

# AIFMD - Investment In Securitisation Positions

Directive 2011/ 61/EU on Alternative Investment Fund Managers (AIFMD) must be implemented by EU member states by 22 July 2013. AIFMD is supplemented by a delegated regulation (the **AIFMD Regulation**). AIFMD regulates the activities of Alternative Investment Fund Managers (AIFMs) and their Alternative Investment Funds (AIFs).

## Overview

AIFMD through the AIFMD Regulation introduces requirements for AIFs investing in securitisation transactions.

The provisions of the AIFMD Regulation are intended to address the potential misalignment between the interests of firms that repackage loans into tradable securities and originators, and the AIFMs that invest in those securities. It is also intended to achieve cross-sectoral consistency and reduce opportunity for regulatory arbitrage. In this regard, the requirements are equivalent to the securitisation provisions set out in Directive 2006/48/EC (the **Capital Requirements Directive**).

For an AIF to invest in a securitisation, the originator, sponsor or original lender must explicitly disclose to the AIFM that it has retained a material economic interest of not less than 5%. This is the 'skin in the game' requirement. In addition, the AIFM has to ensure that the sponsor and originator comply with certain quantitative requirements. The AIFM must also comply with a set of qualitative requirements. The AIFMD Regulation provides for corrective action to be taken if the retained net economic interest is below the required level.

Securitisation, for the purposes of the AIFMD Regulation, means a transaction or scheme, whereby the credit risk associated with an exposure is tranching and has the following characteristics:

- payments in the transaction or scheme are dependent upon the performance of the exposure; and
- the subordination of tranches determines the distribution of losses during the on-going life of the transaction.

## Application

The AIFMD Regulation applies to new securitisations issued on or after 1 January 2011, but also (after 31 December 2014) to securitisations existing before that date where new underlying exposures are added. The AIFMD Regulation will apply to an AIF assuming synthetic exposure to a securitisation as well as the transfer of title to securitised instruments.

## Retained Interest

An AIFM may only invest in securitisations where the originator, sponsor or original lender has explicitly disclosed its on-going retention of at least 5% material net economic interest. The AIFMD Regulation states that only the following shall satisfy this requirement:

- retention of at least 5% of the nominal value of each of the tranches sold or transferred to the investors;
- for securitisations of revolving exposures, retention of the originator's interest of at least 5% of the nominal value of the securitised exposures;
- retention of randomly selected exposures, equivalent to at least 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 no less than 100 at origination;
- 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 to investors, so that the retention equals at least 5% of the nominal value of the securitised exposures; and
- retention of a first loss exposure of at least 5% of every securitised exposure in the securitisation.

The level of the material net economic interest is measured at the time of origination and interest or exposure cannot be reduced through any credit risk mitigation, such as the taking of short positions or other hedge, and cannot be sold.

The requirement that an originator retain at least 5% material net economic interest does not apply where the securitised exposures are to certain government and public sector bodies (or other institutions risk-weighted at 50% or lower under the CRD).

## Qualitative Requirements Concerning Originators and Sponsors

The AIFM must ensure that the sponsor and originator meet qualitative standards including:

- granting credit based on sound and well-defined criteria;
- operating effective systems to administer and monitor credit risk-bearing portfolios and exposures;
- diversifying credit portfolios based on target market and credit strategy;
- having a written credit risk policy to include risk tolerance limits;
- allowing access to all materially relevant data; and

- disclosing retained net economic interests and any matters that could affect the maintenance of the required amount.

The AIFMD Regulation suggests that there are circumstances where someone other than the originator, sponsor or original lender might be able to meet the retention requirement, but their interests must be optimally aligned with the interests of the investors in the securitisation. For the avoidance of doubt, this other entity will not be obliged to fulfil the retention requirement if the requirement is already fulfilled (by the originator, sponsor or original lender).

### Qualitative Requirements Concerning AIFMs

The AIFMs must understand their securitisation positions and by implication, will be required to carry out extensive due diligence before their AIFs invest in securitisations. The AIFM must implement policies and procedures for analysing and recording:

- the net economic interest retained by the originator or sponsor;
- the risk of each securitisation;
- the risk of the exposures underlying the securitisation;
- the history of the originator or sponsor and any loss they may have experienced previously;
- the response of the originator or sponsor to due diligence in respect of the quality of collateral supporting the securitisation;
- how the collateral supporting the securitisation is calculated;
- the policies adopted by the originator and sponsor to ensure the independence of the collateral valuer; and
- any structural features of the securitisation that could materially impact the performance of the AIF's position.

Once an AIF has assumed exposure to a securitisation, the AIFM must:

- perform regular stress tests if exposed to a material value of the credit risk of the securitisation;
- establish formal procedures for monitoring the performance of the exposures underlying the securitisation;
- identify, measure, monitor, manage, control and report the risks that arise because of mismatches between the assets and liabilities of the AIF and the concentration risk and investment risk arising from investment in securitisations for risk and liquidity management;
- ensure the risk profile of the securitisation positions match the size, overall portfolio structure, investment strategies and objectives of the AIF;
- ensure adequate internal reporting to the directors of the AIFM so that they are fully aware of material exposures to securitisations; and
- include appropriate information on investment in securitisations and risk management procedures in annual reports for the AIF, disclosures to investors and reporting to competent authorities as required under AIFMD.

### Corrective Action

The AIFMD Regulation requires an AIFM to take corrective action (such as hedging, selling or reducing the exposure or seeking compliance) if it establishes, after investing in a securitisation, that:

- the determination and disclosure of the retained interest did not meet requirements set out in the AIFMD Regulation; or
- the retained interest has fallen below 5% (except where this is due to the natural payment mechanism of the transaction).

Corrective action should be in the best interests of investors in the AIF.

## KEY CONTACTS



### Brian McDermott

Partner  
T: +353 1 649 2307  
E: [bmcdermott@algoodbody.com](mailto:bmcdermott@algoodbody.com)



### Michael Barr

Partner  
T: +353 1 649 2327  
E: [mbarr@algoodbody.com](mailto:mbarr@algoodbody.com)



### Mary McKenna

Partner  
T: +353 1 649 2344  
E: [mmckenna@algoodbody.com](mailto:mmckenna@algoodbody.com)



### Niamh Ryan

Partner  
T: +44 20 73 820 820  
E: [nryan@algoodbody.com](mailto:nryan@algoodbody.com)



### Elaine Keane

Partner  
T: +353 1 649 2544  
E: [elkeane@algoodbody.com](mailto:elkeane@algoodbody.com)



### Nollaig Greene

Professional Support Lawyer  
T: +353 1 649 2359  
E: [nngreene@algoodbody.com](mailto:nngreene@algoodbody.com)

The contents of this note are necessarily expressed in broad terms and limited to general information rather than detailed analyses or legal advice. Specialist professional advice should always be obtained to address legal and other issues arising in specific contexts.

© A&L Goodbody July 2013