- (a) retention of no less than 5% of the nominal value of each of the tranches sold or transferred to the investors;
- (b) in the case of securitisations of revolving exposures, retention of the originator's interest of no less than 5% of the nominal value of the securitised exposures;
- (c) retention of randomly selected exposures, equivalent to not less than 5% of the nominal value of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is not less than 100 at origination;
- (d) retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total not less than 5% of the nominal value of the securitised exposures;
- (e) retention of a first loss exposure of not less than 5% of every securitised exposure in the securitisation.

Net economic interest shall be measured at the origination and shall be maintained on an on-going basis. The net economic interest, including retained positions, interest or exposures, shall not be subject to any credit risk mitigation or any short positions or any other hedge and shall not be sold. The net economic interest shall be determined by the notional value for off-balance sheet items.

The retention requirements set out above shall only be applied once for any given securitisation.



- 4.2 Section 4.1 shall not apply where the securitised exposures are claims or contingent claims on or fully, unconditionally and irrevocably guaranteed by
- (a) central governments or central banks;
 - (b) regional governments, local authorities and public sector entities of Member States;
 - (c) institutions to which a 50% risk weight or less is assigned in accordance with Articles 78 to 83 of Directive 2006/48/EC (on credit institutions); or
 - (d) multilateral development banks.
- 4.3 Section 4.1 shall also not apply to:
- (a) transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than securitisation positions; or
 - (b) syndicated loans, purchased receivables or credit default swaps where these instruments are not used to package and/or hedge a securitisation that is covered by section 4.2.

5. Qualitative requirements concerning sponsors and originators

Article 52 of Level 2

- 5.1 Prior to an AIFM assuming exposure to the credit risk of a securitisation on behalf of one or more AIFs, it shall ensure that the sponsor and originator:
- (a) grant credit based on sound and well-defined criteria and clearly establish the process for approving, amending, renewing and re-financing loans to exposures to be securitised as they apply to exposures they hold;
 - (b) have in place and operate effective systems to manage the ongoing administration and monitoring of their credit risk-bearing portfolios and exposures, including for identifying and managing problem loans and for making adequate value adjustments and provisions;
 - (c) adequately diversify each credit portfolio based on the target market and overall credit strategy;
 - (d) have a written policy on credit risk that includes their risk tolerance limits and provisioning policy and describes how it measures, monitors and controls that risk;
 - (e) grant readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure and such information that is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures. For that purpose, materially relevant data shall be determined as at the date of the securitisation and where appropriate due to the nature of the securitisation thereafter;
 - (f) grant readily available access to all other relevant data necessary for the AIFM to comply with the requirements laid down in section 6 below;
 - (g) disclose the level of their retained net economic interest as referred to in section 4 above, as well as any matters that could undermine the

maintenance of the minimum required net economic interest as referred to in that Article.

6. Qualitative requirements concerning AIFMs exposed to securitisations

Article 53 of Level 2

- 6.1 Before becoming exposed to the credit risk of a securitisation on behalf of one or more AIFs, and as appropriate thereafter, AIFMs must be able to demonstrate to the FSC for each of their individual securitisation positions that they have a comprehensive and thorough understanding of those positions and have implemented formal policies and procedures appropriate to the risk profile of the relevant AIF's investments in securitised positions for analysing and recording:
- (a) information disclosed under section 4, by originators or sponsors to specify the net economic interest that they maintain, on an on-going basis, in the securitisation;
 - (b) the risk characteristics of the individual securitisation position;
 - (c) the risk characteristics of the exposures underlying the securitisation position;
 - (d) the reputation and loss experience in earlier securitisations of the originators or sponsors in the relevant exposure classes underlying the securitisation position;
 - (e) the statements and disclosures made by the originators or sponsors, or their agents or advisors, about their due diligence on the securitised exposures and, where applicable, on the quality of the collateral supporting the securitised exposures;
 - (f) where applicable, the methodologies and concepts on which the valuation of collateral supporting the securitised exposures is based and the policies adopted by the originator or sponsor to ensure the independence of the valuer;
 - (g) all the structural features of the securitisation that can materially impact the performance of the institutions securitisation position, such as the contractual waterfall and waterfall related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definitions of default.
- 6.2 Where an AIFM has assumed exposure to a material value of the credit risk of a securitisation on behalf of one or more AIFs, it shall regularly perform stress tests appropriate to such securitisation positions in accordance with Article 15(3)(b) of the AIFMD (on risk management). The stress test shall be commensurate with the nature, scale and complexity of the risk inherent in the securitisation positions.

AIFMs shall establish formal monitoring procedures in line with the principles laid down in Article 15 of the AIFMD (on risk management) commensurate with the risk profile of the relevant AIF in relation to the credit risk of a securitisation position in order to monitor on an on-going basis and in a timely manner performance information on the exposures underlying such securitisation positions. Such information shall include (if relevant to the specific type of securitisation and not limited to such types of information further described

herein), the exposure type, the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy, frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification and frequency distribution of loan to value ratios with bandwidths that facilitate adequate sensitivity analysis. - Where the underlying exposures are themselves securitisation positions. AIFMs shall have the information set out in this subparagraph not only on the underlying securitisation tranches, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those securitisation tranches.

AIFMs shall apply the same standards of analysis to participations or underwritings in securitisation issues purchased from third parties.

- 6.3 For the purposes of appropriate risk and liquidity management, AIFMs assuming exposure to the credit risk of a securitisation on behalf of one or more AIFs shall properly identify, measure, monitor, manage, control and report the risks that arise because of mismatches between the assets and liabilities of the relevant AIF, concentration risk or investment risk arising from these instruments. The AIFM shall ensure that the risk profile of such securitisation positions corresponds to the size, overall portfolio structure, investment strategies and objectives of the relevant AIF as laid down in the AIF rules or instruments of incorporation, prospectus and offering documents.
- 6.4 AIFMs shall ensure, in line with the requirements laid down in Article 18 of the AIFMD (on general organisational requirements)¹, that there is an adequate degree of internal reporting to the senior management so that senior management is fully aware of any material assumption of exposure to securitisations and that the risks arising from those exposures are adequately managed.
- 6.5 AIFMs shall include appropriate information on their exposures to the credit risk of securitisation and their risk management procedures in this area in the reports and disclosures to be submitted in accordance with Articles 22, 23 and 24 of the AIFMD (on transparency requirements)².

7. Corrective action

Article 54 of Level 2

- 7.1 AIFMs shall take such corrective action as is in the best interest of the investors in the relevant AIF where they discover, after the assumption of an exposure to a securitisation, that the determination and disclosure of the retained interest did not meet the requirements laid down in this information page.
- 7.2 AIFMs shall take such corrective action as is in the best interest of the investors in the relevant AIF, where the retained interest becomes less than 5% at a given

¹ For further information please refer to the FSC information page on "AIFMD – Organisational requirements – General".

² For further information please refer to the FSC information page on "AIFMD – Transparency requirements".



moment after the assumption of the exposure and this is not due to the natural payment mechanism of the transaction.

8. Grandfathering clause

Article 55 of Level 2

- 8.1 Section 4 to 7 will apply in relation to new securitisations issued on or after 1 January 2011. Sections 4 to 7 will, after 31 December 2014, apply in relation to existing securitisations where new underlying exposures are added or substituted after that date.

9. Interpretation

Article 56 of Level 2

- 9.1 In the absence of specific interpretation given by ESMA or by the Joint Committee of the European Supervisory Authorities, the provisions of this information page shall be interpreted in a consistent manner with the corresponding provisions of Directive 2006/48/EC (on credit institutions) and with the Guidelines to Article 122a of the Capital Requirements Directive of 31 December 2010³ issued by the Committee of European Banking Supervisors and their subsequent amendments.

10. Application of implementing measures

Any measures adopted by the European Union Commission under Article 17 of the AIFMD will also be applicable.

³ Committee of European Banking Supervisors. Guidelines to Article 122a of the Capital Requirements Directive of 31 December 2010:
<http://www.eba.europa.eu/cpbs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf>