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Securitisation 2024

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Contributing Editor
Tamara Box
Reed Smith

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Global Practice Guides

Securitisation

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Reed Smith

2024

Chambers Global Practice Guides

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INTRODUCTION

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Reed Smith has a team of over 3,000 people, including more than 1,700 lawyers, operating across 31 offices in the US, Europe, the Middle East, and Asia. The firm's global structured finance team has over 45 skilled, experienced lawyers committed to building long-term relationships to support clients' business. Reed Smith has one of the broadest and most dynamic structured finance teams in the industry. The firm believes that the practice of law has the power to drive progress. Clients' time is valuable and their matters are important. Reed Smith focus on outcomes, with a highly collaborative approach, and has deep industry insight that, when coupled with the firm's local market knowledge, allows it to anticipate and address its clients' needs. Clients deserve purposeful, highly engaged client service, and the firm's commitment to building strong relationships helps each client achieve their goals. Reed Smith is ranked in Chambers UK 2024 as a leading firm.

Contributing Editor

Tamara Box leads the structured finance team at Reed Smith. She is the immediately preceding managing partner, EME, and spent almost a decade on the global board of the firm, stepping down from both roles in July 2023. Tamara has twice been named by Financial News as one of the "50 Most Influential Lawyers" in the UK (2022 and 2023), been included in the Global HERoes Women Role Model List every year since its inception in 2016, and was named Law Firm Leader of the Year – Large Law Firm at the Women and Diversity in Law Awards, 2023. She is "top ranked" in Chambers UK 2024.

Co-author

Sarah Caldwell is a partner in Reed Smith's structured finance team, and is recognised for providing strategic advice to financial institutions on structured finance products. Sarah's practice focuses on high-value, cross-border trades, including securitisations, NPLs, forward flow, receivables financing, and India finance work. She sits on the firm's Women's Initiative Committee, EME. Sarah has been ranked in Chambers UK for securitisation in 2021, and she was included in Brummell's Ones to Watch listing, which celebrates the brightest 30 under 40 making waves in the City.

INTRODUCTION

Contributed by: Tamara Box and Sarah Caldwell, **Reed Smith**

Reed Smith

The Broadgate Tower
20 Primrose Street
London
EC2A 2RS
UK

Tel: +44 20 3116 3000
Email: tbox@reedsmith.com
slcaldwell@reedsmith.com
Web: www.reedsmith.com

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An Overview of Securitisation

The year 2023 proved that securitisation remains a robust funding tool for the global finance markets, even in times of economic turmoil and continued uncertainty. Although global issuance figures in the early part of 2023 got off to a slow start, the securitisation market remained resilient with increased securitisation activity seen later in the year, evidenced by sharp rises in the US asset-backed securities (ABS) and European residential mortgage-backed securities (MBS) markets. This is despite central banks arming themselves against rising inflation by hiking interest rates globally, and despite several economies teetering on the edge of recession, leading forecasters to fear that unemployment figures would begin to join interest rates on a slow creep upwards. The war in Ukraine also continued to wreak havoc on commodity prices.

However, securitisation continues to remain a vital product and the positive news as we look forward is that there is now a widespread belief that US interest rates have peaked, with many market participants predicting that the Federal Reserve Board will not lift borrowing costs any further. This is supported by recent US economic data showing a further slowing in inflation, which fell more than expected to 3.2% in October 2023, marking the first decline in four months. As a result, US Treasuries have recovered significant ground; alongside this, both the European Central Bank and the Bank of England have continued to keep borrowing costs steady at their latest policy meetings. This has prompted investors to move into both stocks and bonds, with average cash levels falling from 5.3% to 4.7%, which is a healthy sign of rising investor confidence with regard to deploying their cash. Stabilising interest rates and the slowing of inflation are key factors in promoting both originator and investor confidence in the securitisation markets, which should result in increased issuance figures and a more competitive securitisation market.

Securitisation continues to be a versatile global product, covering multiple asset classes across a variety of industries. This introduction touches on a selection of interesting global, cross-asset statistics to demonstrate how the securitisation markets have been performing, together with views on delinquency impact – a topic on everyone's mind in this economic environment – and the changes to certain regulatory frameworks.

INTRODUCTION

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Issuance statistics

The US securitisation market remains the largest in the world and ABS remained strong in the US though it was down 21.3% year-on-year. The vast majority of issuances this year were backed by auto loans.

Interest rates were, and continue to be, the economic story of the year, and had a dramatic effect on the housing market, with significantly less mortgage activity than usual. This, of course, had a knock-on effect on the securitisation market. Over the first four months of 2023, global MBS issuance stood at USD100 billion (the lowest since 2000). Although higher mortgage rates are largely to blame for this, the collapses of Silicon Valley Bank and Signature Bank, each of which held large amounts of MBS, as well as general market uncertainty, are also likely to have had an impact on prospective issuers' and investors' appetites. That said, although Europe's market also began slowly, Q2 saw European issuance up 173% compared to Q2 of 2022. However, this was primarily driven by a significant French retained residential MBS deal issued in May 2023, without which issuance would have increased by only 32.8% year-on-year.

On the CMBS side, the pandemic's impact on office demand, as well as the related impact on valuations and credit, continues to affect issuance. However, outside the US, Q3 of 2023 did see the first signs of life in the European CMBS market since April 2022, with the first transaction of this kind since then. Given the potential risk of default in this asset class, particularly in the US market, it is likely that the CMBS markets will face similar challenges in 2024.

Interestingly, the Australian securitisation market tells a story of growth. Q1 of 2023 saw a healthy total issuance figure of almost AUD10 billion, the second most successful Q1 of the past six years. Industry participants noted that the market had shifted significantly since 2022, with investors far more open to risk, making transaction structuring and participation far easier.

There were also glimpses of growth outside of the more established securitisation markets. In India, securitisations topped INR1.15 trillion in the first nine months of 2023, representing a 42% increase year-on-year. Small finance banks, in particular, have been acting as originators, increasing securitised issuances to access incremental liquidity.

The increasing demand for ESG investment products also points towards significant potential for growth in this area. This is particularly the case in Europe, where ESG securitisation accounted for only 1.4% of total ESG issuances between 2019 and 2022, compared to 8.1% in China and 32.3% in the US over the same period. AFME and S&P Global Ratings predict that potential securitisable green lending to households across eight major European markets could exceed EUR300 billion annually by 2030. This is inclusive of the growth of gross green mortgage lending of EUR125 billion. Other areas of potential growth include the electric vehicles market, where substantial growth for securitisable financing of new battery electric vehicles is predicted to reach EUR80 billion annually across five major European economies. This is in addition to a further EUR30 billion in predicted growth of annual financing for used electric vehicles. Generally, securitisation of ESG-related asset classes has grown at different paces. In particular, there has been a much greater level of ESG activity in the green RMBS and green auto ABS segments compared to other asset classes.

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Delinquencies

In times of uncertain economic outlook, investors may understandably take interest in the quality of the underlying assets and delinquency rates on securitised products. In some cases, this is not a surprise; in the US commercial MBS space, defaults were on the rise throughout Q2 of 2023, although it should be noted these remain well off their pandemic peaks. Increased default rates have led to ratings actions being taken, resulting in more downgrades than upgrades in this space, particularly in securities backed by underperforming retail malls.

Delinquencies in the auto ABS market remain consistent with pre-pandemic levels for the time being, and investors will be monitoring unemployment figures and interest rates to determine whether they will likely remain low.

European delinquency rates, however, tell a more positive story. The more traditional ABS, RMBS and leveraged collateralised loan obligation (CLO) sectors have seen lifetime default rates of no more than 1.5% since the 1980s. Since the 2008 financial crisis, the lifetime default rate has been only 0.2% across about 7,500 tranches. Even in tough economic times, European securitisations remain a reliable product for both originators and investors.

Regulation updates

Ensuring securitisation default rates remain low requires constant vigilance by financial regulators and complex regulatory regimes. The year 2023 saw regulatory reforms proposed and implemented across Europe, the UK and the US. In the US, the Securities and Exchange Commission proposed stricter rules on securitisation participants engaging in transactions that may represent conflicts of interest with respect to ABS investors. These are likely to affect participants engaging in MBSs, synthetic securitisations and CLOs, and are intended to prohibit transactions that amount to a “bet” against the securitisation.

Financial regulators around the globe continue to steer the transition away from LIBOR, the benchmark interest rate used in many securitisation transactions that is being phased out. The date of 30 June 2023 represented an important date, as the remaining five USD LIBOR settings ceased to be published on a representative basis. This date, however, presented a problem for legacy contracts governed by US state laws which do not include clear and practicable provisions for replacing USD LIBOR. The Federal Reserve Board responded to this by adopting a rule late last year that replaced USD LIBOR with SOFR-based rules in these kinds of contracts. The UK’s Financial Conduct Authority (FCA), however, did not have jurisdiction to deal directly with US-governed contracts of this sort. Instead, the FCA was required to extend the publication of three USD LIBOR settings on an unrepresentative synthetic basis. Despite regulators’ best efforts, it appears LIBOR will continue in 2024.

Within the EU, Luxembourg (second only to Ireland as the most popular jurisdiction in which to incorporate special purpose entities (SPEs)) saw regulatory reform in late 2022, with the introduction of four new legal forms in which a securitisation can be established. These reforms have brought additional flexibility and confidentiality for prospective securitisation participants. By late 2023, they had been put into practice twice and are expected to bolster Luxembourg’s already-thriving securitisation market, which holds a market share of 28.9% in the EU.

Elsewhere, the EU introduced long-awaited risk retention reforms in early November 2023. Some

notable changes include amending the definition of the sole purpose test and changing how risk retention on non-performing exposures is calculated. The UK also announced proposals for the new UK securitisation regime, which are largely in line with many of the EU changes but with some exceptions aimed at ease of access, and greater deal flow, for securitisations in the UK market.

Guide introduction

The regulatory changes touched on in this introduction merely scratch the surface given the vast and fluid securitisation regimes that span the globe. This Global Practice Guide ("Guide") is therefore designed to arm practitioners with the knowledge they need to approach securitisations in 2024 and is intended to ensure that practitioners gain an understanding of the scope, structure, regulations and strategies behind the most popular kinds of securitisations in different jurisdictions. Efforts have been made to keep the Guide accessible and practical, walking the reader through the cycle of a typical securitisation transaction, with a focus on all of the "need to know" transaction features.

Each jurisdiction section begins with an overview of the jurisdiction's most commonly securitised assets, listing the assets and what transaction structures are typically used. The Guide also covers the laws and regulations that apply to these structures, popular jurisdictions used for SPEs, and any material forms of credit enhancement used.

The Guide then deals with the parties to the transactions and their respective roles. Following this, the focus turns to the required documentation, together with explanations regarding bankruptcy-remote asset transfers, warranties, covenants, servicing provisions, indemnities, securities, derivatives and offering memoranda. Finally, and perhaps most importantly for practitioners given the ever-changing regulatory environment, the Guide addresses the various laws, regulations and other requirements directly relating to securitisations in each jurisdiction, such as disclosure laws, credit risk retention rules, rating agency and reporting requirements, and structural considerations. The Guide then deals with associated tax and accounting rules that affect transfers, profits and legal opinions.

The content on each jurisdiction has been prepared by experts in their field and their respective sections touch on far more detail than summarised above. We hope that the reader will find the rest of the Guide informative, engaging and helpful. If readers have any comments, questions or suggestions, these are welcomed as new editions of the Guide are published each year.

CHINA

Law and Practice

Contributed by:
Borong Liu, Xiaoli Liu, Jingyi Lu, Wei Xu and Jidong Hu
Zhong Lun Law Firm

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Zhong Lun Law Firm has led the market in the promotion and facilitation of securitisation transactions in China since 1995, and has actively participated in pilot research and rule-making processes related to all kinds of securitisation products. The firm has also actively assisted regulatory bodies with the development of information disclosure guidelines and practice guidelines. The firm co-founded the China Securitisation Forum in 2006, which is a communication platform for securitisation and structured finance with an international perspective. Based in Beijing, the core securitisation legal service team of Zhong Lun consists of more than 30 experienced lawyers. With the strong support of other practice groups within the firm, it is capable of providing prompt, valuable, and comprehensive assistance to all participants in securitisation transactions, including banks, automobile finance companies, consumer finance companies, financial lease companies, trust companies, securities companies and subsidiaries of fund management companies.

Authors

Borong Liu is a partner at Zhong Lun Law Firm and head of its private equity and asset management department. He has more than 20 years' experience in providing legal services in areas including securitisation, structured finance and asset management, and is highly regarded in the field of asset securitisation in China and Asia. Mr Liu is the co-chairman of the Executive Committee of the China Securitisation Forum, and serves as an external expert or committee member for several self-regulatory organisations. He is also the founder and the chairman of the China DAF Charity, the first charity foundation operated in the mode of donor-advised fund charity account in China.

Xiaoli Liu is a partner at Zhong Lun Law Firm and has dedicated her practice to China's asset securitisation legal service market since 2008. She has extensive experience in the issuance, duration management and liquidation of various types of asset securitisation, including personal residential mortgage loans, personal consumer loans, credit card receivables, retail auto loans, corporate loans, financial leasing assets, and non-performing assets, and has conducted in-depth research on related legal and compliance issues. Ms Liu currently serves as a member of the 3rd Asset Securitisation and Structural Financing Committee of NAFMII.

Jingyi Lu is a partner at Zhong Lun Law Firm. He dedicates his practice to securitisation, asset management and infrastructure REITs, and has over 15 years' experience in these areas. Mr Lu has provided services to financial institutions such as the Industrial and Commercial Bank of China, the Bank of China, and CITIC Securities relating to the issuance of asset-backed securities. His expertise covers a wide range of products, including collateralised loan obligations, residential mortgage-backed securitisations, commercial mortgage-backed securitisations, automobile loan securitisations, credit card receivables securitisations, and non-performing loan securitisations.

Wei Xu is a partner at Zhong Lun Law Firm. She has more than 15 years' experience in financial product areas such as asset securitisation and REITs, and specialises in securitisation and investment funds with underlying real estate and infrastructure assets. Ms Xu is one of the first legal specialists to advise on the research and piloting of asset-backed notes and REITs in China. She serves as a member of the Filing and Review Committee of the China Credit Assets Registry & Exchange Co., Ltd. and as chair of the Legal Issue Research Committee of the China Securitisation Forum.

Jidong Hu is a partner at Zhong Lun Law Firm. He dedicates his legal practice to securitisation and REITs and has rich legal experience in various securitisation products in the China Interbank Bond Market, securities exchanges, NAFMII and the China Insurance Asset Registration and Trading System. In particular, he has been deeply involved in a series of complex and innovative securitisation projects concerning real estate and infrastructure, and has a deep understanding and extensive practical experience of relevant legal difficulties and corresponding solutions. He currently serves as a member of the Filing and Review Committee of the China Credit Assets Registry & Exchange Centre.

Zhong Lun Law Firm

22-31/F, South Tower of CP Center 20
Jin He East Avenue Chaoyang District
Beijing, 100020
P.R. China

Tel: +86 10 5957 2288
Fax: +86 10 6568 1022
Email: liuxiaoli@zhonglun.com
Web: www.zhonglun.com

中倫律師事務所
ZHONG LUN LAW FIRM

1. Specific Financial Asset Types

1.1 Common Financial Assets

Credit Asset Securitisation

In China, asset securitisation can be roughly divided into two types based on the nature of the originator. One is called "credit asset securitisation" originated by licensed financial institutions (mainly credit institutions) and issued in the China Interbank Bond Market (CIBM) where the underlying assets of securitisation are limited to credit assets, including corporate loans, small and micro-enterprise (SME) loans, personal residential mortgage loans, personal consumer loans, auto loans, credit card assets, financial leasing debt claims and non-performing loans.

Business Asset Securitisation

The other type of securitisation is called "business asset securitisation" (issued in the CIBM or listed on the stock exchanges), where the originators are mostly non-financial institutions, and the commonly known underlying assets include petty loans, financial lease debt claims, factoring financing claims, supply chain payables, rights of returns related to infrastructure and public utilities, various kinds of account receivables, commercial mortgage loans, securities margin financing claims, trust beneficial rights and intellectual property. In recent years, consumer loans and SME loans extended by trust companies on popular internet platforms have become a growing part of the field of business asset securitisation. As trust companies are not qualified as originators of credit asset securitisations, these assets can only be structured through business asset securitisations.

1.2 Structures Relating to Financial Assets

Credit Asset Securitisation

Credit asset securitisation adopts a special purpose trust (SPT) as the issuance vehicle, and the trustee shall be a trust company which has got a special permission for such business. The basic structure is as follows:

- the originator, as the settlor, entrusts its legally owned credit assets (underlying assets) as trust property to a trustee, in order to establish an SPT;
- the trustee (as issuer) issues asset-backed securities (ABS) representing the beneficial rights in the trust to the investors, and pays the principal, interests or yields of securities from the cash flows generated by the trust property;

- the lead underwriter shall assemble an underwriter syndicate to underwrite the securities;
- the trustee engages a servicer (usually the originator) to provide daily collection, management and other services for underlying assets;
- the trustee engages a fund custodian to provide the fund custody services in respect of the collections generated by the trust property; and
- the trustee engages the China Central Depository & Clearing Co, Ltd. (CCDC) as securities depository and paying agent for the securities.

Exchange Market Securitisation

Business asset securitisation listed on stock exchanges ("exchange market securitisation") adopts an asset-backed special plan (ABSP) as the issuance vehicle, and its basic structure is as follows:

- the investors sign subscription agreements with the plan manager and make subscription payments to the plan manager to set up an ABSP;
- the plan manager (henceforth representing the ABSP) purchases underlying assets from an originator with the raised funds by signing an underlying asset purchasing agreement with the originator;
- the plan manager engages a servicer to be responsible for the recovery and collection of underlying assets, the disposal of defaulted assets and other management work relating to underlying assets, by signing a servicing agreement with the servicer (usually the originator);
- the plan manager engages a fund custodian bank to safeguard the ABSP account opened in the name of the plan manager, and there is often an account supervision arrangement over the collection account of the servicer; and
- the plan manager engages the China Securities Depository and Clearing Corporation Limited (CSDC) for the registration and depository of the securities and the payments of principal and interest on the securities.

CIBM Business Asset Securitisation

Business asset securitisations carried out in the CIBM ("CIBM business asset securitisation) adopt a structure different to exchange market securitisations but similar to credit asset securitisations. The products of a CIBM business asset securitisation include asset-backed notes (ABNs) and asset-backed commercial paper (ABCPs); the later are issued on rolling basis and with a maturity of less than one year. The specific structure is as below:

- the originator entrusts the underlying assets to a trust company (as trustee and issuing vehicle manager) to establish an SPT;
- the SPT (represented by the trustee), as the issuing vehicle, issues notes (often through an underwriting syndicate) to investors in the CIBM;
- the trustee pays the principal and interest of the notes with the cash flows generated from the trust property, and cash from rolling issuance or liquidity provider in the case of ABCP;
- the trustee engages a servicer to provide management and collection services in connection with the underlying assets, and engages a funds custodian to provide fund custody services for the SPT;
- the Shanghai Clearing House, as the notes depository, provides the registration and depository services for the notes and agency services in relation to the payments of the notes.

1.3 Applicable Laws and Regulations

Credit Asset Securitisation

The laws and regulations that have a material effect on the transaction structure of credit asset securitisations include the Civil Code, the Trust Law, the Administrative Measures for the Securitisation of Credit Assets (Announcement of the People's Bank of China (PBOC) and China Banking and Insurance Regulatory Commission (CBRC) [2005] No 7), the Measures for Supervising and Administrating the Pilot Securitisation of Credit Assets of Financial Institutions (Order of CBRC [2005] No 3), and the Announcement on Further Regulating the Risk Retention of Originator in Credit Asset Securitisation (Announcement of the PBOC and CBRC [2013] No 21).

Exchange Market Securitisation

The laws and regulations that have a material effect on the transaction structure of exchange market securitisation include the Civil Code, the Securities Law, the Securities Investment Fund Law, the Administrative Provisions on Asset Securitisation by the CSRC, and the list condition confirmation guidelines for securitisation issued by the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE).

CIBM Business Asset Securitisation

The laws and regulations that have a material effect on the transaction structure of CIBM business asset securitisation include the Civil Code, the Trust Law, the Measures for Administration of Debt Financing Instruments Issued by Non-Financial Enterprises in the Interbank Bond Market (Order of PBOC [2008] No 1), and the Rules on CIBM Business Asset Securitisation and Information Disclosure Guidelines on CIBM Business Asset Securitisation (Announcement of the National Association of Financial Market Institutional Investors (NAFMII) [2023] No 3).

1.4 Special-Purpose Entity (SPE) Jurisdiction

In most (if not all) circumstances, the SPV will be set up in China and governed by PRC laws. For foreign exchange policy reasons, the transfer of underlying assets to a foreign SPV can hardly be achieved, as there is no explicit rule regarding such cross-border transfer of financial assets except for non-performing loans.

1.5 Material Forms of Credit Enhancement

Credit enhancement in the securitisation market can be divided into internal credit enhancement and external credit enhancement. Forms of internal credit enhancement commonly used include subordination, over-collateralisation, cash deposits, cash reserve accounts, etc. Forms of external credit enhancement include shortfall supplement commitments, guarantees, external liquidity support, credit risk mitigation instruments, etc. In particular, shortfall supplement commitments are only used in business asset securitisations, where the cash flow projection of the underlying assets is not persuasive enough or is highly dependent on the continuous operation of the originator; therefore, the commitments are usually made by the originators, the ultimate financing parties, or their related parties.

2. Roles and Responsibilities of the Parties

2.1 Issuers

Role of the Issuer

In credit asset securitisation, the issuer is the trustee of the SPT, which shall have an SPT trustee qualification approved by the National Administration of Financial Regulation (abbreviated as NAFR, formerly as CBIRC or CBRC).

In exchange market securitisation, the issuer is the manager of the ABSP, which can be a securities company or its subsidiary, a subsidiary of a fund management company, a trust company, or an insurance asset management company.

For CIBM business asset securitisation, the issuer shall be the special purpose vehicle (SPV) or its manager. Currently, the issuers are all trust companies with the SPT trustee qualification, but the National Association of Financial Market Institutional Investors (hereinafter referred to as NAFMII) is considering expanding the scope of SPV manager to other asset management companies, to keep in line with the practice of exchange market securitisation.

Issuer's Responsibilities

As the issuer is also the trustee or plan manager of the SPV, who stands in a trust relationship or agency relationship with the investors, its role is a combination of issuer and bond trustee. Its basic responsibilities include:

- handling the approval, registration and record-filing regarding the securities issuance;
- handling information disclosure during the issuance phase and life of the securities;
- holding and managing asset pools;
- distributing SPV assets to investors or creditors of the SPV;
- convening a security holders' meeting, if necessary;
- supervising other institutions providing services to the SPV; and
- taking measures to protect the interests of investors.

2.2 Sponsors

In credit asset securitisation, the underlying assets are often originated by the originator itself, although there is no restriction on purchased assets in the regulations. In contrast, the role of sponsor has emerged in recent years for business asset securitisation. For example, factoring companies often purchase account receivables in the form of factoring and securitise these assets in the markets. Another example is the trust company, which may be a sponsor of a securitisation where the asset pool is comprised of loans originated by itself or purchased from other trust companies, in either case the underlying assets are served by the same asset servicer and the same eligibility criteria apply.

The regulations set no special requirements on a sponsor, so a sponsor's responsibilities are not different from that of an originator (for details please see **2.3 Originators/Sellers**).

2.3 Originators/Sellers

Role of the Originator

Originators transfer underlying assets to an SPV by means of sale or trust. In credit asset securitisations, the sponsor is a financial institution that originates credit assets and transfers them through the establishment of an SPT. Only financial institutions approved by the NAFR can act as originators. These include commercial banks, policy banks, automobile finance companies, consumer finance companies, financial leasing companies and financial asset management companies.

In business asset securitisations, the originators are basically non-financial enterprises from a range of industries, with limited exceptions for financial institutions.

Originator's Responsibilities

The responsibilities of an originator mainly include:

- providing underlying assets that meet the eligibility criteria;
- redeeming or replacing the ineligible underlying assets;
- co-ordinating and supporting the issuer and related intermediaries in performing their duties;
- maintaining a risk retention of the underlying assets (exemptions are given to qualified business asset securitisation);
- providing relevant disclosure information to the issuer and related intermediaries in a timely manner; and
- ensuring that the information provided is true, accurate and complete.

If the cash flows of the underlying assets depend on the continued operation of the originator, then the originator shall commit to maintaining normal operation throughout the life cycle of the securitisation, and to supplement the shortfalls in the cash flow of the underlying assets.

2.4 Underwriters and Placement Agents

Role of the Underwriter

An underwriter or placement agent is an institution responsible for the promotion and sale of the ABS. It will preside or participate in the bookbuilding or bidding procedure for issuance of the securities; and before that, it will do market investigations and road shows, to form an accurate opinion regarding the margin for price. The lead underwriter normally acts as the transaction arranger or financial adviser, taking the lead in the design of the transaction structure, the co-ordination of the progress of the project participants, filing with the regulatory authorities and other matters.

The underwriters are generally domestic financial institutions, mainly banks and securities companies, as well as foreign banks registered in China. Regarding CIBM business asset securitisation, in addition to banks and securities firms, trust companies can also act as underwriters.

Necessity of the Underwriter

In credit asset securitisation and CIBM business asset securitisation, an underwriter is required. The regulations on credit asset securitisation even require the issuer to organise an underwriting syndicate. In contrast, an underwriter or placement agent is not a requirement for an exchange market securitisation, as the issuers are often capable of placing the securities by themselves.

2.5 Servicers

A servicer is often engaged by the issuer to provide services in relation to the underlying assets. Servicers are usually the originators of the underlying assets, or their affiliates. The issuer may also engage more servicers besides the originator; these are often technical servicers or professional institutions with expertise in the underlying assets. The general responsibilities of the servicers include collecting the cash flow from the underlying assets and transferring it to the SPV, managing the underlying assets and keeping related records, safeguarding the legal documents and records, disposing of the defaulted assets and providing regular service reports to the SPV manager or trustee.

In respect of credit asset securitisation, the servicer shall be a financial institution established in China and qualified to extend loans. For other types of securitisations, there is no specific permission requirement for a servicer, except for authorisation conferred in the servicing agreement.

2.6 Investors

Investors in ABS generally do not actively participate in the management of the SPV, but passively receive payments on the securities. The investors can only attend the security holders' meeting and vote in situations where the investors' rights might be affected. The main obligations and responsibilities of the investors include paying the subscription price in accordance with the terms of the subscription agreement, complying with the trading limits set in the relevant laws, regulations, and transaction documents, complying with the provisions on the exercise of rights, and maintaining confidentiality regarding trade secrets. The business types of investors are introduced under **4.13 Entities Investing in Securitisation**.

2.7 Bond/Note Trustees

Article 92 of the Securities Law requires that a bond trustee shall be appointed for a public offering of corporate bonds. Since securitisation in China has not adopted the corporate form of special purpose company (SPC), there's no requirement of a bond/note trustee: as the SPV for a securitisation is often a trust or agency relationship, and the trustee or plan manager stands in a fiduciary relationship with the investors, a separate bond/note trustee is not necessary. The plan manager or trustee's role often overlaps with the issuer, the main responsibilities of which can be found in **2.1 Issuers**.

2.8 Security Trustees/Agents

A security trustee/agent is not necessary in China's securitisation practices because, legally, the trustee/plan manager (on behalf of the investors) holds legal title to the underlying assets and makes payments using the cash flows generated from the underlying assets; the underlying assets are not designed as collateral for the securities. The trustee/plan manager itself plays the role of a security trustee/agent. When necessary, it has the power to liquidate the underlying assets without authorisation or consent of the originator, but in most circumstances it needs the approval of a meeting of the security holders.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

Trust Agreement

In credit asset securitisations and CIBM business asset securitisations, the bankruptcy-remote transfer of financial assets is achieved through the provisions of the "trust agreement". The trust property is independent and will not be affected by the bankruptcy of the settlor and the trustee, which meets the requirement of risk isolation in securitisation. Meanwhile, the trust can achieve limited recourse – both the settlor's and the trustee's liabilities to the beneficiaries are limited to the trust property. The trust agreement is one of the core transaction documents, and its main provisions include the following:

- the scope, type, standard and status of the trust property;
- the delivery of the trust property;
- the conditions for the establishment of the trust;
- the redemption of ineligible assets;
- the rights perfection mechanism;
- the rights and obligations of the trust parties;
- the types and characteristics of the securities;
- the cash flow allocation order;
- the trust termination and liquidation;
- the organisational form and power of the security holders; and
- the liability for defaults and indemnities.

Asset Transfer Agreement

In exchange market securitisations, the transfer of assets while maintaining bankruptcy remoteness is realised through the "asset transfer agreement". This agreement is signed between the originator and the plan manager of the ABSP. The originator transfers the ownership of the underlying assets to the plan manager to ensure the true sale of the underlying assets, in order to achieve bankruptcy remoteness. The main contents of the asset transfer agreement include the following:

- the status of the underlying assets;
- the purchase and delivery methods of the underlying assets;
- the purchase price and payment;
- the redemption of the ineligible assets;
- the repurchase option of the asset pool;
- the covenants and warranties of the buyer and the seller;
- defaults and liabilities; and
- the effectiveness and termination of the agreements.

3.2 Principal Warranties

"Asset warranties" refer to the representations and warranties of the originator regarding the underlying assets of the securitisation as of a specific date or time (such as the cut-off date and the trust property delivery date). The contents of asset warranties may differ depending on the different types of underlying assets, but customarily include the following:

- the underlying assets meet the eligibility criteria;
- all relevant information and information disclosure of the underlying assets is true, accurate and complete;
- the originator has sole and legally valid ownership of the underlying assets;
- the underlying assets are not encumbered by pledges or other kinds of burdens, nor restrictions on transfer;
- the conditions precedent for the obligor's obligations to perform on contracts concerning the underlying assets have been satisfied;
- the provisions of the contracts concerning the underlying assets are legally valid and binding on the relevant obligors; and
- the originator has not given a third party any option affecting the recoverability of the underlying assets.

If the underlying assets do not satisfy the requirements of the asset warranties at the time of entering the asset pool or transfer, the underlying assets will be recognised as ineligible assets and must be redeemed by the transferor or originator according to the transaction documents.

3.3 Principal Perfection Provisions

Currently, the prevailing right perfection measures include two kinds: (i) sending right perfection notice to the debtor and the guarantor, and (ii) conducting the transfer registration for the related mortgage or pledge. Since the notice and the transfer registration need to be conducted separately, for the purposes of facilitating the collection of the assets and reducing the transaction costs, such measures are not normally required to be taken at the delivery of the underlying assets, but only required upon the occurrence of right perfection events provided in the transaction documents.

Right perfection events usually include but are not limited to situations where:

- the servicer is terminated due to the occurrence of servicer termination events;
- the servicer loses a certain credit rating; and/or

- the originator loses a certain credit rating or solvency.

After the occurrence of a right perfection event, the asset seller or the settlor will send a right perfection notice to the debtor or the guarantor (referred to collectively as the obligor):

- informing the obligor of the transfer of the underlying assets or the establishment of the trust; and
- instructing the corresponding obligor to repay directly to the ABSP account or the trust account from the date of receipt of the right perfection notice.

If the underlying assets are secured by a mortgage or pledge that requires a registration, the asset seller or originator must conduct the transfer registration of the mortgage or pledge promptly upon the occurrence of a right perfection event, to ensure that the mortgage or pledge held by the plan manager or the trustee will be valid against any bona fide third party.

In addition, based on new changes brought by the Civil Code and the Interpretation of the Security System (see **6.3 Transfer of Financial Assets**), more securitisation transactions will consider registering the transfer of account receivables in the Registration and Public Notice System of the PBOC's Credit Reference Centre. However, the actual time of conducting such registration (immediately after the transfer or after the occurrence of an agreed trigger event) may be decided based on the credit status of the settlor or the asset seller.

3.4 Principal Covenants

In order to ensure a smooth transaction, the originator usually makes the following covenants in the transaction documents:

- the originator will continue to fulfil its obligations under the contracts concerning the underlying assets in a comprehensive, complete and timely manner, and not relinquish or delay the exercise of its rights;
- after the transfer of the underlying assets or the establishment of the trust, the underlying assets will not be transferred to or disposed of for the benefit of any third party, nor will any security interests be established regarding the underlying assets;
- any defect in assets or the transaction that might hinder the transfer of the underlying assets shall be remedied with due diligence to facilitate the smooth and lawful execution of the transaction;
- the contract concerning the underlying assets shall not be arbitrarily modified, nor shall any obligations or liabilities of the obligor on the underlying assets be waived, so that material adverse effects on the underlying assets are avoided;
- the originator will provide protection for the underlying assets and related interests to prevent such rights and interests from being infringed upon by third parties;
- the originator will not lose solvency in the foreseeable future due to the establishment of the trust; and
- the originator will not engage in any act that might result in the corresponding debtor exercising a right of set-off or right of defence regarding the underlying assets.

The originator will be deemed to be in default of the contract and liable for indemnities and other liabilities upon breach of any covenant.

3.5 Principal Servicing Provisions

The contents and conditions of the services provided by the servicer are stipulated in the servicing agreement and may vary according to

the types of the underlying assets. However, the main services can be summarised as the following:

- collecting the receivables on the underlying assets and transferring collections thereof to the SPV;
- managing the underlying assets and monitoring their conditions;
- risk management, recovery and disposal of the underlying assets;
- recording the status of the collection of funds in an accurate and timely manner;
- safekeeping of the data and records concerning the underlying assets;
- assisting the trustee/plan manager in replenishing eligible underlying assets when a revolving pool is involved; and
- reporting the conditions of the asset pool on a regular basis.

A servicer generally would not provide any guarantee or assurance on the return of the underlying assets. If the servicer fails to perform its obligations under the servicing agreement, or if any of its representations, warranties and commitments under the servicing agreement is materially false, inaccurate or misleading, the servicer is deemed to be in default and becomes liable for the breach of contract.

3.6 Principal Defaults

In securitisation transactions, the principal default events include accelerated payment events, events of default and termination events. Both accelerated payment events and events of default will result in changes of cash flow distribution order and early amortisation of securities, but accelerated payment events are generally less severe than events of default.

Accelerated Payment Events

Accelerated payment events generally include:

- insolvency of the originator;
- occurrence of a servicer termination event;
- breach of the servicer's main obligations under the transaction documents such as the transfer of collections;
- the accumulative default rate of the underlying assets exceeding a certain threshold; and
- failure to appoint a qualified successor within a certain period of time when it is necessary to replace the trustee or the servicer pursuant to the transaction documents.

Some accelerated payment events are not caused by default of participants in the transaction, but rather circumstances that may have a detrimental impact on the project.

Events of Defaults

Events of default generally include:

- failure to fully pay interest on the highest class of securities within the agreed time;
- failure to pay the full principal amount of the securities within the agreed time after the final maturity date; and
- failure to legally and effectively deliver collections to the trustee/plan manager or to defend against the claims of third parties.

Termination Events

Termination events of the trustee/plan manager, the servicer and the fund custodian usually include:

- loss of corresponding qualifications;
- material breach of contract;
- insolvency; or
- failure to maintain any required rating.

Upon occurrence of any termination event, the meeting of security holders has the power to replace the corresponding institution.

3.7 Principal Indemnities

Typical indemnification provisions in securitisations include indemnification for breach of contract by the servicer, the fund custodian and other securitisation service providers; and indemnification for the trustee/plan manager's failure to manage the assets of the SPV in accordance with relevant laws and the transaction documents. Specifically, in terms of the originator and the trustee/plan manager, it is generally specified in the transaction documents that the securities are not liabilities of the originator or the trustee/plan manager, and the investors' right of recourse is only limited to the assets of the SPV; however, the liability for compensation of the originator or the trustee/plan manager in the event of default under the transaction documents is not limited by the aforementioned provisions.

3.8 Bonds/Notes/Securities

The terms and conditions of the securities/notes are customarily included in the trust agreement/asset management contract as well as the offering circular. The trust agreement/asset management contract is like a charter for the SPV and provides basic terms and conditions of the SPV, such as purpose of trust, parties relating to the SPV, establishment of the SPV, entrustment/purchase of the underlying assets, distribution of the SPV assets, articles for the meeting of security holders, costs and services fees relating to the SPV, information disclosure, etc.

The offering circular often includes risk disclosure, introduction to participating institutions, description of transaction structure (such as distribution of cash flows, credit enhancement measures, meeting of security holders, and a summary of rights and obligations of the transaction parties), information on the underlying assets, information on securities, intermediary opinions, and information on PRC law factors.

3.9 Derivatives

Derivatives such as interest rate swaps, currency swaps, and credit risk mitigation/protection instruments could be used in securitisation transactions. However, most transactions will avoid using derivatives, so as to simplify the transaction structure and to save transaction costs.

Interest Rate Swap

The coupon rates of securities/notes are often designed to cope with the characteristics (fixed/floating) of the asset pool, so there is rarely the need for an interest rate swap. For instance, coupon rates of RMBS are often floating rate and will be adjusted simultaneously with the underlying assets, because most underlying mortgages are floating rate; and the interest rate mismatch risk is almost negligible.

Currency Swap

Currency swaps are also rarely used because the majority of cross-border issuances are in Chinese yuan and are in line with the currency of the underlying assets. Nevertheless, if the securities/notes are issued in other currencies, a currency swap would be required to hedge exchange rate risk.

Credit Risk Mitigation/Protection Instruments

Credit risk mitigation/protection instruments can be used to hedge credit risks in connection with a reference entity or a target debt in a securitisation. These instruments can be roughly divided into two types: agreement and warranty. The former is a financial agreement between the buyer

and seller for the purchase of credit protection, while the latter is a security of value created by the warranty issuer (often a qualified underwriter or guarantee company). However, as the credit derivative market in China is overall less developed, credit instruments are not commonly used in securitisations.

3.10 Offering Memoranda

Offering memoranda are customarily required in a securitisation, often in the form of an offering circular.

For credit asset securitisation, the Administrative Measures for the Securitisation of Credit Assets provides the framework of contents and the release time for an offering circular. The Announcement of Matters Regarding Information Disclosure of Credit Asset Securitisations' Underlying Asset Pool (Announcement of PBOC [2007] No 16) and the disclosure guidelines published by NAFMII for various kinds of underlying assets provide detailed requirements on the contents and forms of an offering circular.

With regard to CIBM business asset securitisation, the Information Disclosure Guidelines on CIBM Business Asset Securitisation sets the basic framework and some specific disclosure requirements such as disclosures pertaining to important obligors and credit enhancement providers. The Registration Documents and Forms for the Public Offerings of Asset Backed Notes by Non-Financial Enterprises (Announcement of NAFMII [2017] No 27) includes Form ZM which provides specific disclosure requirements for an offering circular.

As for exchange market securitisation, the Disclosure Guidelines for the Asset Securitisation Business of Securities Companies and Subsidiaries of Fund Management Companies (Announcement of CSRC [2014] No 49) provides the content framework and some basic disclosure requirements regarding underlying assets for an offering circular. Schedule 5 of Circular [2014] No 459 by the Asset Management Association of China (AMAC) provides particular contents and forms for the offering circular of an ABSP.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Credit Asset Securitisation

Information disclosure regarding credit asset securitisation mainly follows the rules published by the People's Bank of China (PBOC), including the Rules for the Information Disclosure of Asset-Backed Securities (Announcement of PBOC [2005] No 14) and the Announcement of Matters Regarding Information Disclosure of Credit Asset Securitisations' Underlying Asset Pool (Announcement of PBOC [2007] No 16), and the disclosure guidelines for various kinds of underlying assets published by NAFMII, which include SME loans, retail auto loans, personal mortgage loans, redevelopment of shanty towns loans, personal consumer loans, and non-performing loans.

CIBM Business Asset Securitisation

Information disclosure regarding CIBM business asset securitisation mainly follows the Administrative Measures for Debt Financing Instruments of Non-financial Enterprises in the Interbank Bond Market (Order of PBOC [2008] No 1) published by the PBOC, and the rules published by NAFMII in relation to information disclosure, such as the Rules on CIBM Business Asset

Securitisation and the Information Disclosure Guidelines on CIBM Business Asset Securitisation, the Registration Documents and Forms for the Public Offerings of Asset Backed Notes by Non-Financial Enterprises, the Rules for Information Disclosure on CIBM Debt Financing Instruments of Non-Financial Enterprises (2021), and the Duration Information Disclosure Forms for CIBM Debt Financing Instruments by Non-Financial Enterprises (2021) (Announcement of NAFMII [2021] No 10).

Exchange Market Securitisation

Information disclosure regarding exchange market securitisation primarily follows the Administrative Provisions on Asset Securitisation by the CSRC and the Disclosure Guidelines for the Asset Securitisation Business of Securities Companies and Subsidiaries of Fund Management Companies. Based on these provisions, the SSE and the SZSE have respectively published disclosure guidelines for different types of underlying assets, including the Disclosure Guidelines on Financial Lease Claim Asset-Backed Securities, the Disclosure Guidelines on Public-Private Partnership (PPP) Project Asset-Backed Securities, the Disclosure Guidelines on Account Receivable Asset-Backed Securities and the Disclosure Guidelines on Infrastructure Asset-Backed Securities. At the end of 2022, the SSE and SZSE respectively issued a series of Guidelines on the Application of the Recognition Rules for the Listing Conditions for Asset-Backed Securities, which stipulate the information disclosure requirements in the listing periods of the exchange market securitisations.

4.2 General Disclosure Laws or Regulations

As the Securities Law amended in 2019 clearly extends to ABS, some stipulations under Chapter 5 of the Securities Law “Information Disclosure” also apply to securitisation. Article 85 of the Securities Law lays foundation for misrepresentation liabilities of issuers and related parties thereof, underwriters, and intermediaries.

4.3 Credit Risk Retention

Laws and Regulations on Credit Risk Retention

For credit asset securitisation, the Announcement of PBOC and CBRC [2013] No 21 requires an originator to retain no less than 5% of the total issuance amount of the securitisation, and in the meantime no less than 5% of the lowest class of securities. The originator may choose either horizontal retention or vertical retention, as long as it meets the minimum requirements.

As far as exchange market securitisation is concerned, the SSE and SZSE have respectively issued a series of Guidelines on the Application of the Recognition Rules for the Listing Conditions for Asset-Backed Securities, which clearly stipulate the requirements on risk retention. However, the applicable rules may vary based on the types of underlying assets. The risk retention ratio is normally 5% by the originator or its affiliates where the underlying assets are creditor’s claims or future operation income. But if the originator is in good credit condition and the ABSP has credit enhancement mechanisms such as guaranty or shortfall supplements, the risk retention requirements can be exempted.

With respect to CIBM business asset securitisation, in the Rules on CIBM Business Asset Securitisation published in 2023, NAFMII has added risk retention requirements for originators. The proportions of risk retention are basically consistent with those of credit asset securitisation, but exemptions are given to securitisations where the originator or debtor is in good credit condition and the SPV has credit enhancement

mechanisms such as guaranty, shortfall supplements, or debt accessions.

Regulation and Enforcement

The risk retention rules for credit asset securitisation are formulated by the PBOC and the NAFR, and the NAFR authorises the China Credit Assets Registry & Exchange Centre to perform part of its supervisory responsibilities on securitisation. The risk retention rules for CIBM business asset securitisation are formulated by NAFMII and authorised by the PBOC. The risk retention rules for exchange market securitisations are formulated by the SSE and SZSE, authorised by the CSRC. The supervisory authorities will review the risk retention arrangements in the documentation, non-compliant applications will not be able to obtain the pre-issuance approval/registration or confirmation of listing.

Penalties for Non-compliance

Currently, there are no explicit rules relating to penalties for violations of the risk retention requirements, but the relevant regulatory authorities can take regulatory measures such as issuing an order to correct, a warning letter, or an order for public explanation.

4.4 Periodic Reporting

Requirements Regarding Periodic Reporting

The disclosure regulations for each type of securitisation (see **4.1 Specific Disclosure Laws or Regulations**) include particular requirements for periodic reporting. Generally speaking, the trustee/plan manager shall provide reports to investors at a frequency that matches that of the payment of the securities, and shall disclose an audited annual report for the life cycle of the securities. These reports often include the status of the underlying asset pool, information on the principal and interest payments of each class of the securities, statistics on the asset pool, reinvestment of the assets (if a revolving structure is involved), the disposal of defaulted loans, etc. The rating agencies shall also disclose an annual monitoring report to the investors, which must include information on the changes in the underlying asset pool and credit risk analysis.

The SSE Guidelines on the Periodic Report Content and Format of Asset-Backed Securities and the SZSE Guidelines on the Periodic Report Content and Format of Asset-Backed Securities stipulate the compilation of an annual asset management report and annual fund custodian report, as well as the disclosure requirements for these reports. This is intended to make information disclosure more targeted and effective, thus helping investors to make better investment decisions.

Regulators and Penalties for Non-compliance

The disclosure activities in the CIBM are subject to self-regulatory management by NAFMII and supervision by the PBOC. The disclosure activities in exchange market securitisations are subject to self-regulatory management by the securities exchanges, the Securities Association of China (SAC) and the AMAC, and supervision by the CSRC and its local agencies.

In relation to securitisations in the CIBM, NAFMII may impose sanctions on non-compliant information disclosers. These include public denouncements, orders to correct misconduct, orders to attend mandatory training, and suspension of relevant business. If the non-compliant act is suspected of violating the laws and regulations, NAFMII shall hand the matter over to the relevant authorities, including the PBOC.

For misconduct in the disclosure of information regarding exchange market securitisations, the CSRC and its local agencies may impose regula-

tory measures such as orders to correct, warning letters, orders for public explanation and orders to make periodic reports. It also has the power to impose administrative penalties on responsible persons. AMAC may conduct regular or ad hoc on-site and off-site investigations into the SPV managers, and may impose disciplinary sanctions such as written warnings, orders to correct, public condemnations, suspensions of record-filing and cancellation of membership, etc, depending on the seriousness of the case. In addition, the SSE and SZSE have the power to impose disciplinary measures on disclosure violations, and may prudently process subsequent applications by the relevant parties.

4.5 Activities of Rating Agencies

Regulations about the RAs' Activities

Rating services provided by rating agencies (RAs) are regulated by the regulatory authorities of the respective markets and the professional self-regulatory organisations (SROs). The substantive regulations may be divided into the following three categories:

- market entry regulations, including rules for the entrance of different markets and different products;
- requirements relating to business processes, methods and prevention of conflicts of interest; and
- requirements on the disclosure of rating reports.

The rules vary depending on the rated product and market concerned. RAs that meet the relevant requirements to provide credit rating services in the CIBM shall apply to NAFMII for registration of the type of bond rating services to be carried out. In addition, the Chinese regulators have started to permit foreign RAs to provide rating services via their local branches or subsidiaries. S&P Ratings (China) Co, Ltd. and Fitch (China) Bohua Credit Ratings Limited have been officially admitted to provide credit rating services in the CIBM.

Regulators and Penalties for Non-compliance

Regulators of RAs include the credit rating industry regulating authority and the credit rating business administration authorities, such as the PBOC, which is responsible for the supervision of credit rating business across the country and has the authority to formulate the market entry principles and fundamental rules; and the CSRC, which regulates the credit rating business in its corresponding jurisdiction. RAs are also subject to the disciplines of SROs in the corresponding markets. If RAs are found to be violating any law, regulation or rule, then the regulators may impose administrative sanctions such as fines, suspension of business, revocation of business approval, or impose regulatory measures such as issuing a directive to correct, a warning letter, a directive to make public explanation, or a directive to make regular reports.

4.6 Treatment of Securitisation in Financial Entities

Applicable Capital and Liquidity Rules

The volume of risk-weighted assets (RWA) will affect a commercial bank's capital adequacy ratios, and the securitisations that a commercial bank engages in will affect the measurement of its risk-weighted assets. On 1 November 2023, NAFR published the renewed Measures for Administration of Capital of Commercial Banks, which came into force on 1 January 2024. As long as a financial institution incurs securitisation risk exposure because of its business of asset securitisation, the institution shall set aside corresponding capital reserves according to the risk-weighted asset calculation rules.

In terms of liquidity risk regulatory indicators, engaging in securitisation or investing in ABS will affect a commercial bank's liquidity coverage ratio or high-quality liquid asset adequacy ratio, net stable funding ratio and liquidity gap ratio. Different from Basel III, the Measures for Administration of Liquidity Risk of Commercial Banks do not include RMBS as high-quality liquid assets (HQLA).

According to the Administrative Measures for Risk Control Indicators of Securities Companies (2020 Revision) and the Provisions on the Calculation Standard for Risk Control Indicators of Securities Companies (2020), securities companies shall calculate the risk control indicators such as net capital, risk coverage ratio, capital leverage ratio, liquidity coverage ratio, net stable funding ratio, etc, in line with the principles of prudence and substance over form. Securities companies shall set aside capital reserves for ABS held according to the measurement standard provided by the CSRC.

One important regulatory indicator for insurance companies is the solvency ratio. According to the Administrative Provisions on the Solvency of Insurance Companies (2021 Revised), the comprehensive solvency ratio of an insurance company (ie, the ratio of the actual capital to the minimum capital) shall not be lower than 100%. The actual capital of an insurance company refers to the difference between the recognised assets and the recognised liabilities. In calculating recognised assets, different recognised values will be assigned to the securitisation in which an insurance company has invested, depending on the external ratings of the products in question.

Regulation of Capital for Securitisation

In respect of traditional securitisation transactions, the originator may deduct the securitised assets from the calculation of RWA only if:

- the material credit risk related to the transferred asset has been transferred to an independent third party;
- the originator does not retain actual or indirect control over the transferred assets;
- the originator does not bear payment obligations or responsibilities towards the investors of the ABS, the investors only have recourse to the limit of underlying assets;
- the underlying assets has been transferred to the SPV, and the holders of beneficial rights in the SPV have the right to pledge or trade the beneficial rights;
- the trust agreement and other legal documents related to the securitisation do not contain certain specific provisions, such as requiring the originator to change the assets in the asset pool, so as to enhance the quality of the asset pool, or allowing the originator to provide additional credit enhancement after assignment of the underlying assets;
- the procedures for a clean-up call are compliant with the regulatory requirements of the Rules on the Calculation of Risk-Weighted Assets in Securitisation; and
- except for a termination arising from a clean-up call, taxes, certain regulatory changes or early amortisation that meets the regulatory requirements, there are no other triggers or conditions where the originator has the right to terminate the SPV in advance.

Schedule 11 of the Measures for Administration of Capital of Commercial Banks – Rules on the Calculation of Risk-Weighted Assets in Securitisation provides three approaches for capital calculation of securitisations: internal ratings-

based approach (IRBA), external ratings-based approach (ERBA) and standardised approach (SA). Securitisation exposures where none of the aforementioned approaches can be applied must be assigned a 1,250% risk weight to calculate the RWA. The minimum risk weight of the securitisation risk exposures is 15%. For a securitisation which meets the Simple, Transparent, Comparable (STC) standard, the minimum risk weight of the senior class is 10%, in contrast to 15% for the other classes.

4.7 Use of Derivatives

Regulations of Use of Derivatives

Currently, there are no specific laws or regulations on the use of derivatives in securitisations; however, relevant parties (including the plan manager, trustee and investors) shall comply with the general rules applicable to derivatives transactions.

In respect of credit derivatives, the trading of such instruments is mainly subject to a series of rules published by NAFMII, the SAC, AMAC, the SSE and the SZSE, such as the Guidelines for the Credit Risk Mitigation Agreement and the Guidelines for the Credit Risk Mitigation Warrants issued by NAFMII, and the Guidelines for the Investment of Publicly Offered Securities Investment Funds in Credit Derivatives issued by AMAC.

As for interest rate swaps and foreign currency swaps, a body of rules promulgated by the PBOC, the China Foreign Exchange Trade System (CFETS) and the National Interbank Funding Centre will apply, such as the Notice of the People's Bank of China on Issues Concerned in Operating RMB Interest Rate Swap Business, the Notice by the China Foreign Exchange Trade System on Issuing the Trading Rules of Interbank RMB Foreign Exchange Market, etc.

Before entering into any derivatives trading, the SPV manager or trustee needs to obtain qualifications for derivatives trading from the corresponding supervisory authorities. According to the PBOC's applicable rules, participants in the interbank market engaging in derivatives trading shall also be enrolled with NAFMII as members of the interbank market and must execute the master agreement prepared and published by NAFMII.

Regulators and Penalties for Non-compliance

The PBOC has the power to supervise the derivatives trades in the national interbank market, while the State Administration of Foreign Exchange (SAFE), under the authorisation of the PBOC, supervises and manages the forward exchange market. Other than that, NAFMII is authorised by the PBOC to conduct self-regulatory administration over members of the interbank market and the transactions carried out therein; the CFETS provides services related to transactions carried out by members of the interbank market and conducts day-to-day monitoring of transactions under the authorisation of the PBOC.

Banking financial institutions engaging in derivatives trading activities without approval will be subject to administrative sanctions including confiscation, fine, suspension of business and revocation of business licence, etc, by the NAFR. For banking financial institutions that have failed to effectively implement derivatives trading risk management and internal control systems, the NAFR has the power to suspend or revoke their licence to engage in derivative trading and impose monetary sanctions. Meanwhile, SROs including NAFMII and the CFETS have the power to impose sanctions, based on the seriousness of the violation.

4.8 Investor Protection

Regulatory Mechanisms

Investor protection is provided for in some basic laws, including the Securities Law and the Securities Investment Fund Law, as well as various securitisation regulations. Chapter VI of the Securities Law provides general rules for protection of securities investors, covering placement agencies' duties in placement activities, issuers' fraudulent issue and misrepresentation liabilities, representative litigations, etc. Other laws and regulations cover matters such as investor qualifications and limits on the number of investors (see **4.13 Entities Investing in Securitisation**), due diligence, credit risk retention (see **4.3 Credit Risk Retention**) market trading rules, as well as information disclosure (see **4.1 Specific Disclosure Laws or Regulations** and **4.2 General Disclosure Laws or Regulations**), the duration standard operational responsibilities and many other aspects.

One of the mechanisms for investors protection is the meeting of security holders. Securitisation regulations customarily require the issuer to establish a meeting of security holders as the governing organ of the issuing vehicle, to make decisions on important matters pertaining to the issuing SPV. In particular, for CIBM business asset securitisations, NAFMII has promulgated the Procedures of the Meeting of Holders of Non-Financial Enterprises Debt Financing Instruments in the CIBM, which provides for the conditions of convening a meeting, the procedures of the meeting, the voting rights of instrument holders, etc.

Another mechanism for investor protection is the due diligence requirements for the relevant intermediaries. In November 2014, the CSRC issued the Guidelines for Securities Companies and Subsidiaries of Fund Management Companies on Due Diligence for Asset Securitisation, specifying the plan manager as the overall responsible party for due diligence, and proposing the relevant due diligence requirements. In June 2019, AMAC promulgated three detailed guidelines to specify the requirements for due diligence on the securitisation of financial leases, PPP projects and account receivables. The due diligence requirements on related parties in CIBM Business Asset Securitisation are provided in the Guidelines for Due Diligence on the Asset-Backed Notes by Non-Financial Enterprises (Trial Implementation 2021) and Guidelines for Due Diligence on Debt Financing Instruments by Non-Financial Enterprises (2023), both released by NAFMII.

Regulatory Authorities

Two kinds of authorities are in charge of the implementation of investor protection mechanisms.

Authorities such as the NAFR, PBOC and CSRC, may impose a number of administrative penalties or regulatory measures on the trustee or plan manager for failure to fulfil the duties of honesty and diligence, including orders to rectify, warning letters, orders to make public statement, etc. Administrative penalties include fines, suspension of business for rectification or revocation of business licence.

The most important self-regulatory organisations are AMAC, the SSE and SZSE (for exchange market securitisations), and NAFMII (for securitisations in the CIBM). AMAC, for example, according to the Measures for the Administration of the Record Filing of ABSP published by it, may respond to behaviours that violate the self-regulatory structures by imposing written warnings, orders to correct, public condemnations, suspensions of filing, revocations of mem-

bership and/or other actions based on the type and seriousness of the violation.

4.9 Banks Securitising Financial Assets

Commercial banks as originators will be subject to the same regulatory measures as any other originator on credit asset securitisations, along with other financial institutions under the supervision of the NAFR; however, commercial banks investing in credit asset securitisation products are subject to certain specific rules, including the following:

- a commercial bank as the originator shall not invest in securitisation products originated by itself, except for the part retained by itself according to the credit risk retention rule;
- the wealth management products offered by a commercial bank shall not directly or indirectly invest in the subordinated class of ABS issued by itself;
- the wealth management products offered by a commercial bank to non-institutional investors shall not invest in any subordinated class of ABS, or any non-performing asset securitisation products;
- a single commercial bank's holding in the ABS from a single issuance as a proportion of the total volume of the issuance, in principle, shall not exceed 40%; and
- a commercial bank's wealth management product shall also abide by certain concentration limits when investing in ABS.

Additionally, according to the Measures for the Administration of the Large Exposures of Commercial Banks published by the CBIRC in 2018, in principle, a commercial bank's investment in securitisation shall be treated by a "look-through approach", according to which the ultimate obligor of the underlying assets of the securitisation shall be identified as the bank's counterparty and the risk exposure of the underlying assets will be counted towards the risk exposure of the ultimate obligor. Meanwhile, the same measures provide several safe harbours. For example, for underlying assets whose risk exposure is less than 0.15% of the tier 1 net capital of a commercial bank, if the commercial bank can prove that there is no deliberate division of underlying assets, then the investment can be exempted from the look-through approach, in which case the securitisation product itself shall be identified as a counterparty and deemed a non-interbank single client.

4.10 SPEs or Other Entities

The regulations relating to SPVs are different for each type of securitisation. Among them, the Administrative Measures for the Securitisation of Credit Assets stipulates that the SPV for credit asset securitisations shall be an SPT. The Rules for CIBM Business Asset Securitisation stipulates that the SPV shall be an SPT, an SPC or other SPV forms approved by NAFMII. In regard to exchange market securitisations, the Administrative Provisions on Asset Securitisation by the CSRC stipulates that the SPV shall be an ABSP or other SPV approved by the CSRC.

In the case that an SPT is adopted as the issuance vehicle, the establishment and operation of the trust shall be governed by the provisions of the Trust Law. A recent judicial trend tends to regard the relationship of an ABSP as a trust and shall apply the Trust Law as well. On the contrary, SPC and special purpose limited partnership (SPLP), which are common forms of SPE in international securitisation practices, have not been adopted in China's securitisation market, because the Company Law, the Bankruptcy Law and the Partnership Enterprise Law do not contain any specific rules on SPC or SPLP.

Non-financial companies can choose to conduct business asset securitisation either in the CIBM or on the exchange market. The choices of market are mainly affected by the issuance costs and the efficiency of the approval/registration procedure. Many enterprises will apply shelf-registration both in the CIBM and the exchange market, to best satisfy their needs for financing efficiency and flexibility. At least so far, neither the trust structure nor the ABSP has any obvious advantages or disadvantages over the other in terms of tax treatment or bankruptcy remoteness.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

SPVs are established for the purpose of securitisation; therefore, their activities are limited to the needs of carrying out securitisation business, which are generally agreed and stated in the transaction documents. At the same time, relevant laws or regulatory provisions stipulate the prohibited activities of the trustee or the manager. For example, in credit asset securitisation and CIBM business asset securitisation, trust companies shall avoid misappropriating trust property for any non-trust purpose, promising the trust property will suffer no loss or guaranteeing a minimum return, or creating security rights over trust property. In exchange market securitisation, the plan manager shall not embezzle or encroach on the assets of the ABSP, or provide guaranty for a third party with the assets of the ABSP.

4.12 Participation of Government-Sponsored Entities

State-invested or state-controlled enterprises (referred to collectively as state-owned enterprises, or SOEs) constitute an important part of the market economy of China and therefore participate in all kinds of securitisation practices. However, SOEs in the Chinese market need to be differentiated from the government-sponsored entities (GSEs)– such as Ginnie Mae, Freddie Mac or Fannie Mae – in the US market. SOEs in the Chinese market participate in the securitisation business equally with other market participants and are not entitled to special treatment or exemptions under the laws and regulations applicable to securitisation. The products issued by SOEs do not contain any explicit or implicit guaranty by the government.

4.13 Entities Investing in Securitisation

Entity Types of Investor

Only institutional investors are qualified to invest in securitisation. At present, the main institutional investors are financial institutions and asset management products thereof, securities investment funds (public or private), enterprise annuities, and insurance funds.

In addition, foreign investment entities in the CIBM currently include:

- foreign central banks or monetary authorities, sovereign wealth funds and international financial organisations;
- qualified foreign investors, including qualified foreign institutional investors (QFII) and CNY-qualified foreign institutional investors (RQFII); and
- foreign financial institutions (such as commercial banks, insurance companies, securities companies, fund management companies), investment products issued by such financial institutions, and other medium and long-term institutional investors recognised by PBOC, such as pension funds, charity funds and endowment funds.

The aforementioned foreign investors may conduct transactions and settlements in the CIBM

through settlement agents, or may conduct cash bond transactions via third-party platform with domestic market-making institutions by requesting a quote. Foreign investors compliant with the requirements of the PBOC can also invest in the CIBM through the mechanism of arrangement that mutually connects the infrastructure institutions between Hong Kong and the mainland Chinese bond market ("Bond Connect").

According to Announcement No 4 [2022] of the PBOC, CSRC and the State Administration of Foreign Exchange, foreign institutional investors that are admitted to the CIBM may invest in the exchange bond market directly or through the connect scheme between the CIBM and the exchange bond market, which greatly enlarges the scope of foreign investors for securitisation products in the exchange market.

Additional Restrictions of Investment

In addition to the restrictions on commercial banks' investment in securitisation products discussed in **4.9 Banks Securitising Financial Assets**, the restrictions on investments by different types of investors also include the following:

- A trustee in a credit asset securitisation may not use its own funds or trust funds to invest in the securities issued by it, except for the early redemption by the trustee in accordance with relevant regulations or contracts.
- A trust company may invest in ABS with its own funds or with trust funds whose settlor is not a natural person, but the investment balance of ABS under its owner's equity shall not exceed 50% of its net assets.
- A single banking financial institution shall not purchase and hold a single securitisation product exceeding 40% of its issuance scale.
- For insurance institutions, the credit rating of invested product shall not be lower than A, and the pooled credit assets are limited to loans classified as pass or special mention.
- In the case of pension funds, total investment in the securities as a percentage of the net asset shall not exceed 135%.
- Cash management-based products of commercial banks and its wealth management subsidiaries shall not invest in ABS with credit rating lower than AA+, and they are also subject to certain concentration limits relating to the originator of ABS.
- Wealth management products offered by a commercial bank's wealth management subsidiary shall not invest in any subordinated class of ABS originated by its major shareholder, and products offered to non-institutional investors shall not invest in any non-performing asset-backed securities.
- A single securities investment fund shall not hold the same credit tranche of one ABS product exceeding 10% of its issuance scale; the percentage of investment in various ABS of the same originator shall not exceed 10% of the net value of the fund asset.
- Money market funds shall not invest in the bonds and debt financing instruments of non-financial enterprises with a credit rating under AA+, and investment in the bonds, debt financing instruments of non-financial enterprises and ABS of the same originator/issuer shall not exceed 10% of the net value of such fund's asset.

4.14 Other Principal Laws and Regulations

Please refer to **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

According to the Notice of the People's Bank of China, China Banking Regulatory Commission and Ministry of Finance on Further Expanding the Pilot Programme on Credit Asset Securitisation (Yin fa [2012] No 127), resecuritisation and synthetic securitisation are currently explicitly prohibited. In terms of business asset securitisation, although there is no explicit prohibition, resecuritisation and synthetic securitisation are also not allowed in practice.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Insolvency Laws and Securitisation

Insolvency laws are crucial for securitisation, because a primary legal objective for most securitisation transactions is the isolation of the underlying assets from the originator's bankruptcy risks. "True sale" is a precondition for the bankruptcy remoteness of financial assets depends on the type and structure of the transaction. For credit asset securitisation or CIBM business asset securitisation (the structure of which is elaborated in **1.2 Structures Relating to Financial Assets**) in the CIBM, the underlying assets are entrusted by an originator into an SPT, and the underlying assets' bankruptcy remoteness is provided under Article 15 of the Trust Law, meaning that true sale is not an issue for such transactions. However, in the case of exchange market securitisation, where the underlying assets are transferred from an originator to an ABSP, the question of whether the transfer of the underlying assets constitutes a true sale or a financing guarantee is a decisive factor in determining the underlying assets' remoteness from the originator's bankruptcy risks.

Insolvency Laws for True Sale v Secured Loan

Pursuant to Article 30 of the Bankruptcy Law, if the underlying assets have already been legally transferred to others when a bankruptcy petition pertaining to a transferor (as the debtor) is accepted by a court, then the underlying assets will not be held as part of the bankruptcy estate of the transferor, unless the transfer falls within the scope of revocable transfers (including unrequited transfer and transaction at manifestly unreasonable price) within one year prior to the acceptance of the bankruptcy petition, as provided under Article 31 of the Bankruptcy Law.

If a debtor only creates security rights over certain assets, then, according to the applicable laws, when the debtor enters into a bankruptcy proceeding, these assets shall be part of the debtor's bankruptcy estate, but the secured party has a priority claim on the assets. Under Article 19 of the Bankruptcy Law, after a court accepts a bankruptcy petition, preservation measures pertaining to the debtor's estate shall be lifted and enforcement procedures over the estate shall be suspended, which means the secured party must delay the exercise of security rights over the estate. In bankruptcy liquidation and bankruptcy settlement proceedings, while a secured party may make a claim to the administrator at any time to exercise the priority of compensation with respect to the disposition and liquidation of the security property, the administrator may decide to dispose of the security property with the rest of the bankruptcy estate as a whole if the disposition of such security property alone would reduce the value of the rest of the bankruptcy estate, and the

disposition and distribution plan of the bankruptcy estate shall be approved by the meeting of creditors, which makes the exact timing of the realisation of the security rights ultimately uncontrollable. In the bankruptcy reorganisation proceeding, if there is any evidence proving that the security property is necessary for the reorganisation, and the administrator or the debtor can provide a corresponding guarantee or compensation, the People's Court may rule not to approve the resumption of the exercise of the security right. Thus, in a secured loan transaction, a creditor's right over the collateral will be affected by the debtor's bankruptcy procedure in various aspects; in a true sale situation, by contrast, a transferor's bankruptcy will not have any impact on the transferee's exercise of rights over the underlying assets.

6.2 SPEs

SPE Characteristics

Currently, China's Company Law, Securities Law, Bankruptcy Law and other laws and regulations fail to provide room for the development of SPVs in the form of SPCs and SPLPs. The Trust Law was enacted in 2001, wherein the principle of trust property independence provides a solid legal basis for bankruptcy remoteness pursued in securitisation. Therefore, in credit asset securitisations and CIBM Business Asset Securitisations where a trust company serves as an issuer/issuing vehicle manager, SPTs are adopted. As for exchange market securitisations, the initial issuers were limited to securities companies or their subsidiaries, and due to the separate operation principle of trust industry and securities industry under the current financial regulation framework, ABSPs instead of SPTs are used. However, a recent judicial trend tends to regard the relationship of an ABSP as a trust and shall apply the Trust Law as well.

Neither an SPT nor an ABSP constitutes a legal entity, but rather a set of contractual relationships, where the trustee or plan manager conducts transactions or administrative activities on behalf of the trust or the ABSP according to the contracts, and no operations or debts irrelevant to the securitisation are allowed. The trustee or plan manager may further engage a servicer, fund custodian and other institutions to provide services for the SPV.

Bankruptcy Remoteness

An ABSP is set up by a plan manager, who purchases the underlying assets from an originator on behalf of the investors. According to Article 5 of the Administrative Provisions on Asset Securitisation by Securities Companies and Subsidiaries of Fund Management Companies issued by the CSRC, the assets of ABSPs are independent from the inherent property of the originator, manager, custodian and other business participants, and if the above-mentioned entities are subject to liquidation due to dissolution, revocation or declaration of bankruptcy, the assets of the ABSP do not belong to the liquidation property. Naturally, whether the assets of the ABSP can achieve bankruptcy remoteness from the originator also depends on whether the transfer of the assets from the originator to the ABSP can be recognised by the court as a true sale.

As for an SPT, according to Article 15 and 16 of the Trust Law, the trust property is differentiated from other property which the settlor has not entrusted; after the establishment of the trust, when the settlor is dissolved, revoked or declares bankruptcy, and the settlor is not the only beneficiary, the trust survives and the trust property shall not be regarded as the estate or liquidation property of the settlor; meanwhile, the trust property is differentiated from the property

owned by the trustee (inherent property), and if the trust is dissolved, revoked or declares bankruptcy, the trust property does not belong to its liquidation property. Based on the above provisions, in credit asset securitisations and CIBM business asset securitisations, the underlying assets will not generally be consolidated with the bankruptcy estate of the originator or the trustee.

6.3 Transfer of Financial Assets

True Sale v Secured Loan

In China, the typical form of property security is the statutory mortgage or pledge, with a clear security agreement between the guarantor and the creditor, which is different from a sales contract. In practice, there is an atypical kind of security called "security by transfer", whereby the debtor or a third party enters into a contract with the creditor to superficially transfer a property under the creditor's name; if the debtor pays off the matured debt, the creditor shall return such property to the debtor or the third party; if the debtor fails to pay off the matured debt, the creditor could auction or sell the collateral, or be paid off with the collateral based on its estimated price. Due to the similarity in form, such transactions are easily confused with true sales. If the court determines that the purpose of the property transfer is security rather than a true sale, it will decide following the security rules in the Civil Code.

China is a country with a statutory law system, where a judge's discretion is relatively limited. Based on limited judicial cases, when deciding the nature of a deal, a court tends to respect party autonomy, taking an approach under which the text of the contract is closely analysed to determine whether its true meaning complies with the characteristics of a sales contract as defined under the Civil Code. The courts seldom use the equity principle to overturn the explicitly expressed will of the parties to a contract.

Therefore, to achieve the target of a true sale and bankruptcy remoteness, at least the following factors need to be ensured in a transaction:

- there is a true and explicit expression regarding the transfer of the ownership of the underlying assets in the relevant transaction documents; and
- the transferee shall pay a reasonable consideration to acquire the underlying assets – the fairness of the consideration is primarily to ensure the transaction will not be revoked by the aggrieved party or its creditors/bankruptcy administrator as manifestly unfair or prejudicial to the interests of the creditors.

A basic premise is implied in this type of transaction: the underlying assets can legally generate steady cash flows which can match the payment of the securitisation products.

In some securitisation transactions, the originator may commit to make up for a shortfall in cash flows of the underlying assets compared to the predicted value, or to repurchase the underlying assets under certain circumstances (such as the deterioration of the transferor's business condition or a material breach of contract). No judicial case has yet indicated that these arrangements will affect the recognition of a true sale. However, with the increase in legal disputes related to securitisation, it remains to be seen how judicial practice will evolve in respect of the standards for true sale.

"Internal Effect" and "External Effect"

Under PRC laws, the transfer of a creditor's claim can have both an "internal effect" and an "external effect". The internal effect of the trans-

fer refers to its effect in relation to the transferor and the transferee. In this regard, as long as the asset transfer agreement has come into effect and the preconditions of transfer provided in the transfer agreement have been met, the transfer of the assets will be effective against the transferor.

Generally, the external effect of the transfer of a creditor's claim first refers to the effect of the transfer in relation to the debtor. According to Article 546 of the Civil Code, any transfer of a creditor's claim is invalid against the debtor unless the debtor has been informed. This means if a debtor has not received notice of the transfer of the creditor's claim, the transferee cannot, on its own, assert the right against the debtor.

The external effect of the transfer of a creditor's claim also includes the effect on the creditors of the transferor and any third parties. Although it's not a requirement, the transfer of account receivables can be registered in the Registration and Public Notice System of PBOC's Credit Reference Centre. According to Article 768 of the Civil Code and Article 66 of the Interpretation of the Supreme People's Court on the Application of the Security System of the Civil Code of the People's Republic of China (the Interpretation of the Security System), when one account receivable is the underlying asset of a factoring, pledge, and transfer simultaneously, the People's Court will determine the order of priority based on factors such as whether the registration of transfer has been completed, the time order of the registration, and the arrival time of the notice of the transfer to the debtor.

In addition, regarding the mortgage and pledge securing the creditor's claim, although these security rights are transferred to the transferee along with the creditor's claim, the transferee's right may not be able to confront a bona fide third party if no change of mortgage/pledge registration has been made to put the transferee's right on public notice.

General Requirements

As mentioned above, certain perfection measures are required to make a transfer of financial assets definitively enforceable against the debtors, the transferor's creditors and bona fide third parties. These include registering the transfer of account receivables, notifying the debtors of the transfer, a change of mortgage/pledge registration, and the transfer of possession of the pledged movables, etc. For a more detailed analysis on right perfection measures, see **3.3 Principal Perfection Provisions**.

Opinion of Counsel

In a securitisation transaction, a legal counsel is normally not required to issue an opinion on whether a transfer of the underlying assets constitutes a true sale. However, when legal counsel does issue an opinion on whether the underlying assets could achieve bankruptcy remoteness, it would consider the nature of such transaction and its effect on bankruptcy remoteness.

6.4 Construction of Bankruptcy-Remote Transactions

Since China has formulated specialised regulations for various types of securitisations, the transaction structures are relatively "fixed" under the relevant regulations. For now, bankruptcy remoteness can only be achieved through the two means outlined in **6.3 Transfer of Financial Assets**.

6.5 Bankruptcy-Remote SPE

Limited recourse and non-petition provisions are common in transaction documents where an

SPT is adopted, to ensure bankruptcy remoteness. In the case of an ABSP, usually only limited recourse clauses would be stated in the transaction documents. This is probably because an ABSP is regarded as an agency relationship, and in civil law an agency can be rescinded at any time, even though rescission of a contract may cause heavy damages liabilities in practice.

Limited Recourse Provision

It is usually agreed that investors understand and recognise that the securities held by them only represent corresponding beneficial rights and shall not be regarded as liabilities of the trustee or plan manager. Except for wilful misconduct, bad faith, negligence or breach of its obligations under the transaction documents, investors' recourse against the trustee/plan manager shall be limited to the SPV property and to the amounts available for use in accordance with the payment order stated in the agreement. The security holders shall have no claim or recourse against the SPV or the trustee/plan manager for the amounts that remain unsatisfied after the management and disposal of the SPV property and/or the realised proceeds thereof.

Non-petition Provision

Non-petition clauses protect the SPT against insolvency actions by transaction parties, especially the security holders. It is usually agreed that each of the parties undertakes that during the life of the SPT or for a period agreed by all parties, it shall bring no lawsuit or arbitration proceeding for the purpose of terminating the SPT. However, it would also be made clear that such non-petition clauses shall not be regarded as limiting the right of any party to bring a lawsuit or arbitration proceeding against any party in respect of any loss caused by such party as a result of its fraudulent or wilful misconduct.

7. Tax Laws and Issues

7.1 Transfer Taxes

Except for a transfer of the financial products stipulated in the Notice on Full Launch of the Pilot Scheme on Levying Value-Added Tax in Place of Business Tax (Ministry of Finance [2016] No 36), a transfer of financial assets is not currently subject to value-added tax (VAT). The transfer of underlying assets is not subject to stamp duty as well because a trust agreement or a purchase and sale agreement in asset securitisation transactions are not regarded as taxable documents listed in the Stamp Duty Law (2022).

A potential tax on the transfer of underlying assets is income tax. If the transfer price is greater than the tax basis of the transferred assets (ie, the historical cost or the actual amount of costs incurred in the acquisition of the assets), then enterprise income tax may be due on the taxable income. In practice, since the financial assets are usually transferred at parity or at a discount on their historical cost, usually no income tax is due on the transfer.

7.2 Taxes on Profit

In securitisations, the transfer of underlying assets to the SPVs does not generally give rise to a tax burden for the SPVs. On the other hand, income derived from the underlying assets by the SPVs might be subject to enterprise income tax and VAT.

Income Tax

In regard to credit asset securitisations, according to Ministry of Finance [2006] No 5, if the trustee has allocated the income of the trust to institutional investors during the fiscal year, then the institutional investors shall pay the enterprise income tax on this income and, in order to avoid double taxation, no income tax needs to

be paid by the trust. However, the unallocated trust income during the fiscal year shall be subject to enterprise income tax at the trust level. If the income allocated to the investors has already been taxed, then the investors do not need to pay the income tax thereon, to avoid double taxation.

According to the Enterprise Income Tax Law, "enterprises" and "other income-earning organisations" shall pay the enterprise income tax. For other types of asset securitisation business, whether the SPV is an SPT or an ABSP, neither constitutes an "organisation" under the law, and therefore neither is subject to enterprise income tax.

Value-Added Tax

If the underlying assets are interest-bearing assets such as loans or financial leases, then the SPV will acquire rights to such interest or income after the underlying assets are transferred to it. According to the Ministry of Finance [2016] No 140 and the Ministry of Finance [2017] No 56, etc, the manager of the asset management products shall pay VAT at a rate of 3% on its taxable activities occurred in the operation of the asset management products. This rule also applies to securitisation. Nevertheless, in the case of an on-balance sheet securitisation, the tax authority may require the originator to continue to pay a 6% VAT on the proceeds from the transferred underlying assets, which may result in the problem of double taxation. After unremitted communications with tax authorities, some local tax authorities have agreed to a tax on the SPV for interests of the securities issued to the investors instead of interests arising from the underlying asset pool, to alleviate the tax burden. There are also a very small number of local tax authorities that allow trustees not to pay taxes on any interest. But the State Taxation Administration has not yet provided any clear instruction on it, this issue has not been completely resolved.

Stamp Duty

The Ministry of Finance [2006] No 5 provides certain exemptions from stamp duties for credit asset securitisations. An originator or trustee is temporarily exempted from stamp duty arising from taxable agreements between the originator, the trustee and the fund custodian, the securities depository or other service providers in a securitisation transaction. The trustee's sale and the investors' purchase and sale of credit asset securities, as well as accounting books established for the trust, are temporarily exempted from stamp duty. So far, there are no special tax exemptions for exchange market securitisations.

7.3 Withholding Taxes

The relevant parties in an overseas assets transfer shall follow the general tax regulations on the transfer of financial assets. Generally, if the transfer of assets constitutes a true sale, the foreign SPV has not acquired income as transferee during the transfer and the foreign investors have not acquired any income from China, then the transfer will not give rise to any withholding tax issues. However, if the transaction between an originator in China and an overseas SPV (or its investors) is deemed from a tax perspective to be a loan to the originator, then the payment of withholding tax will be an issue.

Additionally, a Chinese originator who sets up a conduit company for securitisation for tax avoidance purposes may be subject to an anti-tax avoidance investigation. The Enterprise Income Tax Law and the Measures for the Administration of General Anti-Tax Avoidance (Trial Implementation) (Order of State Administration of Taxation No 32) have established the general anti-tax avoidance system, according to which a conduit

company may be subject to an anti-tax avoidance investigation by the tax authorities for suspected abusive use of the corporation form and tax havens in order to avoid taxes.

7.4 Other Taxes

If the underlying assets in a securitisation transaction include real estate or equity interests, the transaction might also be subject to taxes related to real estate ownership and transactions, such as property tax, land value-added tax and title deed tax, or enterprise income tax. To alleviate the tax burden on the originator or their affiliates, direct transfers of real estate are generally avoided in favour of transfers of equity rights in the company that holds the real estate.

7.5 Obtaining Legal Opinions

If necessary, transaction parties may ask accredited tax advisers for professional opinions concerning specific tax issues. Lawyers advising on a transaction do not usually provide opinions on specific tax issues.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The accountant's determination regarding the consolidation of an SPV and a true sale is, to some extent, based on the economic essence of the transaction reflected in the terms of the transaction agreements. According to the Accounting Standards for Business Enterprises No 33 (ASBE No 33), published by the Ministry of Finance, the scope of financial statements consolidation shall be determined based on control. When determining control, the accountant may consider three factors: power, variable returns, and the relationship between power and returns.

For the assessment of the first factor, power, the originator's power over the SPV as reflected in the transfer agreement and the servicing agreement is determinative. According to ASBE No 33, factors to be taken into consideration when determining whether the originator can de-recognise certain financial assets include whether or not the originator has transferred almost all the risks and rewards relating to the ownership of the financial assets to the transferee, including whether the originator has transferred the rights to collect the cash flow and, if not, whether it has undertaken to pass on the cash flow of the financial assets. In most securitisation transactions, before sending the notice of transfer to the debtors, the originator still bears the obligation to pass on the cash flows of the financial assets. Therefore, the accountant needs to conduct the "pass-through test" by examining whether the originator has complied with the "no-advance", "no-misappropriation" and "no-delay" principles, which involves an inspection of the advance payment and reimbursement by the servicer, investment of idle funds, frequency of cash flow allocation, and other transaction arrangements.

8.2 Dealing with Legal Issues

For de-recognising financial assets, at the request of the accountant, the legal counsel may have to modify some specific provisions in the transaction documents, subject to the consent of the participating parties. According to the Measures for Supervising and Administrating the Pilot Securitisation of Credit Assets of Financial Institutions, a legal opinion from a practising lawyer is also needed to prove that the originator does not have any actual or indirect control over the credit assets that have been transferred, and that the transferred credit assets have achieved bankruptcy remoteness from the originator.

EGYPT

Law and Practice

Contributed by:
Ashraf Hendi, Esraa El Sayyad and Habiba El Naggar
Matouk Bassiouny & Hennawy

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Matouk Bassiouny & Hennawy was established in 2005 and has since developed into a premier full-service business law firm in Egypt and the MENA region, with offices in Algeria, Sudan, and the UAE, as well as two country desks covering the firm's Libya and South Korea practices. It has over 200 lawyers who are trained locally and internationally in common and civil law systems and are fully conversant in English, Arabic, French, and Korean. The firm's finance & projects practice group's primary goal is to provide its clients with legal advice on the banking and finance sector in the MENA region, and on the strengths and weaknesses of security available to lenders in the market.

Authors

Ashraf Hendi is a partner in Matouk Bassiouny & Hennawy's finance & projects practice group. He has particular expertise in various financing transactions, as well as security creation, and has represented clients in several syndicated and bilateral facilities, project finance, equity finance transactions, and securitisation. Ashraf's expertise brings together the legal and practical know-how gained from representing several financial institutions and corporations in various sectors. He has worked on several banking and finance transactions in the GCC market and represented several international financial institutions in multi-jurisdictional debt finance transactions and Islamic financing. Ashraf has successfully structured and executed numerous securitisation and bond issuance deals for a wide range of clients.

Esraa El Sayyad is an associate at Matouk Bassiouny & Hennawy and a member of the finance & projects team. She has diverse experience in energy and project finance. Her area of expertise includes the drafting and negotiation of facility agreements, finance and security documents and term sheets, as well as the incorporation of establishments in Egypt. Moreover, Esraa has a proven track-record of advising financial institutions; consumer finance, SME lending, micro-finance, and nano-finance companies, and investment firms on securitisation strategies. She has advised on day-to-day business ensuring compliance with local laws, corporate governance, and assisting clients with general day-to-day corporate matters and drafting agreements based on the clients' needs.

Habiba El Naggar is an associate at Matouk Bassiouny & Hennawy and a member of the finance & projects team. Habiba has worked on several project financing and structured finance transactions, due diligences, specifically in the energy sector, as well as general corporate and commercial matters. Further, she has worked on securitisation and bond issuance transactions with several banking and non-banking financial institutions, and SME lending, micro-finance, and nano-finance companies.

Matouk Bassiouny & Hennawy

12 Mohamed Ali Genah
Garden City
Cairo
Egypt

Tel: +202 2796 2042
Fax: +202 2795 4221
Email: info@matoukbassiouny.com
Web: www.matoukbassiouny.com

Matouk Bassiouny &Hennawy
matoukbassiouny.com

1. Specific Financial Asset Types

1.1 Common Financial Assets

The laws and regulations governing securitisation transactions in Egypt have not explicitly identified (or excluded) the types of financial assets that could be securitised. There are certain conditions, such as the financial asset being assignable, unconditional, and free from any encumbrances. If these conditions are met, the assets can be securitised according to the legal process and regulations provided by the law and the regulator.

There is, however, a practice as to which assets are commonly securitised in the Egyptian capital markets. These include consumer finance loans, loans to small and medium enterprises, micro-financing, nano-financing, auto loans, and residential real estate.

1.2 Structures Relating to Financial Assets

The transaction structure remains just about the same for each type of financial asset mentioned and can be characterised as a "true sale securitisation". The originator usually enters an assignment of proceeds agreement with an issuer to assign the financial rights arising from the consumer finance loans or the micro-financing in return for the issuance of securitisation bonds. There must be different professionals engaged in the transaction, such as a legal adviser, an auditor, a financial adviser, a custodian, and a rating agency. The transaction can be generally grouped into three phases.

- Phase 1 – the advisers assist in conducting a due diligence exercise on the documentation underlying the assigned receivables from legal and accounting perspectives. The due diligence reports are sent to the rating agency for review and assessment.
- Phase 2 – then starts a phase of drafting the legal documentation. There is usually an information memorandum or subscription note, an assignment of proceeds agreement between the originator and the issuer, a collection agreement between the issuer and a collection agency, and custody agreement between the issuer and a custodian.
- Phase 3 – the legal documentation, along with other formal requests, corporate, and secretarial documents, must be filed with the Financial Regulatory Authority (the FRA) as the Egyptian capital markets regulator.

There are additional requirements if the securitisation bonds are issued as green bonds or part of a sustainability programme. This includes appointing a consultant to check that the requirements of sustainability or environmental considerations are fulfilled according to the applicable laws and regulations.

1.3 Applicable Laws and Regulations

The Egyptian Capital Markets Law and its Executive Regulation govern securitisation transactions in Egypt. There is a dedicated chapter in the Capital Markets Law that covers the nature and structure of securitisation transactions. The FRA also contribute by issuing different circulars and regulations to address certain procedural or operational matters, as well as providing interpretations or clarifications for issues that are not clear under the law.

1.4 Special-Purpose Entity (SPE) Jurisdiction

The SPEs are defined under the Capital Markets Law as the entity that "carries out the activities of issuing tradable bonds in return for the financial rights and dues, along with any related

securities, assigned to such entity". These companies are incorporated according to the provisions of the Capital Markets Law and obtain a licence from the FRA to act as an issuing company in securitisation transactions. They have the purpose of securitising financial rights and are prohibited to carry out any activities other than these.

1.5 Material Forms of Credit Enhancement

There are various forms commonly used as credit enhancements in Egyptian securitisation transactions. They are all decided by the originator, but their quality is reflected in the rating of the bonds given by the credit rating agency. Material forms of these credit enhancements include letters of guarantee, credit default service accounts, cash reserve accounts, and credit insurance policies.

These forms of credit enhancement are not mandatory by law, although their presence secures a minimum level of credit rating for the bonds and assigned portfolio. In practice, the originator opens a credit default service account with the custodian and deposits a percentage of the issued bonds to be utilised for servicing the bonds in case there are any defaults in the collected proceeds. The amount deposited as a percentage from the bonds issuance is agreed between the credit rating agency and the originator, but there are certain requirements set by the credit rating agency to achieve at least the minimum rating of the bonds as provided by the law. Typically, later, during the bond's lifetime, the originator issues a letter of guarantee in favour of the issuing company and the bondholders to replace the credit default service account and free the cash in that account for other uses by the originator.

At the same time with the credit default service account, the originator creates a cash reserve account to be used as a first line defence against any defaults in the collected sums prior to utilising the credit default service account or the letter of guarantee. Both the credit default service account and the cash reserve account can be invested by the custodian in safe capital market instruments, such as treasure bills, to maximise the benefit for the bondholders.

The credit default service account and the reserve account are considered internal credit enhancements of the bonds that are calculated as a certain percentage of the net present value of the assigned portfolio after deducting the present value of total costs and expenses associated with the bonds throughout their tenor. This calculation takes in consideration risks associated with deficits arising from any early repayment or defaults in payment.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The SPE usually acts as the issuer of the bonds and the assignee of the future cash flows. It is generally responsible for protecting the rights of the bondholders and ensuring that other stakeholders, such as the custodian and collector, are compliant with their contractual obligations. The Capital Market Law provides that the SPE is the company that creates, and issues tradable bonds backed by assigned financial rights and receivables, and any security package associated with such financial rights. These are companies established under the supervision of the FRA and have their main purpose as securitisation companies. They may act on several securitisations with different originators, but they may

not operate any other activities than their main purpose.

The SPE has the central role of being a party to all the legal documents underlying the securitisation process. They execute the assignment agreement as assignee with the originator. They appoint a collector in accordance with a collection and service agreement, and they further appoint a custodian in accordance with a custody agreement.

In all these agreements, they must act as a protector for the rights and interests of the bondholders throughout the tenor of the bonds. The SPE also arranges with the credit rating agency the issuance of the credit rating certificates for the bonds and the assigned portfolio. They provide further documentation and reports needed by the regulator or the custodian to ensure that different stakeholders are observing their obligations under the legal documentation and provisions of the issuance.

2.2 Sponsors

There is no sponsorship in the Egyptian marketplace.

2.3 Originators/Sellers

The originator is the owner of the financial rights that are assigned to the issuer. The originator enters into an assignment agreement as an assignor with the issuer as assignee to assign all the financial rights and future cashflows associated with the underlying portfolio subject of the transaction. The assignment means that all rights, and, in most cases, security packages associated with these financial rights are transferred legally to the issuer. The transfer remains conditional upon the subscription in all the bonds by the subscribers.

The originator usually takes the role of collecting the receivables from each obligor. This is not an obligatory requirement, although, it serves to bypass the process of legally notifying the obligors that the rights of the originator have been assigned. According to the Capital Markets Law, if the originator remains the collector of the assigned proceeds, then there is no obligation to notify the obligors of the assignment.

The Capital Markets Law also compel the originator to exercise due care in protecting the rights of the bondholders. In that respect, the originator is obliged to supply the amounts collected from the debtors to the custodian immediately upon collection, accompanied by a statement showing the amounts collected at the end of each month throughout the issuance period, and to further maintain separate books for each securitisation portfolio.

2.4 Underwriters and Placement Agents

Any placement or underwriter agent must be licensed by the FRA in accordance with the Capital Markets Law. The entities operating these activities are usually departments of investment inside commercial banks, or investment banks. Although, any company can apply for the underwriting activity licence subject to the capital requirements and other provisions of the Capital Markets Law. In securitisation, a financial consultant is appointed to advise the originator throughout the different steps of the process. If the financial consultant is a commercial, they usually – although not necessarily – assume the responsibilities of a placement and underwriter agent.

The agent is responsible for marketing the bonds and looking for investors to subscribe in the bonds. Given that most securitisation transactions in Egypt are offered through a private place-

ment, the placement agent has a limited role in finding investors amongst banks, investment firms, and funds. The placement is conducted privately through an offering to high-net-worth investors and investment firms. The underwriter also charges additional fees for guaranteeing subscription in the full amount of the bonds.

2.5 Servicers

As mentioned earlier, the originators usually perform the role of a servicer and collection agent in the Egyptian marketplace. This is to avoid the process of legally notifying each customer or obligor of the originator that an underlying assignment transaction has taken place. Servicers, or collectors as usually referred to, are agents of the issuer and responsible for collecting the cash proceeds and transferring them to the collection account of the issuer maintained with the custodian.

The servicer is responsible for reporting any defaults by the obligors to the FRA and the issuing company. There is usually a cure period given for the obligors to fulfil their payment obligations of any late payments. Then the servicer would be required to initiate the necessary legal actions – on behalf of the issuer – and inform the FRA and the issuer accordingly concerning any progress made.

2.6 Investors

Investors are entities which invest cash in the issued bonds under a securitisation transaction. These entities can be financial institutions, such as commercial banks, investment banks, capital market funds, and individuals, whether persons subscribing in publicly offered bonds or high-net-worth individuals.

The offering can be either a public offering or a private placement. For private offerings, the investors must be “Qualified Investors” according to the criteria set by the regulations of the FRA as follows.

- High-net-worth individuals:
  - (a) natural persons who have expertise of not less than three years in the credit, money management and investments fields or management of funds or worked at any bank, insurance company or any Egyptian or foreign financial institution (as defined below);
  - (b) natural persons who hold financial instruments or financial debt instruments exceeding EGP500,000 in at least two Egyptian joint-stock companies other than the issuing company; and
  - (c) companies whose paid-up capital is not less than EGP1 million.
- Financial institutions include:
  - (a) banks, and branches of foreign banks that are subject to the supervision of the Central Bank of Egypt;
  - (b) insurance and reinsurance companies;
  - (c) companies whose purpose is to contribute to the incorporation of other companies (ie, holding companies); and
  - (d) companies and entities that practice activities of stock exchanges.

2.7 Bond/Note Trustees

Similar to the concept of trusteeship and appointment of a trustee in other jurisdictions, the Egyptian law requires the appointment of a custodian to safekeep and hold the securitisation bonds in custody. It is important that the custodian is a licensed entity by the FRA to perform such activities in accordance with the Capital Markets Law and the FRA regulations. The custodian usually enters an agreement with the issuer which stipulates all the rights and obligations in relation to the transaction. The contents of this

agreement must be summarised and disclosed in the information memorandum of subscription.

The role of the custodian includes:

- safekeeping the documentation of the pool of assets;
- maintaining the collection accounts, as well as other accounts such as the reserve and default service accounts; and
- preparing periodical reports to the bondholders and the FRA in relation to the collection of proceeds.

The custodian is further obliged to have separate books, financial statements, and accounts for each securitisation transaction.

2.8 Security Trustees/Agents

See **2.7 Bond/Note Trustees**.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The Capitals Market Law states that the issuing of tradable bonds against the financial rights and future receivables, along with prescribed collaterals (the "Securitisation Portfolio") is transferred by the originator and the SPE under an assignment agreement. Such assignment must be conducted by virtue of an agreement in form and substance acceptable to the FRA. Furthermore, for the assignment agreement to be valid and enforceable, the assignment must be immediate, unconditional and must transfer all the rights, payments payable upon maturity and collaterals to the SPE.

The assignment agreement entails a true sale of the assigned portfolio and accordingly no recourse or legal obligations can arise thereafter towards the originator in relation to the assigned debt. The originator usually acts as an agent to the SPE in relation to collecting the debts on behalf of the SPE. Therefore, the originator is at the same time liable in his/her capacity as collection agent.

The documentation used to effect securitisation transactions usually covers the following principal subject matters:

- a description of the assets to be assigned;
- the undertaking to assign those assets;
- the counter value (ie, the purchase price to be paid by the assignee in exchange for the assigned assets);
- the method by which the assignment is effectuated;
- the assignment itself;
- servicing provisions; and
- representations, warranties and covenants.

In light of the most recent amendments to the Capital Markets Law which were issued in 2022 by virtue of Law No 13 of 2022, expected future cash receivables have been introduced under securitisation processes. In this regard, repayments may be secured by payments on future cash flow receivables as opposed to the traditional route of the funding source being banks or non-banking financial institutions. Consequently, FRA – in compliance with the new introductions made to the Capital Markets Law – has issued Decree No 115 of 2022 reiterating the same.

3.2 Principal Warranties

Besides the standard warranties, the originator under the securitisation portfolio assignment agreement, typically represents and warrants the following as required by the FRA being the supervisory authority:

- that it owns the securitisation portfolio and all its related rights and securities;
- that the securitisation portfolio is free from pledges and liens that would affect the interest of bondholders;
- that it is not necessary for his/her debtors to be notified of the securitisation portfolio assignment agreement;
- that the rights and securities, subject to the securitisation portfolio, shall guarantee the rights (principal and return) of the bondholders;
- that it has full authority to conclude, sign and execute the securitisation portfolio assignment agreement; and
- that there is no litigation or lawsuit that would have a material adverse effect on the securitisation portfolio assignment agreement.

3.3 Principal Perfection Provisions

For the assignment of the securitisation portfolio to be duly and fully perfected, the SPE shall notify FRA of the final securitisation portfolio assignment agreement, which shall be in accordance with the form prepared by FRA pursuant to Article 307 of the Executive Regulation of the Capital Markets Law, as well as, publishing the summary of such agreement in two widespread daily newspapers, at least one which is in Arabic within one week of the date of the agreement. Additionally, the FRA must approve the issuance of the relevant securitisation bonds by the SPE.

3.4 Principal Covenants

In a typical securitisation transaction, the originator undertakes the following covenants:

- not to dispose of assets related to the securitisation portfolio;
- to deliver on the effective date of the securitisation portfolio assignment agreement, all contracts and documents evidencing the rights and receivables along with the relevant collateral subject of the securitisation portfolio;
- to obtain and maintain all authorisations; and
- to send notice to the SPE of the occurrence of certain events (eg, stop purchase event, and change of control).

Further, the securitisation entity may undertake that it shall not distribute any of its dividends until the full settlement of the securitisation bondholders.

3.5 Principal Servicing Provisions

The usual practice in the Egyptian marketplace is that the originator acts as an agent on behalf of the SPE in relation to collecting the debts from original debtors. In that case, the originator would be liable in his capacity as an agent on behalf of the SPE. It is typical to include covenants covering these activities as well. Such covenants usually include the obligation to protect the rights of the bondholders, and to maintain all systems necessary for the collection and management of receivables. However, the originator in its capacity as assignor and the SPE in its capacity as the assignee under the securitisation portfolio assignment agreement may not act as a collection agent. In such case, the originator is required to notify each obligor by a registered mail with an acknowledgement of receipt of such assignment, for its due perfection and enforceability towards others.

3.6 Principal Defaults

A distinction between the events of default made by the:

- client under the customers' contracts subject of the assignment; and
- originator should be made.

It is worth noting that FRA has issued templates regarding several securitisation documents including but are not limited to:

- the client's contracts (ie, consumer finance contracts, micro-finance contracts and small and medium-sized enterprises contracts); and
- the information memorandum and related agreements thereto.

The authors set below examples of defaults and cures that are commonly incorporated under customers' contracts and the securitisation agreements:

- The client shall be in an event of default under the customer's contracts in case of the following:
  - (a) failure to pay the due amounts in the prescribed time;
  - (b) utilisation of the amounts extended for purposes other than those prescribed thereunder;
  - (c) submission of inconsistent or incorrect data relating to the client;
  - (d) loss of capacity, death, sequestration, insolvency or bankruptcy of the client; and
  - (e) expropriation measures or administrative seizure are undertaken or if part or all of the financed project is disposed or if it is leased to others.

In this regard, all amounts extended under the customer's contract shall be due and payable by the client and his respective guarantor(s) without need of notification or warning. Additionally, the originator shall attempt to collect the amounts amicably as part of the remedy period. Upon the lapse of such remedy period, the originator shall serve the client a warning for payment. In the event that failure of payment persists, the originator shall commence legal proceedings against the defaulting client.

The originator shall be, in an event of default, under a collection agreement in case of the following:

- inconsistency of any of the rights that ought to be assigned and the undertakings and representations thereunder; and
- failure to assign the rights.

In this regard, the assignor shall repurchase those inconsistent rights and shall be liable to compensate the assignee for the losses incurred. Further, the assignor shall deliver the entirety of the Securitisation Portfolio to the assignee. Additionally and in anticipation of any events of defaults by the originator, the FRA has obliged the SPEs under any securitisation transaction to conclude a backup services agreement with an alternative collector by virtue of which such alternative collector will be responsible of collection in the event that the originator has become in an incurable event of default.

3.7 Principal Indemnities

Indemnities in securitisation vary and are subject to the negotiations between the parties of the securitisation transaction. Generally, the originator indemnifies the SPE in the following cases:

- losses arising from a violation to the securitisation documents; and
- the SPE discovers on the effective date of the assignment agreement that any of the rights constituting the Securitisation Portfolio subject to the assignment are not in conformity with the representation, warranties and covenants provided by the originator under the Securitisation Portfolio assignment agreement.

Further, we have seen that under assignment agreements, the assignor indemnifies the assignee in case of failure of assignment regarding the Securitisation Portfolio or in case the percentage of rights do not conform to the specifications provided thereunder and such inconformity has exceeded an agreed upon percentage of the total value of the rights prescribed thereunder.

Typically, in case of defaults relating to non-payment, a claim may be made using the promissory note and filing a non-payment protest.

3.8 Bonds/Notes/Securities

The documents that are customarily included under the Securitisation Portfolio are:

- the information memorandum entered into amongst all parties to the securitisation transaction as being detailed under **3.10 Offering Memoranda**;
- the assignment agreement entered into between the originator and the SPE;
- the collection and services agreement entered into between the collector (whether the originator or an elected third party) and the SPE;
- the custody agreement entered into between the SPE and the Custodian; and
- the backup services agreement entered into between the backup servicer and the SPE.

3.9 Derivatives

Derivatives in Securitisation Processes

Derivatives are not extensively regulated under Egyptian Law per se; however, other concepts have been introduced that embody the same intention thereof. The authors refer to the Capital Markets Law by virtue of which a derivatives exchange may be created to trade contracts which value derive from financial or in-kind assets, price indicators, commercial papers, commodities, financial instruments or other indicators determined by FRA, whether in the form of future contracts or swap contracts. In alignment with the Capital Markets Law, the FRA has issued Decree No 33 of 2019 regarding the Licensing Conditions and Procedures for a Derivatives Exchange.

Nonetheless, we have not seen the emergence of a derivative exchange. Instead, derivatives are typically traded over the counter in the Egyptian Exchange. In all cases, we have not seen the utilisation or implementation of derivatives in securitisation transactions as opposed to derivatives utilised to hedge against interest rates and fluctuations in foreign currencies exchange rates.

The Risks Being Hedged Against

The principal risk that may arise and is associated with securitisation transaction is the non-payment of the amounts by the clients/debtors under the customers' contracts or the failure of the originator to collect/assign the monies to the SPE. Mitigations for such risks typically include issuance of promissory note by the debtor and its guarantors and the guarantee made by the guarantors of the client/debtor under the customers' contracts.

3.10 Offering Memoranda

Securitisation processes in Egypt take effect through private subscriptions rather than public subscriptions. In this regard, an information memorandum (IM) is prepared as opposed to an offering memorandum.

Typically, an IM includes information regarding the subscription amount, interest levied, redemption period, Securitisation Portfolio including but not limited to the due diligences prepared by the transactions' legal advisor and the transaction's auditor, the events of default,

financial model and coupon information. Further, IMs include details regarding the originator, the SPE, issuance, parties' rights and obligations and a summary on each agreement (stipulated under **3.8 Bonds/Notes/Securities**).

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

The parties of the securitisation are required to make numerous disclosures according to the Capital Markets Law. These disclosures are usually included in the information memorandum or subscription note that is published to the subscribers. For example, the originator must disclose detailed information about the securitised portfolio. This includes the geographic distribution of the obligors, any concentration loans, and the cash flows arranged in many ways so as to give the full picture to any subscriber.

The securitisation company or the issuer must disclose all information about previous securitisation. This includes a disclosure concerning duly payments of principal and interest of previous bonds, and the rating of each bond. It certainly gives comfort to potential subscribers to understand that the issuing company fulfilled its previous obligations towards bondholders.

Different stakeholders disclose their licences obtained from the FRA, such as the placement and underwriting agent, the custodian, and the auditor. Several chapters in the information memorandum disclose the provisions of the agreements executed between the parties, including the assignment agreement, the service contract, and the custody contract. The information memorandum also clarifies the role of each party involved in the process, such as the underwriter, the auditor, and the legal consultant.

4.2 General Disclosure Laws or Regulations

In addition to the disclosures related to the issuance, there are general rules related to financial instruments (ie, bonds) if they are listed in a stock exchange. These are generally subject to the provisions of the Capital Markets Law and its Executive Regulation, in addition to the listing rules of the Egyptian Exchange, and other regulations issued by the FRA.

4.3 Credit Risk Retention

See **1.5 Material Forms of Credit Enhancement**.

4.4 Periodic Reporting

Periodic Reporting of Companies Issuing Financial Instruments to a Public Subscription

In accordance with the Capital Markets Law and its Executive Regulation, each company that issues financial instruments to public subscription shall submit to the FRA the following documents:

- semi-annual reports, regarding its activities and the outcome of its businesses; and
- balance sheet and financial statements, attached with the relevant reports of the board of directors and auditor.

Additionally, the company (ie, company issuing financial instruments) and its auditor must provide FRA with the data and documentation which it may require to verify the contents of the Prospectus, the periodic reports, data and financial statements of the issuing company.

- Semi-annual reports – the reports shall include the data, which disclose and reflect the correct financial position of the issuer.
- Balance sheet and financial statements shall be:
  (a) prepared according to the accounting standards and auditing rules referred to in the Executive Regulation; and
  (b) be attached to the relevant reports of the board of directors and auditor.

The issuer shall further publish the summary of such financial statements, its clarifications and the auditor's report in accordance with the rules and regulations set by the FRA.

Material Requirements of Periodic Reporting of EGX

EGX shall provide the FRA, within one week from the date of its approval to list a particular financial instrument, with any further data requested by the FRA related to a specific financial instrument (ie, shares, bonds, and Sukuk). Additionally, EGX shall submit to the FRA periodic reports about the trading of listed financial instruments in the stock exchange. These reports include the following.

- Daily notification on trading – this includes the type of the traded financial instrument, the price, total amount of financial instruments traded, type of each transaction, total number of the transactions per day, in addition to the total number of over-the-counter transactions.
- Bi-monthly and monthly notification on trading – this includes the volume of traded financial instruments in terms of quantity, total value, and number of transactions.
- Annual notification on trading – this includes the volume of traded financial instruments in terms of quantity, value and number of transactions compared to the previous year. This report must highlight the:
  (a) total trading market for the year;
  (b) the movement of trade distributed among sectors in various activities;
  (c) the most important phenomena that occurred during the year and its impact on the stock market; and
  (d) the volume of dealing in financial instruments and stock market management proposals to remedy the negative effects of this phenomenon.

The FRA is the competent authority for receiving the documents and reporting disclosures. The FRA either examines these documents submitted by the companies issuing financial instruments for public subscription or, otherwise, assign such examination to a specialised entity. The FRA must inform the issuing company about its observations and can request further clarifications depending on the outcome of the examination.

In case of non-compliance with any of the required periodic reporting, there is a penalty of imprisonment and/or a fine of an amount between EGP20,000 and EGP1 million for the non-complying issuing company. The criminal proceedings are initiated against the director who is actually responsible for the daily management of the company.

4.5 Activities of Rating Agencies

Companies having the purpose of rating, classification, and ranking of financial instruments (commonly referred to as rating agencies) are regulated under the Capital Markets Law and its Executive Regulation.

The Executive Regulation provides certain requirements to ensure the transparency of rating agencies, such as the following.

- Companies dealing in financial instruments, banks, auditors, classified entities, or its classified issued financial instruments shall not be a shareholder in rating agencies.
- Rating agencies shall avoid acting in conflict with its nature. Neither the rating agency nor its employees can have an interest in the entity it is working for, such as the issuer of the bond or financing Sukuk subject of classification.
- The credit rating rules and procedures are set in accordance with the Executive Regulation. Rating agencies cannot amend the rules and grades, or its internal control rules and procedures unless after obtaining the approval of the FRA.
- The managing director of a rating agency or its employees holding key positions must have sufficient experience in the field of classification of securities or credit analysis, and examination of creditworthiness.
- The credit rating certificate shall include the name of its issuing company, the date of the classification, its indication, an explanation of its intent, a statement indicating the significance of each of the other classification grades and comparing them with the corresponding grades of other companies engaged in the same activity, to ensure full and clear distinction between different grades.

The FRA provides further requirements on its website for an entity to be licensed as a rating agency and can participate in the rating, classification, and ranking activities. The FRA remains the regulator of entities undertaking these activities. There is a register maintained by the FRA for the registration of licensed rating agencies, which can carry out financial evaluation and prepare studies to determine fair values in cases where this is required under the Capital Markets Law or its Executive Regulation. The FRA sets the controls for registration and write-off from the register.

Rating agencies must further perform their roles in compliance with the financial evaluation standards issued by the FRA. There is currently one rating agency operating in Egypt, which is Middle East Rating & Investors Service (MERIS), which collaborates with Moody's Corporation as its technical agent. The FRA is attempting to allow other entities enter into this field and the obtain the relevant licence. For that purpose, the FRA issued Decree No 151 of 2023 which allows other companies to apply for the rating licence. The Decree sets out the criteria that all applicants must collaborate with a worldwide reputable technical agents to elevate the competition. The FRA has received the application of three new entities (at the time of this), including technical agents such as S&P Global Ratings, and CRIF Ratings.

4.6 Treatment of Securitisation in Financial Entities

The Central Bank of Egypt provides the regulations addressing capital and liquidity rules for banks. There is no similar – publicly available – regulations for other insurance or financial entities. The regulations of the Central Bank of Egypt differentiate between whether the bank is an investor or an originator in a securitisation transaction.

If the bank is an investor, the exposure of a securitisation transaction is calculated as a weighted risk of 100% in the base capital. Whereas if the bank is an originator, it takes a weighted risk in

the base capital gradually increasing from 20% until 350% depending on the rating of the bonds and its tenor.

4.7 Use of Derivatives

The Capital Markets Law and its Executive Regulation provide for the establishment of an Egyptian derivatives exchange. This exchange will be a venue for trading in different derivatives contracts, such as futures, forwards, and swaps. The exchange has not been established until now, and so all derivatives transactions are conducted over the counter.

Derivatives are not regulated under Egyptian law with specific articles or a body of law. Accordingly, derivatives transactions are always subject to the general principles of contract law, taking in consideration certain regulatory requirements and the Banking Law if a bank is party to the agreement. For example, banks are prohibited from entering into any speculative currency swap transactions on the Egyptian pound. Also, non-deliverable forwards were restricted by the CBE until this rule was abolished recently through the CBE Circular dated 27 October 2022, which allowed these transactions between banks and their corporate clients only. There are certain rules as well on how to consider derivatives transactions for capital adequacy based on the nature of the transaction being on the “banking book” or the “trading book” of the bank.

4.8 Investor Protection

The laws governing securitisation are quite centred around the protection of investors through several guarantees. The FRA also issues regulations the guarantee minimum level of transparency to help investors take the right decision.

The disclosures that should be made by all parties in the information memorandum, such as disclosures of the originator, the issuer, the auditors, and the legal consultant are all aimed at providing the highest levels of transparency for the bondholders. The regulatory framework provides highly strict sanctions in case of any fraud, misrepresentation, or deceiving information. The penalties include amounts as high as EGP20 million or double the amount gained, in addition to the criminal charges associated with any such fraudulent practices.

4.9 Banks Securitising Financial Assets

In accordance with the Banking Law, the Central Bank of Egypt is the regulatory authority for banks and gives the necessary licensing to carry out banking activities and other capital market activities by banks. The FRA remains the regulatory authority for filing and reporting of capital market instruments, in addition to the licensing of companies – other than banks – that operate capital market activities.

If a bank intends to issue any capital market instruments, such as securitisation bonds, they must obtain the regulatory clearance of both the Central Bank of Egypt, as the supervisory body of banks, and the FRA, as the supervisory body of issuing capital market instruments. A bank may accordingly securitise its portfolio of loans or credit cards to a securitisation company by filing the required documents and disclosure to the FRA in accordance with the Capital Markets Law and the relevant regulations.

Banks remain subject to Central Bank regulations in terms of disclosure, credit risk retention, reporting, accounting, and capital adequacy ratio requirements of the Central Bank of Egypt. There is a body of regulatory circulars issued by the Central Bank of Egypt which covers all these various topics and require compliance from all banks.

4.10 SPEs or Other Entities

SPEs are defined pursuant to Article 41 bis of the Capital Markets Law as the entity that "carries out the activities of issuing tradable bonds in return for the financial rights and dues, along with any related securities, assigned to such entity". There are certain requirements under the Capital Markets Law and its Executive Regulation to establish an SPE, the most important of these are as follows.

- There must be among the founders at least 50% of the share capital owned by juridical entities, and at least 25% owned by financial institutions.
- The ultimate beneficial owners must be disclosed.
- An economic and technical feasibility study must be submitted to the FRA.
- The directors must have minimum experience in the financial sector.
- The capital must be at least EGP5 million or its equivalent in other currencies.

Some companies can be allowed to issue securitisation bonds – although not having the purpose of being a securitisation company – but this remains subject to the approval of the FRA and is limited to a portfolio of their activities. The FRA further require these entities to separate the securitised portfolio from other books and financial rights of the company from an accounting perspective. The company must submit a request to FRA, in addition to a statement of the rights and securities included in the securitisation portfolio, a letter of acceptance of appointment by a custodian, and a statement of acknowledgement from a service entity that will collect the transferred rights and documents.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

SPEs must have the sole purpose of practicing securitisation activities, as they are prohibited from carrying out any activities other than the securitisation activities.

4.12 Participation of Government-Sponsored Entities

Some public authorities, such as the New Urban Communities Authority (NUCA), have issued securitisation bonds as well, to securitise their portfolio of future cash flows arising from the sale of residential units. NUCA is considered a public authority affiliated to the Ministry of Housing, Utilities, and Urban Communities. They follow the same rules and regulations of the Capital Markets Law and the relevant regulations issued by the FRA. The may be additionally required to comply with their articles of incorporation in terms of the capacity to carry out such transactions.

4.13 Entities Investing in Securitisation

See **2.6 Investors**.

4.14 Other Principal Laws and Regulations

The Capital Markets Law and its Executive Regulation is the main law for securitisation rules and procedures. It is complemented by the regulations and circulars issued periodically by the FRA. The Central Depository Law can be also relevant if the bonds will be listed in the EGX. This is in addition to the listing and trading rules of the EGX.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are not recognised or regulated under Egyptian laws.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

In a true sale securitisation transaction, the bankruptcy of the originator does not have an impact on the financial assets being securitised. This is the case with securitisation transactions in the Egyptian marketplace. Given that the originator assigned the financial rights without recourse, the rights have entered into the balance sheet of the issuer as an asset and cannot be calculated among the assets of the originator anymore.

Pursuant to the Bankruptcy Law No 11 of 2018 ("Bankruptcy Law"), the power of the bankrupt person to control and dispose of its assets ceases immediately upon the issuance of the bankruptcy ruling. Any transactions carried out on the day of the court ruling are considered as having taken place after the ruling.

A bankruptcy may have an effect on the originator if it acts at the same time as the collector, as is mostly the case in the Egyptian marketplace. In that case, the originator would be having further obligations to fulfil as a collection agent. In case the collection agent is declared bankrupt, there is usually a backup servicer or collector appointed according to the requirements of the FRA. The backup service immediately steps in and assumes the role of a servicer and collector.

6.2 SPEs

The company undertaking the securitisation activity shall take the form of either a joint-stock company or limited liability company established for this purpose with a paid-up capital of at least EGP5 million.

The SPE generally must be owned by corporate entities representing at least 50% of its capital, and 25% of these must be financial institutions. The financial rights and future receivables, along with their relevant collaterals, are assigned in the favour of the SPE in a true sale securitisation transaction. The quantity of covenants and obligations set by the law on each part of the securitisation afford a minimum level of transparency for the disclosure of all risks associated with the investment in the securitisation bonds.

The due diligence exercises conducted by the legal consultant and the auditor are also aimed at identifying any legal risks associated with the legal documentation of the assigned portfolio. These represent a safety net along with the other credit support measures taken by the originator, such as reserve account, credit default service account, and credit insurance policy on the obligors. The cumulative effect of these safeguards renders the fact that the SPE declares bankruptcy obsolete. The financial rights of the bondholders are backed by future cash flows paid by the obligors of the originator. If the obligors default, a first line of defence is the reserve account, then there is the default service account, and then the credit insurance. If all these methods do not suffice, the collector must seek legal recourse against the defaulting obligor to recover the rights of the bondholders towards the issuing company.

6.3 Transfer of Financial Assets

The originator as an assignor and the SPE as an assignee to which the title to the portfolio is transferred must enter into an agreement in line with the format required by the FRA for the transfer of the securitisation portfolio. All assigned rights, entitlements, and guarantees must be conveyed in an effective, full, and unconditional manner, and the transferor must attest to their existence at the time of the transfer but shall not be liable for their fulfilment thereafter. A comprehensive summary of the transfer agreement must be published in two widely circulated morning daily newspapers, at least one of which must be in Arabic, and the transfer to the SPE must be finalised. The FRA must be notified of this process as well.

The assignor shall give notice in writing, by registered mail with an acknowledgement of receipt, to all obligors whose financial obligations or receivables, and guarantees were assigned by the originator. In case the originator acts as the collector under a collection and service agreement with the issuer, then the Capital Markets Law exempts the parties from notifying the assignment to each obligor. In that manner, an assignment of rights is valid and enforceable towards the originator and the obligors.

The legal counsel provides a true sale opinion in relation to the securitisation transaction. This opinion covers the legal elements required for a true sale transaction. It includes evidence that transfer has fulfilled all the legal elements based in the reviewed documents and executed agreements between the parties. The legal contracts underlying such future financial obligations must allow the originator to assign its rights without the consent of the obligor. Accordingly, the rating agency can reply on such legal opinion to give the bonds and the portfolio the credit rating adequate for a true sale securitisation transaction.

6.4 Construction of Bankruptcy-Remote Transactions

This can be achieved through a true sale transaction as clarified in **6.1 Insolvency Laws**, **6.2 SPEs**, and **6.3 Transfer of Financial Assets**.

6.5 Bankruptcy-Remote SPE

The SPE can be considered a bankruptcy-remote entity given its nature and purpose of establishment. By its definition, the SPE is a company established for the sole purpose of issuing securitisation bonds. It has an obligation to separate the books of each transaction in terms of the accounts and receivables. Each bondholder is supposed to have a claim against the SPE, but this is backed by the future cash flows of the securitised portfolio.

7. Tax Laws and Issues

7.1 Transfer Taxes

The authors prefer not to write on tax matters.

7.2 Taxes on Profit

No information has been provided in this jurisdiction. See **7.1 Transfer Taxes**.

7.3 Withholding Taxes

No information has been provided in this jurisdiction. See **7.1 Transfer Taxes**.

7.4 Other Taxes

No information has been provided in this jurisdiction. See **7.1 Transfer Taxes**.

7.5 Obtaining Legal Opinions

No information has been provided in this jurisdiction. See **7.1 Transfer Taxes**.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

All Egyptian companies, including the custodian, the SPE, and the originator are bound by the Egyptian Accounting Standards (EAS) according to the Companies' Law. The EAS are essentially derived from the IFRS. The Capital Market Law reiterates the importance of keeping separate accounting books for different securitisation transactions by all stakeholders of the securitisation transaction. This is reflected in the many declarations that need to be submitted to the FRA from the custodian, the originator, and the issuer that they can keep separate accounting books for each securitisation transaction. The FRA further requires the auditor of the SPE to submit a detailed report that clarifies the methods and capability of the SPE to keep that obligation from an accounting perspective.

8.2 Dealing with Legal Issues

The legal counsel conducts a due diligence exercise on the securitised portfolio. This exercise is followed by a report that raises any material issues found during the review of the documents. The report is reviewed and assessed by the rating agency to help have a transparent picture regarding the legal documents underlying the financial rights and its guarantees.

The legal counsel further assists all parties with the drafting of the securitisation documents. This includes mainly the information memorandum or subscription note, the assignment agreement, the custody agreement, and the collection and service agreement.

In the final phases of the securitisation, the legal counsel assists with submitting the required documents to the FRA and help in clarifying any legal issues that may arise during the submission.

Trends and Developments

Contributed by:
Ashraf Hendi, Esraa El Sayyad and Habiba El Naggar
Matouk Bassiouny & Hennawy

Matouk Bassiouny & Hennawy was established in 2005 and has since developed into a premier full-service business law firm in Egypt and the MENA region, with offices in Algeria, Sudan, and the UAE, as well as two country desks covering the firm's Libya and South Korea practices. It has over 200 lawyers who are trained locally and internationally in common and civil law systems and are fully conversant in English, Arabic, French, and Korean. The firm's finance & projects practice group's primary goal is to provide its clients with legal advice on the banking and finance sector in the MENA region, and on the strengths and weaknesses of security available to lenders in the market.

Authors

Ashraf Hendi is a partner in Matouk Bassiouny & Hennawy's finance & projects practice group. He has particular expertise in various financing transactions, as well as security creation, and has represented clients in several syndicated and bilateral facilities, project finance, equity finance transactions, and securitisation. Ashraf's expertise brings together the legal and practical know-how gained from representing several financial institutions and corporations in various sectors. He has worked on several banking and finance transactions in the GCC market and represented several international financial institutions in multi-jurisdictional debt finance transactions and Islamic financing. Ashraf has successfully structured and executed numerous securitisation and bond issuance deals for a wide range of clients.

Esraa El Sayyad is an associate at Matouk Bassiouny & Hennawy and a member of the finance & projects team. She has diverse experience in energy and project finance. Her area of expertise includes the drafting and negotiation of facility agreements, finance and security documents and term sheets, as well as the incorporation of establishments in Egypt. Moreover, Esraa has a proven track-record of advising financial institutions; consumer finance, SME lending, micro-finance, and nano-finance companies, and investment firms on securitisation strategies. She has advised on day-to-day business ensuring compliance with local laws, corporate governance, and assisting clients with general day-to-day corporate matters and drafting agreements based on the clients' needs.

Habiba El Naggar is an associate at Matouk Bassiouny & Hennawy and a member of the finance & projects team. Habiba has worked on several project financing and structured finance transactions, due diligences, specifically in the energy sector, as well as general corporate and commercial matters. Further, she has worked on securitisation and bond issuance transactions with several banking and non-banking financial institutions, and SME lending, micro-finance, and nano-finance companies.

Matouk Bassiouny & Hennawy

12 Mohamed Ali Genah
Garden City
Cairo
Egypt

Tel: +202 2796 2042
Fax: +202 2795 4221
Email: info@matoukbassiouny.com
Web: www.matoukbassiouny.com

Matouk Bassiouny & Hennawy
matoukbassiouny.com

An Overview of Securitisation in Egypt

Securitisation has been at the forefront of financial transactions in Egypt throughout recent years. Many Egyptian companies prefer to raise funds through securitisation rather than the loan market to make use of their receivables in generating immediate cash flows. This has been particularly relevant for non-banking financial institutions and capital market companies whose balance sheets contain high volumes of receivable accounts pertaining to their nature of activities.

Securitisation is the process used to issue bonds backed by other financial assets. It entails selling (or as the legal term suggests, assigning) the assets of a company (the originator) to the bondholders – through a special purpose vehicle (SPV) – against immediate cash proceeds going the other way into the originator that result from the subscription in the bonds by the bondholders. It is quite common for financial companies in Egypt, and other parts of the world, to raise funds through securitisation using their portfolio of receivables in activities such as financial leases, consumer loans, mortgages, and credit card debts of its customers.

The process of securitisation is a win-win situation for both financing companies and investors. For financing companies as originators, they can raise immediate cash at more affordable rates than they can get through commercial banks. This cash is generated through receivable accounts (in other words, the money a business is owed by its customers) sitting on their balance sheet that cannot be immediately collected (ie, illiquid assets). They can utilise this cash in expansion plans or to increase their portfolio of customers and reach larger clientele.

Another benefit for the originator is that the securitisation process does not entail the burdening terms of a loan agreement with a commercial bank. Commercial banks tend to include detailed terms about how the business is run, including restrictions on borrowing, selling of assets, and certain senior management decisions. These requirements can be demanding and costly for the business in terms of having to negotiate and secure the bank consent on common operational matters.

For investors, they benefit from the income generated by the bonds which includes the principal and the interest on the bonds. Investors may also sell these bonds to another buyer at any time, thanks to the liquidity of the bond as a security. It is commonplace in the Egyptian market that the securitisation bonds are offered to private and high-net-worth individuals in a private offering. This allows entities such as commercial banks, money market funds, and investment banks to participate and subscribe in the offering.

There are different types of securitisations in jurisdictions around the world depending on the type of assets and the legal mechanism adopted in the process. The most common type adopted by Egyptian capital market financiers is the issuance of securities backed by accounts receivable in a "true sale securitisation" as the legal term goes. This process requires the originator to hire different consultants that assist with requirements of offering and subscription by the regulator.

The originator must have a financial advisor that prepares the financial model of the issuance. The financial adviser also arranges the financial roadshow for the bonds to promote to investors. There must be a legal adviser that prepares the documentation, conducts a due diligence

on the assigned portfolio, and assists in fulfilling any legal requirements from the regulator. The bonds must be given a financial rating through an acknowledged credit rating agency, and the portfolio of receivables must be reviewed by an auditor.

The Egyptian regulator is the Financial Regulatory Authority (the FRA), which oversees all capital market activities as per the law. The process must comply with and fulfil all the guidelines of the regulator issued in the form of regulations and directives. This is certainly in addition to the laws and by-laws pertaining to capital market activities and companies in general.

There is a similarity between the role of the regulator in giving the authorisation to offer the bonds, and commercial banks in loan transactions which authorise drawdown under the conditions precedent to the terms of the loan. The requirements are uniform and anticipated to a larger extent in the case of the regulator than commercial banks. In drawing this comparison, the time of drawdown (or effectively receiving the proceeds of the bonds by the originator) is considered the most crucial and time-sensitive procedure in the process from the company's perspective. The regulator has a certain set of rules that must be followed consistently, as opposed to commercial banks which conduct lengthy negotiations to have more favourable terms of drawdown.

FINLAND

Law and Practice

Contributed by:
Maria Lehtimäki, Niklas Thibblin and Timo Lehtimäki
Waselius & Wist

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Waselius & Wist is an independent Helsinki-based business law firm that provides services in all areas of business law with efficient teams and partner involvement throughout the assignment, combining specialist expertise with generalist training and international experience. The banking and finance and capital markets team has three partners and ten other qualified lawyers. Waselius & Wist advises market participants on transactions and regulatory matters relating to loans, securities, hybrid instruments, crypto, alternative investment funds and collective investment schemes, securitised products, investment services, securities trading, share buy-backs, netting, clearing and settlement, derivatives and associated matters of company law and taxation, working together with the tax structuring team. The firm is a key player in shaping the Finnish securitisation market and promoting discourse between issuers and regulators. It advises clients such as Santander Consumer Finance and LocalTapiola Finance on the structuring and execution of internationally known hallmark securitisation transactions.

Authors

Maria Lehtimäki is a partner in the banking and finance and capital markets team at Waselius & Wist, and steers the firm's securitisation practice. She is a member of the Finnish Bar Association, and joined the firm in 2012 after obtaining her Master of Laws from the University of Helsinki. Maria has also spent time at Cravath, Swaine & Moore, working on capital markets transactions. She advises market participants on cross-border financing and capital markets transactions and regulatory matters. A key area of her practice is structured finance across a variety of asset classes and industries, including automotive and aviation.

Niklas Thibblin is the managing partner of Waselius & Wist and head of the tax and structuring practice. He is a member of the Finnish Bar Association, and joined the firm in 2000 after obtaining his Master of Laws from the University of Helsinki; he has been a partner since 2009. Niklas has also spent time at Loyens & Loeff in Rotterdam and Luxembourg, working on various international tax issues. He has extensive experience in structuring demanding cross-border transactions, including securitisation transactions.

Timo Lehtimäki is a partner and head of the banking and finance practice at Waselius & Wist, whose primary focus is on demanding cross-border transactions. His clients include numerous leading international banks, other lending entities, private equity houses and corporates, which he advises on their Finland-related matters. Timo's key areas of expertise include financing transactions, asset-based lending and bond issuances. He joined the firm in 2007 and the partnership in 2013, and is a member of the Finnish Bar Association.

Waselius & Wist

Eteläesplanadi 24 A
00130 Helsinki
Finland

Tel: +358 9 668 9520
Fax: +358 9 668 95222
Email: ww@ww.fi
Web: www.ww.fi

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1. Specific Financial Asset Types

1.1 Common Financial Assets

Securitised assets include various types of financial assets, such as equipment finance receivables, unsecured consumer loans and trade receivables. The most active issuers are specialised lenders, which originate these types of assets. There is currently no securitisation market for housing and commercial mortgages in Finland, because these are typically used as collateral for covered bonds, but there is no legislative obstacle to securitising such assets. Some corporate and SME loans are securitised synthetically.

1.2 Structures Relating to Financial Assets

All securitisation transactions where tranched exposures are backed by a pool of assets are generally governed by the EU Securitisation Regulation. There is no specific Finnish securitisation law. The rules regarding the transfer of receivables are generally governed by the Finnish Promissory Notes Act and related legal principles, precedents and doctrine.

As there is no specific securitisation legislation that would steer or confine the market to a specific structure, there is some diversity in structures. However, generally, private transactions are structured in a less complicated manner than public transactions, with the latter being much influenced by existing public transaction structures.

The common goal in all off-balance sheet structures is that the pool of assets is segregated from the originator's assets and safe from the reach of the creditors of the originator, even if the originator becomes insolvent. In practice, segregation is accomplished by the originator selling the assets to a special purpose entity (SPE) established specifically for the transaction to purchase and hold the assets and issue the instrument.

There are only a handful of synthetic transactions in the market and these are generally structured as risk sharing transactions involving the issuance of credit-linked notes to investors, referencing the first-loss piece of the portfolio.

1.3 Applicable Laws and Regulations

The principal applicable laws and regulations that have a material effect on the structures referred to in **1.2 Structures Relating to Financial Assets** are:

- the EU Securitisation Regulation (Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, as amended – the "EU Securitisation Regulation"), and its delegated rules and regulatory guidelines and technical standards.
- the Finnish Act on Credit Institutions (610/2014, as amended, implementing the EU Capital Requirement Regulation and Directive regime in Finland).
- the Finnish Promissory Notes Act (622/1947, as amended).
- the Finnish Act on Mortgage Banks and Covered Bonds (151/2022, as amended).

1.4 Special-Purpose Entity (SPE) Jurisdiction

For commercial purposes, in Finnish securitisation transactions, it is common to set up the SPE in an offshore jurisdiction such as Ireland or Luxembourg that:

- is within the EU, for reputational and stability reasons;
- is well known to investors and rating agencies, for pricing reasons;
- has specific securitisation legislation or otherwise suitable companies law and tax law and praxis, for legal opinion reasons; and
- has a large selection of experienced and cost-efficient corporate services providers, for operational reasons.

1.5 Material Forms of Credit Enhancement

It is common to combine different methods of credit enhancement – eg, subordination, over-collateralisation and cash reserves – in a manner that is proportionate to the transaction, so that the credit risk of the underlying assets is still overwhelmingly transferred to the SPE. An excessive use of credit enhancement may adversely impact the true sale assessment and off-balance sheet treatment.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The is the SPE that issues the debt, usually in the form of notes. The SPE's role is limited to purchasing the assets and issuing the debt to finance the purchase. The SPE does not have any employees and it does not conduct any other business activities beyond the securitisation transaction. It is wound up when the transaction ends.

2.2 Sponsors

Under the EU Securitisation Regulation, a sponsor is a credit institution or an investment firm, other than an originator, that establishes and manages a securitisation transaction involving purchases exposures from third-party entities. Finnish securitisation transactions are typically led by the originator and there is no sponsor.

2.3 Originators/Sellers

The originator begins the entire transaction to obtain funding, manage capital or risk, or both. The originator engages all the other transaction parties to assist it in the transaction. The originator typically has many additional roles, such as subordinated lender, servicer and risk retention holder. The originators in Finnish transactions are typically non-bank lenders (such as auto financing companies or unsecured consumer lenders financing their portfolios) or industrial companies (financing trade receivables) seeking to obtain funding at beneficial terms compared to bond markets or leveraged financing.

2.4 Underwriters and Placement Agents

The main adviser in a Finnish securitisation transaction is generally the arranger or lead manager, which usually helps the originator engage all other advisers (including agent, trustee, cash manager, swap counterparty, legal advisers in all jurisdictions, corporate services provider, listing agent, rating agencies, verification agent and securitisation repository), structure the transaction and sell the transaction. In a public transaction, there is typically more than one such adviser, in which case they are called joint lead managers. In a private transaction, it is common for the arranger or its affiliate to also be the original noteholder or lender.

2.5 Servicers

The servicer needs to have the requisite experience and operational readiness to take care of the portfolio, including monitoring and reporting collections and loan-level performance. The servicer acts as the interface with the underlying debtors, since the SPE does not have any

employees. The servicer sends notices of transfer to the underlying debtors at the commencement of the transaction and in connection with any additional portfolio sales. The servicer also manages debt collection, with the help of an external debt collection agency where required.

Generally, the originator is appointed to act as the servicer for seamless customer service and cost-efficiency reasons. The parties agree in the transaction documents that the servicer manages the receivables portfolio essentially as it would manage its own, unsecuritised portfolio, but on behalf of the SPE. However, the transaction documents usually provide for a back-up servicer, or back-up servicer facilitator, to step in if the servicer defaults, to ensure continuing operations. Back-up servicers are typically debt collection agencies.

2.6 Investors

Investors are usually large, international institutions. Pursuant to the EU Securitisation Regulation, the investors are obliged to conduct due diligence on the securitisation transaction prior to investing. The investors generally act as passive holders of the notes, but in certain situations they may be called upon to vote on certain matters, such as amendments to the main transaction documents or enforcement actions.

2.7 Bond/Note Trustees

An agent or bond trustee is usually appointed to manage the practical relationship between the SPE on the one hand and the investors on the other. The agent usually receives the reports to be distributed to investors and the SPE primarily communicates with the agent while the transaction is ongoing. If there is only one lender, there is no need to have an agent or bond trustee.

2.8 Security Trustees/Agents

The security agent or security trustee is entered into the transaction security documents as a representative of the secured creditors and holds the security assets on behalf of the secured creditors. The security agent or trustee also carries out enforcement of security and represents the secured creditors collectively in matters relating to the enforcement process. Finnish law does not have a concept of trust or trustee and, from a Finnish law perspective, a party appointed as security trustee acts as an agent and representative of the secured creditors.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The asset purchase agreement is the primary document used to effect a bankruptcy-remote transfer of assets. It typically contains the transfer and perfection mechanics, the purchase price, the eligibility criteria, representations and warranties relating to the business of the seller and the purchaser as well as the underlying assets, possible repurchase mechanisms (which need to be limited in scope to achieve a true sale), covenants, indemnity for breach of representations and covenants, the conditions and mechanism for further purchases, jurisdiction and dispute resolution information. It is common for the asset purchase agreement to be governed by the laws of the place where the assets are located and for the courts of that same place to have jurisdiction.

3.2 Principal Warranties

The seller's warranties typically relate to the seller as a corporate entity on the one hand and to the securitised assets on the other hand. The seller warrants through corporate warranties that

it has the legal and factual ability to enter into the contemplated transactions. The seller's warranties relating to the assets typically relate to the quality of origination, the eligibility and quality of the assets and underlying debtors, and certain tax matters.

The purchaser also typically gives certain corporate warranties, but these are more limited than the seller's warranties and generally relate to its corporate powers and tax presence in Finland.

If the parties wish to achieve a simple, transparent and standardised (STS) securitisation under the EU Securitisation Regulation, certain additional warranties are given to cover the matters required for the assets and the transaction to meet all STS requirements.

Breach of a corporate warranty, if not remedied, could result in a default by the breaching party and an early termination or amortisation of the transaction. Breach of eligibility criteria and asset warranties will typically result in an obligation to repurchase and replace the affected asset.

3.3 Principal Perfection Provisions

The specific perfection measures required for a valid and enforceable transfer of assets depend on the type of assets to be securitised. In Finland, an undisclosed transfer of receivables is not effective other than between the parties. Therefore, a notice to the underlying debtor is always required for a perfected transfer of receivables. The underlying debtors should also be instructed to make payments to the transferee instead of the transferor. A general requirement for a perfected transfer of assets is that control of the assets is vested with the transferee. It is also important to ensure that the incoming collections are not commingled with the assets of the transferor. In practice, a new collection account is usually opened in the name of the SPE to receive collections. If the securitised assets are receivables secured by collateral, the related collateral should generally also be transferred to the transferee.

The parties agree in the asset purchase agreement and the relevant security documents on the nature and timing of perfection measures. If the party required to complete a perfection measure fails to do so, certain other transaction parties are usually authorised to complete such measures on their behalf. Unlike in certain other jurisdictions, perfection measures in Finland should always be taken without delay. Accordingly, it is not feasible to delay perfection until a trigger event in transactions involving Finnish assets.

3.4 Principal Covenants

Typically, the SPE's activities will be limited by negative covenants in the debt documents that restrict it to the role of a securitisation SPE. The covenants in the asset purchase agreement generally relate to maintaining the seller's and the purchaser's ability to comply with their respective obligations under the asset purchase agreement. A breach of covenants, if not remedied, may result in an early termination or amortisation of the transaction.

3.5 Principal Servicing Provisions

The main document governing servicing is the servicing agreement. The SPE and the security agent, as part of their respective roles, appoint the servicer to carry out its tasks during the transaction. The servicer's primary tasks include:

- reporting on the receivables and the collections;
- maintaining records;
- processing personal data with respect to the securitised portfolio; and

- making payments from the collection account to the transaction account.

The servicing agreement also contains provisions on servicer default and termination and replacement of servicer.

3.6 Principal Defaults

The principal defaults and their effects in securitisation documentation are slightly different for each transaction party, but generally the default is triggered by insolvency, a ratings downgrade or failure to comply with transaction documents. If the SPE defaults, the notes become payable, transaction security becomes enforceable and the transaction switches to post-enforcement priority of payments. If the servicer defaults, it is replaced by the back-up servicer. If the originator defaults, any revolving period ends and the seller is no longer able to sell further assets to the SPE.

3.7 Principal Indemnities

The principal indemnities in a securitisation relate to the seller indemnifying the SPE against any breach or misrepresentation by the seller. These indemnities are typically included in the asset purchase agreement.

However, to achieve a true sale, it is crucial that the seller does not indemnify the SPE for any losses resulting from the inability or unwillingness of the underlying debtor(s) to make payments.

The various external service providers, including in particular the agent and security trustee, will typically demand that they receive customary indemnities against any claims that arise from them performing their respective services.

3.8 Bonds/Notes/Securities

The main liability documents can be in any form that the parties structuring the transaction consider appropriate for the transaction. In a public transaction, the liability documents are in the form of listed notes. In a private transaction, the main liability document is usually a loan facility agreement or variable funding note issuance facility agreement. These documents regulate the terms of the funding provided by the investors or lenders to the SPE.

3.9 Derivatives

The types of derivatives commonly used are for interest rate hedging and, if relevant, currency hedging.

3.10 Offering Memoranda

If the securities are listed, a prospectus compliant with Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market is required. If the transaction falls within the scope of the EU Securitisation Regulation, a transaction summary is required if no prospectus is prepared.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Detailed and specific disclosure requirements are contained in EU Securitisation Regulation and its delegated rules and regulatory guidelines and technical standards.

The due diligence and transparency provisions of the EU Securitisation Regulation impose obli-

gations on originators, SPEs and sponsors to provide detailed disclosure, and on investors to seek such disclosure. The disclosed information includes the prospectus or transaction summary, transaction documents, initial and ongoing loan-level data and information on certain exceptional events affecting the securitisation transaction throughout the life of the transaction.

4.2 General Disclosure Laws or Regulations

This is not applicable in Finland.

4.3 Credit Risk Retention

The EU Securitisation Regulation requires the originator, sponsor or original lender to retain a material net economic interest in the securitisation transaction of not less than 5%, on an ongoing basis. The regulation sets out the permitted methods for risk retention, which include retaining 5% of the first loss tranche or 5% of randomly selected exposures that would otherwise have been part of the securitisation. The national competent authorities, including the Finnish Financial Supervisory Authority (FIN-FSA) in Finland, are tasked with supervising the satisfaction of the risk retention requirement, and non-compliance will trigger administrative sanctions.

4.4 Periodic Reporting

The EU Securitisation Regulation imposes periodic reporting requirements on loan-level data on a quarterly basis for transactions that are not asset-backed commercial paper programmes, and on a monthly basis for transactions that are. Sometimes, the parties will voluntarily agree on a more frequent reporting interval than required under the regulation – for example, if the investor itself is an asset-backed commercial paper conduit subject to the more frequent reporting interval. The European regulatory authorities issue technical standards and guidance on the form and contents of reporting and the national competent authorities, including the FIN-FSA in Finland, are tasked with supervising the satisfaction of the reporting requirements.

4.5 Activities of Rating Agencies

The EU Credit Rating Agencies Regulation (Regulation (EU) No 462/2013 amending regulation (EC) No 1060 on credit rating agencies) and its delegated rules and guidelines regulate the activities of rating agencies in the European Union, including Finland. Any firm that is established in the EU and carrying out credit rating activities without being registered with the European Securities and Markets Authority (ESMA) is operating in breach of the regulation and will be subject to supervisory measures and fines. Any firm that is registered with and certified by ESMA to act as a rating agency but fails to comply with the ongoing requirements of the regulation may be subject to an investigation resulting in public notices, fines and withdrawal of registration.

4.6 Treatment of Securitisation in Financial Entities

The capital, liquidity and risk rules that apply to credit institutions and investment firms are set out in Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the EU CRR) and its related directives, implementing domestic legislation, regulations and guidelines. Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (“Solvency II Recast”) and its implementing domestic legislation, regulations and guidelines set out the capital and liquidity rules that apply to insurance undertakings. The treatment of securitisation positions under capital, liquidity and risk rules is regulated by these pieces of legislation in detail, including

the calculation of regulatory capital to be held with respect to securitisation exposures.

4.7 Use of Derivatives

The use of derivatives under the EU Securitisation Regulation is limited to hedging the SPE's interest and currency risk. The key piece of legislation that applies to the use of derivatives by SPEs in securitisation transactions is Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, as amended and recast (the "EMIR Recast"). The EMIR Recast contains requirements to report detailed information on each derivative contract to trade repositories and make the same available to supervisory authorities, and generally to clear all standardised OTC derivatives contracts centrally through a central securities depository, or to apply risk mitigation techniques.

4.8 Investor Protection

The EU Securitisation Regulation provides that securitisations may only be sold to retail clients subject to a suitability test. Furthermore, the mandatory provisions of the EU Securitisation Regulations regarding investor due diligence, reporting, risk retention and a ban on resecuritisation are all designed to protect investors and promote stability in the securitisation market. The provisions of the EU MiFID, EU Market Abuse Regulation, Prospectus Regulation and other applicable securities markets legislation must also be taken into account when selling securitisations. In addition, Finnish consumer protection legislation on the sale of financial instruments may become applicable. The national competent authorities, including the FIN-FSA in Finland, are tasked with supervising compliance with the investor protection provisions. Penalties for non-compliance include prohibition on operations, administrative fines, or criminal liability in certain cases.

4.9 Banks Securitising Financial Assets

The Finnish act on credit institutions (610/2014, as amended, implementing the EU CRR and CRD regime in Finland) regulates certain aspects of banks securitising their assets and investing in securitisation positions.

Finland is a covered bond jurisdiction. The Finnish act on mortgage banks and covered bonds (151/2022) regulates the licensing of mortgage banks in Finland and the issuance of covered bonds by Finnish mortgage banks. The act sets out requirements on certain operational matters and structures of covered bonds and their permitted collateral. It also regulates the disclosure requirements to investors and the treatment of covered bonds following the insolvency of the mortgage bank.

4.10 SPEs or Other Entities

In Finnish transactions, the SPE is usually established offshore in an EU jurisdiction that is commonly used for SPE structures. Where the SPE is a Finnish entity, the legal entity is generally formed as a limited liability company, although it has been suggested in literature that a limited partnership might also be suitable. In Finland, the companies act does not specifically cater for special purpose entities, but it is in principle possible to include provisions in the SPE's articles of association regarding its purpose and, for example, winding-up. Limited recourse and non-petition provisions may also be included in the articles, but their enforceability is limited.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Where the SPE is established in Finland, it should avoid activities that would trigger licensing or registration requirements – for example, taking deposits or other repayable funds or originating new loans. Penalties for conducting activities

without an appropriate licence or registration include prohibition of activities and administrative fines imposed by the relevant supervisory authority, usually the FIN-FSA.

4.12 Participation of Government-Sponsored Entities

Historically, Finnish government and municipality-sponsored entities have actively participated in the securitisation market, but there has been no notable market activity by publicly sponsored entities since the mid-2000s.

4.13 Entities Investing in Securitisation

Investors in Finnish securitisation transactions are typically large European institutions or their affiliates.

4.14 Other Principal Laws and Regulations

The Finnish Promissory Notes Act (622/1947, as amended) contains provisions that regulate, for example, transfer perfection requirements and the underlying debtor's right to make payments or set off their receivables. Many of these provisions apply regardless of whether or not the seller is a bank or other financial institution, but some of the rules are different for banks and other financial institutions compared to non-financial originators.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisation is permitted under the EU Securitisation Regulation, which sets out the rules for such securitisations.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

If the originator becomes insolvent and is placed in insolvency proceedings, all transactions it concluded before the insolvency proceedings are reviewed carefully by the insolvency officer for any weaknesses that would enable the insolvency officer to demand the return of assets to the insolvency estate.

Under Finnish insolvency laws, the legal grounds for such demand for return primarily consist of sham transactions and transactions at undervalue, as well as so-called claw-back grounds, where transactions concluded during a specified period before insolvency may be revoked if they meet certain objective criteria set out under law. Claw-back grounds include improper preference of a particular creditor over other creditors, payment by unusual means and delayed granting or perfection of security.

In addition, where a transaction's true factual nature does not correspond to its supposed form, the form may be ignored and the transaction may be recharacterised to fit its true nature. Recharacterisation may result in the counterparty of the transaction having to return all or some of the assets that it received from the insolvent party.

6.2 SPEs

The SPE's exposure to external liabilities should be limited to achieve bankruptcy remoteness, meaning that the SPE and its assets should be safe from bankruptcy proceedings. The SPE should be established specifically for the transaction and not have any business activities or liabilities beyond the securitisation transaction. Its only function is to purchase the securitised

assets, issue the notes to fund the purchase of assets and passively hold the assets for the duration of the transaction. The SPE should not have any employees.

In Finland, there is no legal consolidation of an SPE or its assets in the insolvency of the originator as such, but transactions with related parties are scrutinised more closely and subject to longer claw-back periods than transactions between unrelated parties. For this reason, it is preferable for the SPE to be unrelated to the originator. In private securitisation transactions, the parties will sometimes take a conscious risk to deviate from one or more aspects that ensure the bankruptcy remoteness of the SPE – for example, by using an SPE held by the originator group and not an orphan SPE.

6.3 Transfer of Financial Assets

To avoid the securitisation transaction falling into any of the above-described traps in the event of the insolvency of the originator, the transaction should be structured so that the transfer of assets away from the originator is legally valid and enforceable even if the originator becomes insolvent and so that no aspect of the asset transfer can be avoided, revoked or recharacterised under insolvency laws to the detriment of the SPE and investors.

To ensure that the transaction is not recharacterised as a secured loan transaction, the transfer of assets from the originator to the SPE should meet the requirements for a legal true sale. For a legal true sale, it is generally required that the transaction seeks to irrevocably transfer title to – and risk of – the assets to the SPE and not, for example, to create a secured financing transaction that is meant to be unwound once the financier has received payment. There is no specific legislation on true sales: the criteria are discussed in legal doctrine, but not in a clear or definitive manner. A true sale is assessed as a whole, considering all relevant facts and circumstances of the transaction either supporting a true sale or speaking against it. Legal opinions are typically obtained to confirm the validity and enforceability of a transaction, and to assess its true sale nature. Due to the lack of definitive rules, the Finnish true sale opinion is a reasoned or discussing opinion.

6.4 Construction of Bankruptcy-Remote Transactions

Legal opinions will typically address certain aspects of insolvency laws that are critical to the assessment of the bankruptcy remoteness of the transaction, such as rules on the avoidance or revocation of transactions in the event of the insolvency of the originator.

6.5 Bankruptcy-Remote SPE

Limited recourse and non-petition provisions are included in the constitutional documents and transaction documents to safeguard the SPE against legal action and insolvency filings that could jeopardise the transaction. However, the effectiveness of such provisions may be limited by general principles of law with respect to a Finnish SPE.

The transaction cashflows need to be modelled and reserves need to be sized such that the SPE's liquidity is ensured.

7. Tax Laws and Issues

7.1 Transfer Taxes

There is no transfer tax on the transfer of receivables, assuming that the receivables do not qualify as securities for transfer tax purposes. There are no stamp, registration or similar taxes

in connection with the execution of securitisation transaction documents.

7.2 Taxes on Profit

Finnish tax issues are typically mitigated by establishing the SPE offshore. Finnish corporation tax is assessed in accordance with territorial limitations, such that a company may only be assessed to Finnish corporation tax to the extent that it is:

- resident for corporation tax purposes in Finland; or
- carrying on a trade in Finland through a Finnish permanent establishment (which generally excludes agents of independent status acting in the ordinary course of their business).

In addition, a non-Finnish resident company that does not have a branch or permanent establishment in Finland may be liable to Finnish income tax on certain Finnish source income, subject to the provisions of an applicable double tax treaty.

Neither a permanent establishment nor any other charge to Finnish income tax would generally be expected to arise for the SPE solely as a result of purchasing Finnish receivables and appointing a servicer to service them. In public securitisation transactions, it is common to seek an advance tax ruling confirming that no permanent establishment will arise for the SPE in Finland as a result of the transaction.

7.3 Withholding Taxes

Withholding tax is generally not levied on any payments on receivables to a non-Finnish resident purchaser.

7.4 Other Taxes

Certain goods and services are excluded from VAT, such as financial and insurance services. The purchase of receivables would generally qualify for this exemption. Servicing and debt collection are generally subject to Finnish VAT at the standard rate (currently 24%). However, services that are not deemed to be supplied in Finland for VAT purposes are not subject to Finnish VAT. With respect to certain types of collateral assets, the SPE may be liable for VAT in Finland for the realised profit margin in connection with an enforcement action against the underlying debtor.

7.5 Obtaining Legal Opinions

It is common for the transaction parties to seek customary tax opinions and for such opinions to be qualified by standard assumptions and qualifications – for example, to the effect that the tax authorities may change their interpretation or application of the provisions of law or regulations in the future.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The off-balance sheet treatment analysis of accounting and the legal true sale analysis have many features in common and the conclusions are frequently the same, but not always. The lawyers advising the transaction parties will conduct their analysis based on the transaction documents and applicable legal rules, and the seller's and purchaser's accountants will conduct their own analysis following the applicable accounting rules. Accordingly, it is possible to reach off-balance sheet treatment without a legal true sale and vice versa.

8.2 Dealing with Legal Issues

The lawyers advising on a securitisation transaction are usually required to opine on the legal

true sale nature of the transaction. As there are no definitive rules on what constitutes a legal true sale, the opinion is a reasoned or discussing legal opinion.

Trends and Developments

Contributed by:
Maria Lehtimäki, Niklas Thibblin and Timo Lehtimäki
Waselius & Wist

Waselius & Wist is an independent Helsinki-based business law firm that provides services in all areas of business law with efficient teams and partner involvement throughout the assignment, combining specialist expertise with generalist training and international experience. The banking and finance and capital markets team has three partners and ten other qualified lawyers. Waselius & Wist advises market participants on transactions and regulatory matters relating to loans, securities, hybrid instruments, crypto, alternative investment funds and collective investment schemes, securitised products, investment services, securities trading, share buy-backs, netting, clearing and settlement, derivatives and associated matters of company law and taxation, working together with the tax structuring team. The firm is a key player in shaping the Finnish securitisation market and promoting discourse between issuers and regulators. It advises clients such as Santander Consumer Finance and LocalTapiola Finance on the structuring and execution of internationally known hallmark securitisation transactions.

Authors

Maria Lehtimäki is a partner in the banking and finance and capital markets team at Waselius & Wist, and steers the firm's securitisation practice. She is a member of the Finnish Bar Association, and joined the firm in 2012 after obtaining her Master of Laws from the University of Helsinki. Maria has also spent time at Cravath, Swaine & Moore, working on capital markets transactions. She advises market participants on cross-border financing and capital markets transactions and regulatory matters. A key area of her practice is structured finance across a variety of asset classes and industries, including automotive and aviation.

Niklas Thibblin is the managing partner of Waselius & Wist and head of the tax and structuring practice. He is a member of the Finnish Bar Association, and joined the firm in 2000 after obtaining his Master of Laws from the University of Helsinki; he has been a partner since 2009. Niklas has also spent time at Loyens & Loeff in Rotterdam and Luxembourg, working on various international tax issues. He has extensive experience in structuring demanding cross-border transactions, including securitisation transactions.

Timo Lehtimäki is a partner and head of the banking and finance practice at Waselius & Wist, whose primary focus is on demanding cross-border transactions. His clients include numerous leading international banks, other lending entities, private equity houses and corporates, which he advises on their Finland-related matters. Timo's key areas of expertise include financing transactions, asset-based lending and bond issuances. He joined the firm in 2007 and the partnership in 2013, and is a member of the Finnish Bar Association.

Waselius & Wist

Eteläesplanadi 24 A
00130 Helsinki
Finland

Tel: +358 9 668 9520
Fax: +358 9 668 95222
Email: ww@ww.fi
Web: www.ww.fi

WASELIUS & WIST

Contributed by: Maria Lehtimäki, Niklas Thibblin and Timo Lehtimäki, **Waselius & Wist**

The Introduction of Securitisation in Finland

Almost as soon as it was first introduced to the USA and global markets, Finland embraced securitisation; similarly to the way it took to extreme winter sports and auto racing: boldly, head-on and with decent success. The first issuers of securitisation transactions in the markets were publicly sponsored. These transactions by municipal and government bodies were structured like private transactions, although it was common to have publicly guaranteed elements, which resulted in very favourable ratings and rates on the senior tranches. Government-sponsored securitisation of social housing loans through the popular "Fennica" series was also one of the key tools used to rehabilitate the public balance sheet in preparation for Finland joining the European Monetary Union.

These government-sponsored and municipal-sponsored deals were soon joined by private originators of financial assets; ranging from trade receivables and corporate and consumer loans to whole businesses and paper and forest assets. Although deal volume and size did not even nearly rival those of larger economies, it can be said that the market was active from the early 1990s to late 2000s until the global financial crisis. However, bank originators were conspicuously absent from that market, for reasons that will be examined below.

Post-crash – the Lead Into the Current Market

Despite the dubious reputation securitisation holds (in some quarters) as the irresponsible instrument that caused the financial crisis of 2008, in Finland securitisation next reared its head in the aftermath of the global financial crisis. As many former banking relationships had been through choppy waters and many of those ships had sunk without hope for meaningful salvage, traditional Nordic-style "relationship banking" held less sway and borrowers were on the lookout for alternative and diversified sources of financing.

Many non-bank lenders and corporates found an exciting opportunity to obtain funding at attractive rates through private securitisation transactions, and in one case, an auto lender through a successful annual public asset-backed securitisation (ABS) series that has continued for a decade. That series was recently joined in the market by another popular auto warehouse and ABS series, finessing the structure and issuing both private and public transactions even more frequently while raising some EUR3 billion over just two years. Bank originators were, however, still nowhere to be seen.

Drivers Behind Legislative Development

Securitisation has never been subject to specific domestic legislation in Finland, which has been both a blessing and a curse for the development of the market. The lack of a clear legislative framework for securitisation is perhaps one of the main reasons why prudentially supervised issuers like credit institutions have had a difficult time tapping the market. At the same time, that same lack of legislation led to the flexibility of approach that enabled non-bank lenders and corporates to come up with innovative deal structures.

Initially, there were both pull and push reasons for credit institutions to enter the market – banks were both curious on their own accord and driven by external circumstances to explore securitisation as a tool for capital management. In Finland, the 1980s were a time of monetary and economic liberation, culminating into a wild era of "casino economics". Lending and borrowing from domestic and international sources had

been deregulated and the domestic currency was maintained at an artificially strong level. Domestic banks' balance sheets were becoming bloated, and the prudential regulator was beginning to take issue. At the introduction of Basel I in 1988, domestic banks were forced to look at ways to manage capital adequacy. Many plans to launch real estate mortgage-backed securitisations (RMBS) were promptly put in place, some of them progressing all the way to agreed form. However, since there was no clear legislation in place, every single one of these plans was ultimately abandoned due to structuring difficulties or escalating disagreements with the authorities – both the financial supervisory authority and the tax authority.

At the turn of the 1990s, as the housing bubble burst and the market fell into a depression worse than that of the 1930s. Securitisation was not to blame, nor was it blamed. On the contrary, the government saw securitisation as a potential tool to help the economy recover.

Consequently, the Ministry of Environment's Housing Department set up a task force that issued a discussion paper on the need to update domestic legislation to enable and facilitate securitisation transactions. The outcome of that discussion paper was the conclusion that there were in fact no obstacles to securitisation in the current legislative framework and therefore no need for any legislative change. However, the discussion paper did call for the financial supervisory authority to set out guidance to make securitisation clearer and easier. These guidelines were issued a few years later. Updates to the Basel framework resulted in additional guidance on the capital requirements in connection with securitisations in 2006. These guidelines remained the primary source of guidance until the introduction of the EU Securitisation Regulation and its entry into force in 2018.

EU Securitisation Regulation

After the global financial crisis, regulators and pundits across the world and Europe, alarmed at its detrimental effects, spoke about the need to rein in unchecked securitisation activity. This discourse ultimately resulted in the EU Securitisation Regulation. In Finland, securitisation was never a dirty word, as outcomes for investors were generally quite positive during and after the crisis. Nonetheless, the outcome of these global developments was that there was now a firm legislative framework for many aspects of securitisation that became directly applicable law in Finland. Through the introduction of the EU Securitisation Regulation, securitisation turned from something a little complicated and obscure into a relatively simple, standardised and transparent process.

Legislative Status Quo in Finland

Today, the EU Securitisation Regulation and its delegated acts and regulatory guidelines issued by pan-European authorities are the main rules that govern securitisation in Finland. Although it is undisputed that securitisation is a specific type of instrument that serves a specific purpose with the EU Securitisation Regulation as the main legal source of regulation, the questions relating to the effectiveness of asset transfers and security take are based on traditional domestic legislation governing asset transfers and security take generally, and general domestic insolvency legislation forms the parameters and perimeters for bankruptcy-remote structures and transactions in Finland. The concept and definition of "true sale" remains mostly a topic of academic legal doctrine, which is both theoretical and complicated with some of it being outdated as well as conflicting. Further uncertainties that

arise from general company law and tax law – which are suitable for most economic activity, but not specifically designed to cater for securitisation – create additional pressure that drives many structures to other EU jurisdictions that are more familiar to investors and where there is greater legal certainty.

Of course, as described above, this has been the case for the entire history of securitisation in Finland and has not prevented market participants from successfully completing many securitisation transactions that have withstood economic cycles of boom and bust. The government bodies have time and again concluded that the legislative status quo is acceptable. Nonetheless, the lack of a clear and suitable legislative framework creates high transaction costs and execution uncertainty. Seeing the practical hurdles and finding ways to cross those hurdles, it is easy to say that further development of the Finnish securitisation market would be served by specific legislation that addresses the issues that the EU Securitisation Regulation is unable to – owing to the lack of competency of the European Union under the EU constitutive treaties.

Competition From Covered Bonds

In the early 2000s, the first iteration of the Finnish Act on Mortgage Banks was introduced to regulate the issuance of covered bonds. Although covered bonds do not offer the same capital management opportunities as securitisation – as the cover pool remains on the bank's balance sheet – their clarity and ease, and consequently relatively low transaction costs, made covered bonds the go-to instrument for mortgage banks. The trend continues to date and Finland, with the other Nordic countries, is a strong covered bonds jurisdiction. Nonetheless, the ongoing tightening of prudential and regulatory requirements has already led to some Nordic banks tapping the securitisation market and further forays are expected.

Where the Market is Now and What Next?

Nowadays, unsecured consumer loans and trade receivables are typically securitised privately, and the transaction structure is typically less complicated than in public deals. The public deal space currently consists of auto ABS transactions. The prevalence f auto ABS is explained by the availability of good quality assets and the fact that there is already industry precedent paving the way for new issuances. The availability and quality of assets is explained by geopolitical circumstances – Finland is a sparsely populated country with a large land mass and personal transportation is a necessity in most parts of the country. Finns are notoriously good at paying their auto debt and it is said that a Finnish consumer would rather lose their house than the wheels in front of it, and there may be some truth to this as auto finance default rates are at record lows when compared to European and global levels. However, as the instrument is becoming more familiar to originators and investors, it looks likely that there will be more issuers and a larger variety of assets coming onto the market.

After a long period of negative reference rates, the new interest rate environment combined with the tumultuous geopolitical climate put a temporary hold on public ABS issuances in early 2023. However, issuers gained momentum with warehousing structures, and some of these are now primed for exit into the public ABS market. One ABS issuance has already occurred in 2023. Assets have adjusted to the new interest rates and market participants have again remembered that it is in fact normal to pay some interest on debt funding. Publicly available precedents show the way for new first-time issuers. Fully

private transactions with no intention for a public ABS exit, will, however, remain popular for smaller portfolio sizes due to a lack of commercial feasibility for a public transaction.

Simple, transparent and standardised (STS) transactions were first introduced by the EU Securitisation Regulation on the true sale side and expanded into the synthetic transaction space by the 2019 amendment. Seeking the STS label is an investment made by the originator to show the quality of the transaction and can shave off a significant number of basis points from the pricing of deals. In Finland, the first STS transactions were issued quickly after the entry into force of the regulation and have caught on in both public and private deals.

Synthetic securitisations are not yet commonplace in Finland, but it is expected that more synthetics will be seen after the first few examples. Synthetic securitisations are used for capital and risk management purposes by transferring the risk of the underlying exposures to a counterparty by derivative or other instruments without a true sale of the assets. Nordea Bank has explored synthetic risk-sharing transactions in several Nordic jurisdictions and, in 2022, the Finnish bank entered into a multi-billion STS-labelled, synthetic risk sharing transaction covering corporate loan exposures across Denmark, Finland, Norway and Sweden.

ESG will be a topic of increasing importance in future transactions, with a primary focus on the environmental part. The European Banking Authority released a framework for sustainable securitisation, including an update on the sustainability-related disclosures and due diligence requirements for securitisation products. The work seeks to conform the EU Securitisation Regulation with the sphere of the broader European environmental, social and governance regulatory development. While this important work is ongoing and encompasses a multitude of issues ranging from ethical and philosophical to practical and quantitative, we are starting to see practical ripples in actual transactions.

The European Problem

Statistically, when compared with global securitisation markets, the fact is that European markets remain underdeveloped in terms of the number of issuances, as well as aggregate issue size in comparison to the size of the economy. Within Europe, the Nordic markets are among those with least activity. It is believed that one of the primary reasons is the heterogenous nature of domestic legislation and regulation – what works in a neighbouring jurisdiction with otherwise very similar political, cultural and economic circumstances, may not work at all in another jurisdiction. Consequently, it is difficult to develop structures that have scalability across jurisdictions.

The legislative problem is exacerbated by the national competent authorities' divergent supervisory agendas, practices and interpretations of the common European regulatory framework. Today, the main common feature among the European regulators seems to be either suspicion of or indifference to securitisation. However, the European Securities and Markets Authority has commenced a review of the national competent authorities with a view to remedying unhelpful or harmful supervisory practices. There is hope that this process will remove some obstacles to unlocking the hidden potential in the European markets for a larger and better functioning securitisation market.

GERMANY

Law and Practice

Contributed by:
Andreas Lange, Kirsten Schürmann, Susan Günther and Dr Patrick Scholl
Mayer Brown LLP

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Mayer Brown LLP has more than 100 structured finance lawyers in offices across the Americas, Asia and Europe and one of the largest structured finance practices in the world – and with that size comes the knowledge, experience and manpower to tackle transactions of any scale in any jurisdiction. The firm carried out the first CLO transaction in 1988, the first partially enhanced multi-seller commercial paper conduit in 1989 and the first TSI-certified securitisation in Germany (Driver One) in 2004. It has experience in the conduit, CDO and synthetic markets, and expertise in the areas of securitisation of intellectual property and non-performing loans, securitisation as an acquisition financing tool, large rescue structures for distressed assets or structured credit products and other hybrids or derivatives. Globally, Mayer Brown advises intensively on auto-related securitisations. Its German securitisation practice advises on all aspects of securitisation and structured finance transactions, including trade receivables securitisations, factoring and asset-based lending transactions.

Authors

Andreas Lange is a banking and finance partner in Mayer Brown's Frankfurt office and focuses on securitisation, regulatory banking law, derivatives and other asset-backed financing forms. He advises predominantly in the area of securitisation (loan, lease and trade receivables), ABCP and other types of asset-backed financing, including asset-based lending, factoring and supply chain finance. He also has considerable experience in derivatives, loan financing and regulatory questions.

Kirsten Schürmann is of counsel in the Frankfurt office of Mayer Brown's banking and finance practice. She advises on banking and finance, securitisation and capital markets issues. Kirsten has experience in national and international matters across a broad spectrum of asset-based lending transactions, securitisation transactions (with a focus on German auto loan, consumer loan and trade receivables) and distressed debt transactions, as well as supply chain finance.

Susan Günther advises Mayer Brown's national and international clients on all aspects of tax law related to the structuring and implementation of M&A, real estate transactions, and securitisation transactions. Furthermore, Susan has extensive experience advising insurance companies and insured parties in connection with entering into W&I insurances and special tax insurance products. Susan is dual-qualified as a lawyer and a tax consultant (Steuerberater) and is a certified advisor for international tax law (Fachberater Internationales Steuerrecht). She has lectured on German tax law at the Frankfurt School of Finance and Management.

Dr Patrick Scholl is a partner and head of Mayer Brown's German debt capital markets practice and advises on debt capital transactions, debt issue programmes, derivative products, synthetic securitisations and repackagings. He regularly advises on securitisations, with a focus on synthetic structures as well as on bond issues, Schuldschein loans and registered notes (Namensschuldverschreibungen), buy-backs, and structured notes platforms. Patrick is heavily involved in equity-linked, credit-linked, fund-linked, commodity-linked and other derivatives, including repo and stock lending, master agreements for derivatives, collateralised derivatives and retail structured products.

Mayer Brown LLP

Friedrich-Ebert-Anlage 35-37
60327 Frankfurt am Main
Germany

Tel: +49 69 7941 0
Fax: +49 69 7941 100
Email: alange@mayerbrown.com
Web: www.mayerbrown.com

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1. Specific Financial Asset Types

1.1 Common Financial Assets

German securitisations refer to a wide range of financial assets, most commonly bank loan receivables, consumer loan receivables, auto loan receivables, auto lease receivables, SME loans or trade receivables. Due to the strong standing of German covered bonds (Pfandbriefe), true sale commercial mortgage-backed securities (CMBS) or residential mortgage-backed securities (RMBS) are less common in the German market. However, synthetic CMBS, RMBS or ship portfolio securitisations are used in the German market with a focus on regulatory risk transfer. In contrast to other jurisdictions, credit card or student loan securitisations are not relevant in Germany. For legal reasons, whole-business securitisations or the securitisation of operating lease receivables are also difficult to implement.

1.2 Structures Relating to Financial Assets

The basic structure of a German securitisation transaction does not generally change based solely on the underlying securitised financial asset. The usual structure involves the separation of assets in the form of true sale or by derivatives (in a synthetic securitisation). For true sale, very often an orphan SPV is used in a tax favourable jurisdiction. The SPV refinances itself through notes or loans, uses – if required – hedging instruments and externalises the different tasks which an SPV/purchaser has to fulfil. A trustee will hold all assets of the SPV to enhance the insolvency remoteness of the structure.

A driver for the securitisation of bank assets is the originator's intention to utilise ABS bonds as European Central Bank (ECB) collateral. It is therefore essential, in particular for retained transactions, that such transactions comply with the ECB's collateral requirements.

In line with the ECB's collateral eligibility criteria, securitisations of German credit institutions comply with the ECB's loan level templates. The eligibility of assets is assessed by the national central banks (NCBs) according to the criteria specified in the Eurosystem legal framework for monetary policy instruments. Detailed rules governing the individual eligibility criteria for eligible assets can be found in Part Four of Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (recast) (ECB/2014/60), as last amended.

The examination of whether an ABS issuance complies with applicable eligibility criteria is done by the relevant NCB in the country of admission to trading. The NCB verifies the eligibility of the bonds to be submitted as collateral with the participation of the NCB bank in the originator's country. In the case of eligible bonds, the decision is announced and the bonds are listed on the Eligible Assets Data Base (EADB) website of the ECB.

Expected new structures can be described as sustainable or green ABS. In June 2022, the European Banking Authority (EBA) issued a report on developing a framework for sustainable securitisations to explore whether and how EU regulations on sustainable finance, including the EU Green Bond Standard, the EU Taxanomy and Sustainable Finance Disclosure Regulations can be applied. Prior to the establishment of a dedicated framework for green securitsations, green ABS is mostly used as a label for securitising green assets (ie, financial assets originated from the financing or leasing of zero-emission vehicles). Due to the dominance of covered

bonds (Pfandbriefe) in the German market, it is expected that green RMBS or CMBS will be less relevant compared to other markets. It is also expected that green or social securitisations will be enhanced by investors dedicated to green or social investment standards.

In May 2023, the EBA issued a final report on draft regulatory technical standards with regard to the content, methodologies and presentation of disclosures in respect to the sustainability indicators in relation to the adverse impacts of the assets financed by the underlying exposures for simple, transparent and standardised (STS) securitisations on the climate and other environmental, social and governance-related adverse impacts pursuant to Article 22(6) and 26d(6) of 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 648/20122 (the "Securities Regulation" or SR).

1.3 Applicable Laws and Regulations

The structure set out in **1.2 Structures Relating to Financial Assets** is mainly driven by the requirements of German civil law in the form of the German Civil Code (eg, transfer of assets), German insolvency law in the form of the German Insolvency Act (*Insolvenzordnung*), German tax law dealing with income tax, value added tax and trade tax and a couple of regulatory requirements, which are set out in more detail in **4. Laws and Regulations Specifically Relating to Securitisation**.

1.4 Special-Purpose Entity (SPE) Jurisdiction

SPEs are either located in Germany, which is becoming more and more rare (eg, in the case of a bank loan, auto loan or consumer loan securitisations) or outside of Germany (eg, in the case of auto leases or trade receivables) – mostly Luxembourg, Ireland and the Netherlands. The choice of appropriate SPE jurisdiction is driven mainly by tax considerations, set-up and maintenance costs, reliability in the market participants and confidence in the legal system's ability to ensure a ring-fencing of the assets.

1.5 Material Forms of Credit Enhancement

German securitisations can benefit from various forms of credit enhancement. In public deals these are mostly subordination, over-collateralisation, cash reserves (funded by sub-loans) or excess spread. Credit insurances are also used in trade receivables transactions and liquidity facilities (mostly fully supported) in conduit transactions. However, if the issuer retains a significant interest in the credit risk attached to a sold and transferred financial asset (eg, in the case of subordinated and deferred purchase price payment), there is a risk that the transfer of a sold and assigned receivable under a receivables purchase agreement could be questioned and re-characterised as an assignment of receivables for security purposes (*Sicherungszession*) – ie, as a secured lending transaction – with respect to receivables that will be purchased on a recourse basis because the economic risk of the receivables would remain with the seller. In addition, there is a risk that the sale would not qualify as a cash transaction (with equivalent payment consideration for the sale of receivables) and thus could be a voidable transaction.

This risk should be mitigated if the terms of the receivables purchase do not have the economic effect that the credit risk (*Delkredererisiko*) of the receivables has been factually retained by the seller, despite the sale and assignment of them. This would be the case if the credit risk participation retained by the seller (due to, retained purchase price provisions, default risk reserves, etc) were not at arm's length for a non-recourse receivables sale. It should be noted in this context that retained dilution reserves or yield reserves or deemed collections due to broken representations and warranties will not impact the German legal true sale analysis.

Credit enhancement means a contractual arrangement whereby the credit quality of a position in a securitisation is improved in relation to what it would have been if the enhancement had not been provided, including the enhancement provided by more junior tranches in the securitisation and other types of credit protection (Article 4 (1) 65 of the Capital Requirements Regulation (CRR)).

Credit enhancement can be provided to a securitisation transaction in various forms, for example:

- the subordination of junior notes or the granting of subordinated loans to the issuer;
- deferred purchase price provisions;
- over-collateralisation (sale and transfer of financial assets to the issuer at a value greater than that of the consideration paid for them);
- excess spread or excess discounting (interest-bearing financial assets generating a greater interest cash flow (including by way of discounting) than the coupon of the issued asset-backed security, or, in the case of non-interest-bearing assets, the discount being greater than the coupon); and/or
- cash reserves.

2. Roles and Responsibilities of the Parties

2.1 Issuers

Issuers are insolvency remote SPVs. Issuers of German ABS are typically organised as bankruptcy remote SPEs. Issuers are typically running the whole transaction (ie, buying the receivables, issuing the notes and distributing the collections), but are supported by specialists for these tasks like paying agents, cash administrators, account banks or calculation agents. The servicing of the receivables remains mostly with the seller. There are specialised corporate service providers that run these issuers. They need to run the issuer from the country where it is set up to avoid tax issues around permanent establishment.

2.2 Sponsors

The sponsor is the party that usually initiates the securitisation transaction. The sponsor can be the originator of the receivables to be securitised or an affiliate, often being the parent company of the originator. The parent often gives a performance guarantee for the affiliated seller that runs the servicing of the receivables. In a conduit transaction, the sponsor is the bank that stands behind the conduit and usually fully supports the conduit through its liquidity facilities. A conduit sponsor can provide risk retention.

2.3 Originators/Sellers

An originator or seller is a legal entity that has created an asset through an extension of credit or otherwise, that is sold and assigned to an issuer backed by security. Originators/sellers in

the German market are typically manufacturer (eg, vehicles or computer), banks or leasing companies. They use securitisations to diversify their funding or achieve better financing conditions. Sellers often use non-public transactions with banks to ramp up a certain portfolio size, repurchase it and sell it again to a public securitisation issuer.

2.4 Underwriters and Placement Agents

Underwriters are banks which are usually also referred to as managers and/or arrangers. Underwriters are needed in public deals to underwrite a commitment to purchase ABS notes. As arrangers, they are responsible for arranging the securitisation transactions and for the marketing thereof. Together with the originator – which may also act as arranger – the underwriters underwrite the notes issued by the issuer. Underwriters and placement agents are typically only required if the notes issued by the issuer are to be listed on the official list of the competent stock exchange and admitted to trading. Underwriters often collect orders from investors and on-sell the notes (they are obliged to purchase) immediately.

2.5 Servicers

Servicing is usually undertaken by the seller (also referred to as originator) of the receivables. The main responsibility of the servicer is the servicing of the purchased receivables, ie, the administration and collection of the purchased receivables. The collection of receivables is a legal service. If such service is provided by a person for the benefit of another person (*Tätigkeit in konkreten fremden Angelegenheiten*), it is subject to the restrictions of the Act on Rendering of Legal Advice (*Rechtsdienstleistungsgesetz*, “RDG”) provided that the relevant service requires in each case an individual legal analysis (*rechtliche Prüfung des Einzelfalls*). Such services may only be carried out by qualified lawyers. Irrespective of the requirements set forth in Section 2(1) of the RDG, the collection of third-party receivables or receivables assigned for collection purposes (*Einziehung fremder oder zum Zweck der Einziehung auf fremde Rechnung abgetretener Forderungen*) is expressed to be a legal service within the meaning of the RDG if such collection services are rendered as an independent business (*eigenständiges Geschäft betrieben*). Affiliates of the creditor and the assignor of a receivable are exempted from the licence requirements.

The servicing of the assets is a key activity in a securitisation and hence the structures often provide for a fall-back plan should the servicer lose its ability to provide such service, either by using a back-up servicer or a lighter version of a cold back-up servicer.

2.6 Investors

Investors are typically banks or other financial institutions but can be also unregulated investors. The investors fund the issuer by subscribing the notes and paying the respective purchase price. Regulated investors will likely seek to influence the structuring of the transaction and make it eligible for its regulatory purposes.

2.7 Bond/Note Trustees

Bond/note trustees are not typically used in German law transactions. In German law transactions, the security created in favour of the secured parties (including the noteholders) is regularly held (and when required, administered and enforced) by a security trustee/collateral agent. In private transactions, the refinancing instrument does not usually need to be held by a custodian, but can be held by each investor or is a loan instrument. In public transactions, clearing and custody systems (like Clearstream)

are used. For further details, see **2.8 Security Trustee/Agents**.

2.8 Security Trustees/Agents

Trustees are usually also referred to as "security trustees" or "collateral agents". Their function is to hold and administer (and in an enforcement scenario, also to enforce) the security granted over the assets of the issuer. The security is to be held in favour of the secured parties, in particular the noteholders. Trustees are often professional trust corporations, in some cases being affiliates of banks. The purpose of the trust is two-sided: (i) the separation of assets from the issuer, and (ii) the holding of security for several investors and secured creditors which may change over time.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

Under German law-governed true sale securitisations, the bankruptcy-remote transfer of the assets to be securitised is typically achieved by core transaction documents, consisting of:

- a receivables purchase agreement (RPA), entered into between the originator and the issuer;
- a servicing agreement entered into between the originator in its capacity as servicer, the security trustee as trustee and the issuer;
- a security trust agreement entered into between, among others, the issuer and the transaction security trustee; and
- a data trust agreement in the case of sensitive personal obligor data or aspects which are covered by the principle of banking secrecy (*Bankgeheimnis*).

Core Provisions of the RPA

The RPA defines in detail:

- the receivables to be sold to the issuer (eg, by reference to an asset list);
- the purchase price to be paid by the issuer to the originator as equivalent for the transfer; and
- any collateral transferred by the originator to the issuer that secures the performance of the sold receivables.

The originator typically warrants that:

- the sold receivables legally exist and will not be impaired or reduced by obligor defences or set-off rights;
- the originator holds good and unencumbered title to the sold receivables;
- the sold receivables comply with the eligibility criteria;
- the originator will not amend its credit and collection policy without the issuer's consent; and
- the credit and collection policy applied by the originator to the sold receivables is consistent with the credit and collection policy applied by the originator to its own (not securitised) receivables.

The RPA further stipulates that the originator must be deemed to have received deemed collections or benefits from indemnities if collections on the sold receivables will be reduced by non-credit risk or non-default risk-related shortfalls. Under German law, notification of the obligor on the sale of a securitised receivable is not a requirement for the perfection of the issuer's title in the acquired receivables.

German RPAs typically provide that the obligor of the sold receivables is not notified on the sale

of the securitised receivables by the originator to the issuer as long as the originator is in compliance with its contractual obligations under the RPA and the servicing agreement and in good financial standing. However, the issuer reserves the right to inform the obligor of the acquisition of the securitised receivables upon occurrence of an obligor notification event, which is typically combined with a servicer replacement event.

Core Provisions of the Servicing Agreement

Under a tripartite servicing agreement entered into between the originator in its capacity as servicer, the issuer and the security trustee as trustee, the issuer appoints the originator as its servicer to service, administer, collect and enforce the securitised receivables and available receivables collateral (eg, financed or leased vehicles) in accordance with the originator's credit and collection policy and to transfer collections on securitised receivables to the issuer. The servicing agreement typically provides for indemnifications for any losses or damages arising from the issuer's reliance on information, representations, warranties and reports derived from or included in servicer reports or any claims which arise from the servicer's collection activities. Servicing agreements typically provide for the replacement of the originator/servicer by a third-party replacement servicer if a servicer replacement event is triggered.

Core Provisions of the Trust Agreement

The security trustee, originator/servicer, the issuer and all other transaction parties enter into a trust agreement. Pursuant to the terms of this trust agreement, the issuer will transfer all assets and the related collateral acquired from the originator, and all claims against the servicer and other transaction parties, as note collateral to the security trustee. The security trustee will hold the collateral in trust for the beneficiaries, which includes the noteholders. The key elements of the trust agreement are the definition of the priority of payments (waterfall provisions), as well as the acceptance of the limited recourse and non-petition clauses by all transaction parties. The trust agreement contains issuer undertakings to the security trustee:

- not to sell or charge the collateral;
- to refrain from all actions and omissions to act which may result in a significant decrease in the value or loss of the collateral;
- to have independent directors; and
- not to enter into any other agreements unless such agreements contain limited recourse, non-petition and limitation on payments provisions, as defined in detail in the trust agreement.

Core Provisions of the Data Trust Agreement

In order not to disclose sensitive obligor data to the issuer which are subject to restrictions resulting from data privacy and are subject to disclosure restrictions resulting from the principle of banking secrecy (*Bankgeheimnis*), the RPA will contain provisions that the originator will disclose the identity (ie, name and address) of the obligor of bank loan receivables to the issuer only in encrypted form and that the decryption key will be safely kept by a data trustee. The Federal Financial Supervisory Authority (BaFin) proposes to use as data trustee a credit institution licensed to do banking business in the EU or the EEA. However, in practice, data trustees are not always credit institutions. The data trust agreement provides that the identity of the respective obligors will not be disclosed to the issuer as long as the originator/servicer services the securitised receivables on behalf of the issuer. Upon replacement of the originator/servicer by a third-party replacement servicer (eg, in the case of the servicer's insolvency or of a signifi-

cant default of its obligations), the data trustee will provide the replacement servicer with the decryption key, enabling the replacement servicer to collect the securitised receivables on behalf of the issuer.

Corporate Administration Agreement

The issuer and a corporate service provider (as administrator) enter into a corporate administration agreement to provide corporate services to the issuer. The independent directors provided by the corporate service provider to the issuer are obliged to ensure that the issuer does not carry out any activities, and, in particular, does not incur any financial indebtedness, other than as required for the specific securitisation transaction.

3.2 Principal Warranties

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.3 Principal Perfection Provisions

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.4 Principal Covenants

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.5 Principal Servicing Provisions

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.6 Principal Defaults

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.7 Principal Indemnities

See **3.1 Bankruptcy-Remote Transfer of Financial Assets.**

3.8 Bonds/Notes/Securities

For public ABS programmes, global notes that can be cleared via Clearstream are usually used. Conduit programmes use commercial papers whereas the instrument by which the conduit invests into the transaction is often variable funding notes.

3.9 Derivatives

See **4.7 Use of Derivatives**.

3.10 Offering Memoranda

See **4.2 General Disclosure Laws or Regulations**.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

There is no specific German disclosure law applying to securitisations. However, relevant regulations pursuant to applicable European law include, in particular, the SR and any regulatory technical standards authorised thereunder.

The SR has been applicable since 1 January 2019 to all securitisations (as defined therein) other than securitisations existing prior to that date to the extent that they are grandfathered.

Prior to holding a securitisation position, an institutional investor, other than the originator, sponsor or original lender, shall verify that (if established in the EU) the originator, sponsor or original lender retains on an ongoing basis a material net economic interest and the risk retention is disclosed to the institutional investor each in accordance with the SR.

On 3 September 2020, two regulations were published regarding the detailed disclosure requirements under the SR (the "Disclosure Technical Standards"). These consist of regulatory technical standards concerning the information to be made available and the details of a securitisation by Commission Delegated Regulation (EU) 2020/1224 of 16 October 2019 supplementing the SR with regard to regulatory technical standards specifying the information and the details of a securitisation to be made available by the originator, sponsor and SPE (the "Disclosure RTS") and implementing technical standards with regard to the standardised templates by 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 SPE (the "Disclosure ITS"). The Disclosure Technical Standards entered into force on 23 September 2020.

Certain specific disclosure requirements will also apply if the notes are intended to be admitted to trading on the regulated market at a stock exchange, or admitted as eligible collateral with the ECB.

4.2 General Disclosure Laws or Regulations

In practice, ABS are not offered to the public or retail clients (as defined under Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) (MIFID II)), but only to qualified investors (as defined in Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC – the "Prospectus Regulation"). Therefore, no key information document pursuant to Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) is required.

Public German ABS issuances are mostly structured as "wholesale transactions" – ie, with a denomination of at least EUR100,000 and listed on the regulated market of Luxembourg or the Irish Stock Exchange. Such listing prospectus needs to comply with the requirements of the Prospectus Regulation for "wholesale transactions".

ABS that are intended to be placed with institutional investors (as defined in the SR) – eg, credit institutes, insurance enterprises, reinsurers, alternative investment fund managers (AIFMs) or undertakings for collective investment in transferable securities (UCITs), need to comply with the transparency requirements of Article 7 of the SR.

In order to achieve a uniform and clear implementation of the SR, the SR requires the European Securities and Markets Authority (ESMA) and EBA to issue numerous RTS and ITS as well as Guidelines. In particular, the extensive STS criteria need to be specified in terms of how they are to be interpreted and how compliance with the STS criteria can be demonstrated and, if necessary, verified by an independent third-party verifier.

Where originators, sponsors and securitisation vehicles wish to use the STS designation for their securitisations, investors, competent

authorities and the ESMA must be notified that the securitisation complies with the STS requirements and how the individual STS criteria are met. The ESMA must then include the securitisation in a list of reported STS securitisations which it makes available on its website for information purposes. Article 28 of the SR requires the involvement of an independent third party in the review of a securitisation for compliance with the STS requirements for investors, originators, sponsors and securitisation SPVs. These third parties, known as STS verifiers, will be approved by the competent national supervisory authority (in Germany: BaFin). Their assessment is included in the originator's, sponsor's or SPV's notification to the ESMA in accordance with Article 27 (2) of the SR and provides some certainty in the market that the rules will be applied in high quality and uniform manner.

German STS Verification International GmbH (SVI) is such an STS third-party verifier licensed in accordance with Article 28 of the SR for all asset classes for all countries of the EU for the transaction types non-ABCP securitisations (ie, ABS), ABCP securitisations (on transaction and on programme level) and synthetic on-balance sheet securitisations.

Where, in respect of a securitisation reported as an STS securitisation, a competent authority has determined that the securitisation does not comply with the requirements in the case of negligence or intentional infringement and there is reason to believe that the originator acted negligently and not in good faith, the responsible authority, ie, the regulator of the originator, shall impose administrative sanctions and shall also inform ESMA without delay to include the sanctions concerned in its list of STS notifications in order to inform investors of the sanctions and the reliability of the STS notifications. Therefore, originators, sponsors or securitisation vehicles are required to prepare their reports carefully in order to avoid damage to their reputation.

4.3 Credit Risk Retention

ABS that are intended to be placed with institutional investors (as defined in the SR) – ie, credit institutes, insurance enterprises, reinsurers, AIFMs or UCITs, must comply with the risk retention requirements pursuant to Article 6 of the SR. The originator, sponsor or original lender of a securitisation shall retain, on an ongoing basis, a material net economic interest in the securitisation of not less than 5%. This retention of the material net economic interest in the securitisation can only be achieved by:

- the retention of not less than 5% of the nominal value of each tranche sold or transferred to investors ("vertical slice");
- the retention of the originator's interest of not less than 5% of the nominal value of each securitised exposures (in the case of revolving securitisations);
- the retention of randomly selected exposures, equivalent to not less than 5% of the nominal value of the securitised exposures;
- the retention of the first loss tranche; or
- the retention of a first loss exposure of not less than 5% of every securitised exposure in the securitisation.

The material net economic interest shall not be split among different types of retainers, or be subject to any credit-risk mitigation or hedging.

It is an administrative offence pursuant to Section 56 (5c) of the German Banking Act (KWG) to infringe the SR by deliberately or negligently failing to hold the required risk retention contrary to Article 6(1) of the SR. Administrative penalties awarded against legal entities and partnerships

must not exceed the higher of EUR5 million or 10% of the entities' turnover (Section 56 (6a) of the KWG).

4.4 Periodic Reporting

ABS that are intended to be placed with institutional investors (as defined in the SR) need to comply with the transparency requirements of Article 7 of the SR. In the case of ABS quarterly investor reports, or, in the case of asset-backed commercial paper (ABCP), monthly investor reports, are to be published to the competent authorities and, upon request, to potential investors (as per Article 7 of the SR). The originator and the sponsor in the case of ABS and the sponsor at ABCP programme level shall be responsible for compliance with Article 7 of the SR.

The originator, sponsor and SPE of a securitisation shall designate one entity to fulfil the information requirements. The designated entity shall make the information for a securitisation transaction available by means of a securitisation repository. Where no securitisation repository is registered in accordance with Article 10 of the SR, the entity designated to fulfil the requirements shall make the information available by means of a website which meets certain requirements as set forth in Article 7(2) of the SR.

If an originator, sponsor, original lender or SPE breaches the requirements of, inter alia, Article 7 of the SR, the supervisory authority may order the permanent cessation of the acts or conduct that gave rise to the breach and may require that their repetition be prevented (Section 48(1) of the KWG).

It is an administrative offence to infringe the SR by deliberately or negligently failing to provide information, or by failing to do so correctly, completely, in the prescribed manner or in good time, contrary to the first to fourth or fifth subparagraphs of Article 7(1) of the SR. For Germany, the competent authority is BaFin pursuant to Article 7(1) and Article 29(4) of the SR and the implementation law the German Act on the Adaption of Financial Market Laws to Regulation (EU) 2017/2402 and to Regulation (EU) No 575/2013 as amended by Regulation (EU) 2017/2401 (*Gesetz zur 957802907.1957802907.2 957802907.1957802907.2 Anpassung von Finanzmarktgesetzen an die Verordnung (EU) 2017/2402 und an die durch die Verordnung (EU) 2017/2401 geänderte Verordnung (EU) Nr. 575/2013*).

4.5 Activities of Rating Agencies

Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013, amending Regulation (EC) No 1060/2009 on credit rating agencies (the CRA3 Regulation), sets out a compulsory process of registration with the ESMA for rating agencies (RA). German public asset-backed securities that shall serve as collateral for Eurosystem purposes (ECB collateral) are typically rated by two rating agencies and are structured to comply with ECB collateral eligibility criteria.

4.6 Treatment of Securitisation in Financial Entities

Credit institutions and investment firms have to calculate their regulatory capital as provided for under the CRR.

The regulatory capital risk weight of a securitisation position will depend, in particular, on the question of whether a securitisation position results from a traditional securitisation or meets the requirements of an STS securitisation as defined by the SR.

Articles 20 to 22 of the SR define the STS criteria for non-ABCP securitisations.

4.7 Use of Derivatives

Derivatives can be used in securitisation in different forms. In true sale securitisations, derivatives are most often used to hedge mismatches in the interest rate calculation (eg, fixed income from receivables against floating interest under the notes or no interest-bearing receivables against floating interest under the notes, but also different sources of interest rate calculations). In multi-jurisdictional trade receivables transactions, there can also be mismatches between the sources and uses if different currencies are involved and currency swaps become necessary.

There are different ways to hedge the currency or interest risks: there can be an exact match of hedging like under a balance-guaranteed swap where the notional amount of the swap is automatically adjusted to the corresponding receivables balance. Balance-guaranteed swaps are rather expensive because of the unpredictability of the receivables balance. Part of the unpredictability can be hedged by a back-to-back swap which needs to be structured in a way that defaults on the back swap do not affect the front swap and no credit risk must be taken back by the originator through the back swap to not jeopardise the true sale of the sale of receivables. Alternatively, corridors can be used either for the interest rate by using caps or floors or for the notional amount which oblige the SPE to enter into swap amendments if the corridor between the notional amount of the swap and the receivables balance exceeds a certain level.

In synthetic securitisation transactions, derivatives are used by banks for the regulatory risk transfer and by SPEs to hedge interest rate risks and to hedge currency exchange risks. To the extent the SPE invests proceeds in eligible investments, asset protection swaps (eg, total return swaps) may also become necessary.

Regulation of Derivatives

Derivatives are generally regulated by Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 (EMIR). The EMIR provides, inter alia, for central clearing of derivatives (because the bespoke nature of the derivatives used in securitisations in most cases does not apply) or for collateral posting. The collateral posting obligation applies already to non-financial counterparties exceeding a certain threshold for the type of derivative. Naturally, the SPE would not have the financial resources to provide such collateral if the threshold is exceeded.

For STS-compliant securitisations there is an exemption from the clearing obligation (and collateral posting obligation) if the relevant derivative contract is concluded by a securitisation SPE in connection with an STS-securitisation and if the counterparty credit risk is adequately mitigated in accordance with Article 2 of the Commission Delegated Regulation (EU) 2020/447. This means that the transaction must provide for the following features (in addition to being STS-compliant):

- the swap counterparty must rank at least pari passu with the most senior investors (unless the counterparty is the defaulting or affected party); and
- the most senior notes are subject to a credit enhancement of more than 2% of the outstanding balance of these notes.

4.8 Investor Protection

The SR intends to provide investor protection to institutional investors (as defined in the SR) – ie, credit institutes, insurance enterprises, reinsurers, AIFMs or UCITs. Investor protection is achieved in particular by means of:

- pre-investment due diligence requirements for institutional investors (Article 5 of the SR);
- the originator, sponsor and original lender of a securitisation retaining, on an ongoing basis, a material net economic interest in the securitisation of not less than 5% (Article 6 of the SR);
- transparency requirements for the underlying exposures (loan-level information, documentation, investor reporting) (Article 7 of the SR);
- the ban on re-securitisations (Article 8 of the SR);
- the obligation to disclose the originator's criteria for the granting of credit (Article 9 of the SR); and
- the obligation to hold data in a securitisation repository (Article 17 of the SR).

4.9 Banks Securitising Financial Assets

The legal environment for securitisations of German regulated institutions is governed by the provisions of the CRR and the Securitisation Regulation. When German financial institutions securitise financial assets, they often use the German securitisation platform provider True Sale International and often structure securitisation transactions in line with the collateral requirements of the ECB.

4.10 SPEs or Other Entities

German law does not provide for specific legislation relating to SPEs as securitisation companies, however, the German Banking Act (KWG) contains for regulatory purposes definitions of the terms refinance enterprise, refinance intermediary and SPE (Section 1 (24) to (26) KWG) (for further details, see **1.4 Special-Purpose Entity (SPE) Jurisdiction**).

4.11 Activities Avoided by SPEs or Other Securitisation Entities

There is no legislation available in Germany that defines activities to be avoided by SPEs or other securitisation entities. Restrictions on SPEs or other securitisation entities result from rating criteria or the requirements defined by securitisation platform providers like TSI or PCS. For further details, see **1.4 Special-Purpose Entity (SPE) Jurisdiction**.

4.12 Participation of Government-Sponsored Entities

There are currently no German government-sponsored entities active in German securitisations. However, the ECB has recently been an active investor in the ABS market.

4.13 Entities Investing in Securitisation

According to True Sale International in 2018, UK investors (41%) followed by Benelux investors (11%) and US investors (10%) invested in European ABS. In 2018, European ABS was placed predominantly to funds (52%), pension funds (15%) and banks (29%).

4.14 Other Principal Laws and Regulations

See **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Institutions in Germany primarily use synthetic securitisations for the purpose of regulatory

risk transfer. The regulatory regime of synthetic securitisations is governed by the CRR.

A synthetic securitisation is a securitisation where the transfer of risk is achieved by the use of a credit derivative or a financial guarantee, and the exposures being securitised remain exposures of the originator institution (Article 242, paragraph 11 of the CRR). The credit derivative and financial guarantee are granted by a securitisation SPV (or directly by the protection seller) to the originator with respect to a specific loan portfolio. By setting the relevant attachment point and detachment point for losses of interest and capital under the loan portfolio, the synthetic securitisation and first loss piece will be tranched.

Interest or Capital Loss

If an interest or capital loss is determined under the loan portfolio due to a failure to pay, a bankruptcy or, under certain conditions, a restructuring, and is verified under the credit derivative or the financial guarantee within the relevant attachment and detachment points, then the securitisation SPV will be required to make a relevant payment to the originator under the credit derivative or financial guarantee. These payment obligations are funded by way of the proceeds from the issuance of a credit-linked note to investors. The cash proceeds from such an issuance serve as collateral and funding basis for the potential loss payments under the credit derivative or the financial guarantee.

A synthetic securitisation will be recognised for regulatory risk transfer purposes if the requirements of Article 244 of the CRR have been satisfied. This requires, inter alia, that an originator institution:

- transfers significant risk to third parties, either through funded or unfunded credit protection; and
- applies a 1.250% risk weight to all securitisation positions it holds in the securitisation or deducts these securitisation positions from its common equity tier 1 items in accordance with Article 36, paragraph 1 (k) of the CRR.

A regulatory risk transfer can also be achieved by an unfunded credit protection – ie, without raising debt from capital markets investors. In this case, the originator will enter into a credit default swap structure in accordance with the aforementioned CRR requirements.

Regulatory and Legal Questions

Many other regulatory and legal questions arise in the context of synthetic securitisations and must be taken into account when structuring a transaction, including whether or not the derivatives regulation applies and whether or not the granting of a financial guarantee is subject to a licence requirement. There are also limitations with respect to investors, for example, the German regulatory BaFin required the market to have investor protection criteria in place for credit-linked notes offered to retail investors.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Although the term “legal true sale” is used in German market practice by the parties to financial transactions, it cannot be defined by reference to a specific provision of German law. A German “legal true sale” as the term is used in the following document, and in German market practice, means:

- the insolvency-proof assignment/transfer of a financial asset from a seller (the originator) to a purchaser, with the effect that the sold and assigned/transferred assets cease to form part of the seller's insolvency estate in the event that the seller becomes insolvent subsequent to the assignment/transfer of the respective asset; and
- that the assigned/transferred asset is not exposed to the risk that the seller's insolvency administrator may successfully challenge the assignment/transfer of the asset, or that the seller's insolvency administrator may successfully raise claw-back rights with respect to the sold and assigned/transferred asset.

This requires that the seller is subject to German law insolvency proceedings. If there is a risk that a seller of the receivables/assets shall not be subject to German law insolvency proceedings, then it is advisable to examine whether or not a perfection of the sale and assignment/transfer of the receivables/assets under the receivables purchase agreement will be acknowledged under the non-German insolvency proceedings applying to the seller.

For the German legal true sale analysis, the most important aspect to consider in connection with the sale and assignment of a receivable is whether or not the seller has also transferred the credit risk, the risk that the obligor would have to pay – on condition of its solvency – the receivables on the agreed date) to the purchaser. In contrast with a retained seller participation in the credit risk of a sold and assigned receivable, any retained seller risk in the verity or dilution risk will not be taken into account for German true sale analysis purposes.

Insolvency Proceedings

If the seller is subject to insolvency proceedings under German law, there are no additional requirements for a legal true sale if the sale and assignment is non-recourse with respect to the credit risk of the receivables that have been sold. The transfer of the credit risk should not be questioned or re-characterised as an assignment of receivables for security purposes (*Sicherungszession*) with respect to receivables that will be purchased on a non-recourse basis, provided that the terms of the receivables purchase do not have the economic effect that the credit risk (*Delkredererisiko*) of the receivables has (despite the sale and assignment of them) in fact been retained by the seller. This would be the case if the seller's retained credit risk participation (due to retained purchase price provisions, default risk reserves, etc) were not at arm's length for a non-recourse receivables sale. It is notable in this context that retained dilution reserves or yield reserves or deemed collections due to broken representations and warranties will not impact the German legal true sale analysis.

The transfer of a sold and assigned receivable under a receivables purchase agreement could be questioned and re-characterised as an assignment of receivables for security purposes (*Sicherungszession*) – ie, as a secured lending transaction, with respect to receivables that will be purchased on a recourse basis. In the latter case, the acquirer of receivables for security purposes will, in the case of the commencement of German law insolvency proceedings against the seller, be treated as a preferred creditor and will have a right to separate satisfaction (*Absonderungsrecht*). If the transaction contemplates a secured loan facility (as opposed to a receivables purchase agreement) secured by the receivables, then the assignment of the receivables

would be deemed a security assignment rather than a true sale.

Re-characterisation

Under German law, it is not possible to combine both principles: there is no "true sale for security purposes". In the case of a re-characterisation of a sale of receivables as a secured lending transaction, and in the case of the commencement of German insolvency proceedings against the transferor, German insolvency law provides that the insolvency administrator of the German transferor will mandatorily enforce and collect receivables that had been transferred for security purposes (unless such security qualifies as financial collateral in the sense of Directive 2002/47/EC), meaning that the acquirer would be barred from enforcing the receivables assigned to it itself or through an agent. The insolvency administrator is, however, obliged to transfer the proceeds from such an enforcement of receivables for security purposes to the acquirer. The German insolvency administrator will, however, deduct fees from such enforcement proceeds, as provided for under German insolvency law. These fees amount to 4% of the enforcement proceeds for the determination of the receivables, plus up to a further 5% for the enforcement process (or, under certain conditions, more or less than 5%) plus applicable VAT.

A true sale should be structured as a so-called "cash transaction", which means that the receivables are sold for immediate and equivalent consideration. If the sale is characterised as a cash transaction, then most of the reasons to challenge the sale and transfer under German insolvency law are excluded. Qualification as financial collateral has the effect of excluding some of the reasons to challenge the transaction, but not as many as would be excluded in a cash transaction.

6.2 SPEs

Issuers of German ABS are typically organised as bankruptcy remote SPEs. Depending on the type of the securitised asset, SPEs are either located in Germany (eg, in the case of a bank loan, auto loan or consumer loan securitisations) or outside of Germany (eg, in the case of auto leases or trade receivables) – mostly Luxembourg, Ireland and the Netherlands. The choice of appropriate SPE jurisdiction is driven mainly by tax considerations, set-up and maintenance costs and confidence in the legal system's ability to ensure a ring-fencing of the assets.

An SPE is typically established as an "orphan" by corporate service providers. Its share capital is held by charitable trusts or charitable foundations.

The corporate structure and organisation of an SPE follows (for public term transactions) the requirements of the applicable rating criteria or securitisation platform provider – eg, True Sale International GmbH (TSI as the brand for German quality securitisations) or Prime Collateralised Securities (PCS) UK Limited (True Sale PCS Label).

6.3 Transfer of Financial Assets

Transfer requirements depend on the type of asset. Transfer of trade receivables under German law does not require registration. Registration can be required for certain IP rights.

6.4 Construction of Bankruptcy-Remote Transactions

German securitisation transactions usually achieve an insolvency remote transfer of assets to an SPE and legal opinions are obtained. The insolvency part of the legal opinions covers:

- determination of applicable insolvency law;

- valid transfer of assets;
- treatment of transfer as segregated assets in the case of insolvency of the originator (true sale); and
- exclusion of ordinary voidance risk (cash transaction).

6.5 Bankruptcy-Remote SPE

The SPE is prevented from becoming bankrupt by limited recourse and non-petition provisions with all creditors of the SPE and by transferring all assets of the SPE to a trust or trustee.

7. Tax Laws and Issues

7.1 Transfer Taxes

Germany does not impose any stamp duty or other documentary taxes on the sale of receivables.

7.2 Taxes on Profit

The purchase of receivables would not generally result in German tax liability for a non-German purchaser if the purchaser did not conduct any other business in Germany and the receivables did not give rise to income from German sources (where receivables may generate German-source income, see the exceptions in **7.3 Withholding Taxes**).

German tax liability could arise for the purchaser if the receivables were collected, monitored and/or administrated by a German originator or servicer, and the services provided resulted in a permanent representative, a permanent establishment or an effective place of management of the purchaser situated in Germany. To limit the risk of this, a non-German purchaser should display a substantial presence outside Germany and not maintain a fixed place of business inside Germany. Moreover, all relevant business decisions of the purchaser, especially in relation to the acquisition of receivables and its financing, should be made abroad. Further, the purchaser should not provide instructions in respect of the collection services performed by the originator or servicer, and such entities should not have the power to represent or legally bind the purchaser.

7.3 Withholding Taxes

Payments on receivables (eg, trade receivables), including interest payments, are not generally subject to withholding taxes in Germany. Exceptions may apply, for example, to:

- receivables qualifying as hybrid debt instruments;
- receivables the obligor of which is a bank or financial services institution in Germany;
- securitised receivables; and
- receivables secured by German real estate (in limited circumstances).

7.4 Other Taxes

In general, the sale of receivables is exempt from German value added tax. An exception might apply if not only receivables but entire contractual relations were transferred. However, this is not usually the case in a true sale securitisation.

Value added tax may be imposed on factoring services – eg, on collection services provided by the purchaser. However, no factoring services are generally provided if, following a sale, the seller continues to collect the receivables (as is frequently the case in a true sale securitisation).

In respect of a sale of trade receivables that originate from the sale of goods and services being subject to value added tax, a purchaser may become secondarily liable for any value added tax not duly paid by the seller. A secondary liability does not generally exist if and to the extent

that the purchaser pays a consideration for the receivables to the free disposition of the seller.

7.5 Obtaining Legal Opinions

Practitioners commonly give tax opinions for securitisation transactions. Such tax statements usually cover:

- potential stamp taxes and withholding taxes;
- the tax treatment of the SPE;
- potential value added tax on the transfer of the receivables and the services provided to the SPE; and
- secondary value added tax liability (if relevant).

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The Institute of Auditors (*Institut der Wirtschaftsprüfer*) summarised the requirements for a true sale for German commercial balance sheet purposes in its statement dated 1 October 2003 (IDW RS HFA 8, as amended on 9 December 2003 – the "IDW Statement"). Pursuant to the IDW Statement, a true sale of receivables for accounting purposes can be assumed if the economic ownership of the receivables is passed to the purchaser of the receivables. This is the case if, among other things, the following criteria are fulfilled:

- from an economic perspective, the credit risk (ie, the risk that the debtor of the receivables does not meet its payment obligations) is assumed by the purchaser;
- the sale of the receivables is final (which would not be the case, for example, if the reassignment/resale of the receivables had already been agreed at the time of the sale);
- there are no default guarantees from the seller and no total return swap is entered into between the seller and the purchaser, nor an agreement pursuant to which the purchase price will be adjusted in accordance with the losses of the sold receivables;
- the seller of the receivables does not hold equity in the purchaser and does not acquire debt securities issued by the purchaser (either in full or in a significant amount); and
- any purchase price discount agreed between the parties is either non-adjustable or, if adjustable, qualifies as appropriate and customary in the market (eg, because it is determined in accordance with the quota of actual past losses plus a reasonable risk surcharge).

8.2 Dealing with Legal Issues

Accounting analysis in relation to a securitisation is generally undertaken separately from the legal analysis.

In order to provide an opinion that the asset has been assigned on a true sale basis for accounting purposes, legal practitioners ordinarily ensure through the documentation that the assignor bears no risk for the due realisation of the assigned assets and that representations and warranties are limited to title. To the extent that the assignor provides any undertaking to ensure realisation of any of the assets, or part thereof, the opinion is qualified to state that the true sale has not occurred to that extent. Hence, the receivables/assets which have not been subject to a true sale will continue to be accounted in the books of the assignor as a receivable.

GHANA

Law and Practice

Contributed by:
Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman,
Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi
B&P Associates

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Contributed by: Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman, Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi, **B&P Associates**

B&P Associates is a reputable law firm located at Labone, Accra, with 20 core team members including the managing partner and five non-lawyers. The firm keenly promotes the ease of doing business in Ghana, and provides top-notch, user-friendly legal advice to domestic and international investors. It provides clients with all forms of assistance to navigate the legal and regulatory landscape, as well as providing training and consultancy for international organisations on the Ghanaian investment scheme. The team is experienced in assisting companies set up and run successfully in Ghana with respect to business formation and financing, operational matters, as well as myriad corporate transactions, contracts, securities, joint ventures and shareholding agreements, corporate governance, and company secretarial services. The firm would like to acknowledge Audrey Nana Oye Addy for her contribution to the preparation of this publication.

Authors

Adelaide Benneh Prempeh is the founder and managing partner of B&P Associates. Adelaide is a top-ranked lawyer, whose expertise spans across sectors. She is a certified insolvency practitioner and an insolvency consultant to the International Finance Corporation (IFC) of the World Bank Group on the Ghana Investment Advisory Project. Adelaide was called to the English Bar in 2001 and in 2012, she was called to the Ghana Bar as a barrister and a solicitor of the Supreme Court of Ghana. She is a lecturer at the Ghana School of Law and a member of the Ghana Bar Association.

Michelle Nana Yaa Essuman is a senior legal associate with invaluable expertise in investment law, tax, finance and insolvency. She has assisted local and international clients in many intricate transactions and has rendered relevant regulatory advice in line with the transactions. Michelle is a professional-level candidate at the Ghana Investment and Securities Institute (Ghana). She is also a member of the Ghana Bar Association.

Bessy Agyeiwaa Crentsil is a legal associate of B&P Associates. She has advised on matters with respect to the firm's practice areas including corporate and commercial, banking and finance, energy, projects and infrastructure, fintech regulation and insolvency. She is a member of the Ghana Bar Association.

David William Akuoko-Nyantakyi is a Ghanaian lawyer with expertise in corporate and commercial transactions, as well as banking and investment. He is a legal associate of B&P Associates and a member of the Ghana Bar Association.

Contributed by: Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman, Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi, **B&P Associates**

B&P Associates

House No 99A
Fourth Norla Street
Labone
Accra
Ghana

Tel: +233 55 6607614
Email: info@bpaghana.com
Web: www.bpaghana.com

1. Specific Financial Asset Types

1.1 Common Financial Assets

Securitisation in Ghana has not undergone extensive exploration; nevertheless, the few instances in which securitisation has been employed involved assets including: future receivables, tax receipts and consumer loans. Currently, there have been three main securitisation transactions approved by SEC. In those transactions, the financial assets used are categorised as follows:

- cashflows – levies paid to the government [GetFund and Energy Sector Levy]; and
- consumer loans issued to public sector employees [Controller ABS PLC].

1.2 Structures Relating to Financial Assets

The most commonly used form of securitisation in Ghana is Future Flow Securitisation (FFS). The structure applied in cases involving taxes and future receivables is the traditional structure. Here, the originator leverages on its levies and taxes to be received in the future. The originator transfers its right to cash flows to an SPE. The SPE (incorporated as an independent public liability company) issues bonds backed by the cash flows. Investors invest in the bonds providing immediate proceeds paid upfront to the originator and the cash flows are used to pay off the bonds.

1.3 Applicable Laws and Regulations

While Ghana lacks dedicated securitisation legislation, securitisation transactions are nonetheless regulated by the following laws and documents:

- Companies Act 2019 (Act 992);
- Securities Industry Act 2016 (Act 929), as amended;
- SEC Regulations 2003 (LI 1728);
- Securities and Exchange Commission (Amendment) Regulations 2019 LI 2387;
- Energy Sector Levy Act 2015 (Act 899);
- Ghana Education Trust Fund (GetFund) Act 2000 (Act 581), as amended;
- Listing Rules of the Ghana Stock Exchange; and
- The Corporate Governance Code of the Securities and Exchange Commission.

1.4 Special-Purpose Entity (SPE) Jurisdiction

Although, securitisation transactions in Ghana are uncommon, there are no specific laws in

Ghana that prevent SPEs incorporated in other jurisdictions from participating in the Ghanaian economy. Accordingly, the choice of jurisdiction of incorporation of SPEs is subject to the aims of the originator.

Generally, Special Purpose Entities (SPEs) are often created with the aim of obtaining specific advantages provided by the host jurisdiction. The most desirable feature of an SPE in a securitisation transaction is arguably the extent of its bankruptcy remoteness. A country with more accommodating insolvency laws could be potentially more attractive for the purposes of incorporating an SPE for securitisation.

1.5 Material Forms of Credit Enhancement

Securitisation transactions in Ghana are relatively limited. However, when these transactions do occur, over-collateralisation is the most commonly used credit enhancement method.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The term "issuer" pertains to an individual or any other entity that issues, has previously issued, or plans to issue securities. In the context of securitisation, an issuer would be the SPE securitisation vehicle.

Its primary role is to create securities and sell them in the market. Where an issuer issues securities to the public, it is tasked with complying with regulatory requirements.

2.2 Sponsors

A sponsor purchases the pool of assets with the ultimate intention of securitising them. In some transactions, the sponsor is also the originator. This role has been predominantly played by the Government of Ghana in the majority of the securitisation transactions that have occurred in Ghana.

2.3 Originators/Sellers

The originator refers to the company that originally pools the assets and assigns them to the SPE or purchases the exposures of other parties with the aim of securitising them.

Originators tend to be financial institutions (such as banks), large companies and commercial enterprises, and specialist entities set up for securitisation. In the Ghanaian context of securitisation, however, the originator tends to be the government.

2.4 Underwriters and Placement Agents

Underwriters are corporate bodies that buy securities outright from an issuer and sell them to open-market investors (Section 109, Act 929). An underwriter may be an investment bank, however, where it is a bank, it is referred to as an issuing house.

The underwriter is the entity responsible for arranging the sale of the issuer's securities to the initial investors. It serves as an intermediary between the issuer (SPE) and investors in an offering. The underwriter analyses investor demand and – in collaboration with the Credit Rating Agency – provides guidance on structuring the transaction in an efficient and cost-effective manner.

In order to act as an underwriter, the company must be duly licensed by the SEC. Underwriters may take the form of Licensed Dealing Members (LDM) who operate through Authorised Dealing Officers.

In order to issue a bond on the Ghana Stock Exchange (GSE), the issuer is required to appoint an LDM to sponsor its application to list. The LDM would be required to file all the application documentation with the GSE (GSE Listing Rules 20).

2.5 Servicers

Servicers are generally tasked as the originator's representative to ensure compliance by the SPE. This role has not been designated within the structures explored in Ghana, however, it may be said that the role of a servicer is in some parts played by the following parties working together.

- Lead managers/arrangers – structure the transaction and ensure that parties participate and play their respective roles.
- Debt-service Bank – provides banking services to the SPE. The debt service bank must comply with the regulations of the Banks and Specialised Deposit Taking Institutions Act 2016 (Act 930). In the transactions that have occurred in Ghana so far, due to the nature of the financial assets, the debt-service bank has also been tasked with the collection and proper distribution of cash flows.
- Manager of the SPE – which is usually a corporate body, based on the transactions that have occurred. They handle the day-to-day activities of the SPE and ensure that all roles and obligations of the SPE on both ends of the transaction are satisfied.

2.6 Investors

Investors are key parties to the securitisation transaction. They purchase the securities issued and where the security is a bond, they would receive coupons and the face value of the bond at maturity. Regarding investors, the main responsibility of the SEC as a regulator is to ensure investor protection. The investor may therefore not have responsibilities beyond the payment for the security.

Additionally, the investor may have rights that exist under the trust deed based on which the bonds are issued.

The typical investors in securitisation are financial institutions, insurance companies, pension funds, hedge funds, corporations and high net worth individuals.

2.7 Bond/Note Trustees

The bond trustee acts as a representative of investors in the transaction. The primary role of the trustee is to ensure that the interests of bondholders/investors are protected. The responsibilities of the trustee vary and are largely dependent on a separate trust agreement. It is important to note that apart from a government debt security, any other debt security must be issued subject to a trust deed approved by the SEC (GSE Listing Rules 7).

2.8 Security Trustees/Agents

A security trustee or agent acts as the entity responsible for holding the different security interests established in trust for these various creditors, which may include banks or bondholders. This setup eliminates the need to provide security individually to each creditor, which would be both expensive and unmanageable. Security interests held by security trustees are enforceable in Ghana. A security trustee may be appointed to hold security in trust for, or on behalf of multiple lenders or other secured parties, provided that any security interests granted in favour of that trustee are properly perfected.

Contributed by: Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman, Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi, **B&P Associates**

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The agreements that are relevant to a bankruptcy remote transfer largely depend on the type of underlying asset, however, an Asset Purchase Agreement may be explored in this instance. In order to avoid transfer pricing issues, there must be adequate consideration commensurate with the value of the asset in line with the arm's length theory.

Additionally, there must be a reflection of a true sale in its entirety. For instance, in an effective transfer of the asset, the originator must not continue to exercise control over the asset in the capacity of an owner. In the absence of specific legislation, the SEC is open to tailor-made terms that express the concept of securitisation.

3.2 Principal Warranties

The principal warranties that may be included in securitisation documentation are as follows:

- an assurance that the asset is free from encumbrance;
- an assurance that the originator has perfect title to the asset and has the capacity to transfer it;
- an assurance of complete regulatory compliance and due authorisations; and
- any other peculiar warranties that the parties may wish to include.

Regarding enforcement of the warranties given, parties may include a clause by which the SPE may be indemnified upon breach of the warranties provided. Usually, parties provide for a dispute resolution clause which gives the disgruntled party an avenue to remedy a breach of the terms of an agreement.

3.3 Principal Perfection Provisions

Perfection is contingent on the nature of the asset being transferred.

Generally, some principal perfection provisions that may be included are delivery of the title documents to the transferee; and provisions on filing the changes in title with the regulatory authorities.

3.4 Principal Covenants

As described above, the nature of the agreement largely depends on the type of financial asset. However, regarding covenants, parties will include terms relating to the obligations of each party. This covers payment obligations, delivery mechanism, notice required, reporting obligations, collateral obligations, if any, and any other covenants as permitted by the SEC.

In relation to enforcement, the dispute resolution clause would provide for the agreed process to make claims.

3.5 Principal Servicing Provisions

This will reflect the obligations of the servicer, reporting obligations, notices and information to be given. There may be timelines provided for the delivery of required reports.

3.6 Principal Defaults

Defaults in securitisation documentation may take the following forms.

- General defaults by parties – in this case there may be a general breach of the agreement or a breach of specified events of default such as the insolvency of the SPE, which may instigate a sequence of events for the claiming of remedies from the defaulting party.

- Early amortisation – certain events may trigger the claim of investors for a payout, irrespective of when the maturity date of the bond issued may be. Some instances that may pre-empt such occurrences include the decline in underlying assets, which may be cash flows, and an increased rate in default by debtors where the underlying asset may be loans.

In the case of general events of default, the most likely avenue would be the exploration of the dispute resolution clause for enforcement. In relation to early amortisation, investors will be at liberty to make their claims. However, due to the liquidity issues that this may pose for the SPE and the likelihood that some investors may encounter a loss on their investments, the SEC may have to be involved in the process.

3.7 Principal Indemnities

The parties may include indemnity clauses for defaults owing to the acts or negligence of a party. Due to the absence of direct laws and regulations, the parties are at liberty to structure such clauses to meet their preferences, subject to the approval of the relevant regulators.

3.8 Bonds/Notes/Securities

The principal transaction documents in a securitisation include the following:

- offering memorandum;
- trust deed;
- paying agency agreement;
- subscription agreement;
- servicing agreement;
- sale agreement;
- security agreement;
- investment or collateral management agreement;
- post enforcement call option agreement;
- swap contracts; and
- legal opinions.

3.9 Derivatives

Ghana's financial system has not evolved to incorporate the extensive use of derivatives. The SEC and the GSE are presently working on a comprehensive legal and regulatory framework that would make the development of a derivatives market possible.

3.10 Offering Memoranda

An offering memorandum is principally a legal and regulatory disclosure document. An offering memorandum is typically required in situations where an issuer, especially a new one, or an issuer with weaker creditworthiness, is looking to raise capital through debt securities in the capital markets. It may sometimes be referred to as the prospectus, offering circular, offering memorandum, information memorandum or listing particulars. In Ghana, however, it is commonly referred to as the prospectus.

Regarding specific regulations, there are no securitisation-specific disclosure laws and regulations. However, the SEC Regulations 2003 (LI 1728) (see Sections 50–62) generally provide regulations for disclosure by issuers. This has been further incorporated in the GSE Listing Rules.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

There are no securitisation-specific disclosure laws or regulations.

4.2 General Disclosure Laws or Regulations

The SEC Regulations 2003 (LI 1728) (see Sections 50–62) set out the regulations for disclosure by issuers. These regulations have also been incorporated in the GSE Listing Rules. The Regulations provide that the SPE, as an issuer, has a duty to:

- maintain high standards of disclosure;
- fully disclose information needed to make informed investment decisions to the public;
- ensure the immediate release of information, reasonably expected to have a material effect on the market activity and price of its listed securities;
- ensure the maintenance of a fair and orderly market in its securities; and
- help to ensure that investors have simultaneous and equal access to the same information.

The SPE is not required to disclose its internal estimates or to disclose the projections of its earnings. If it chooses to disclose this information, then it has a duty to ensure that the information prepared is thorough, factual and realistic with appropriate qualifications, and subsequent developments that vary should be promptly reported with the reasons for the variance adequately explained.

The SPE is required to promptly announce the following in writing to the SEC:

- non-payment of interest on the “due date” on account of debt securities;
- non-payment of capital on the redemption date on account of debt securities;
- a joint venture, merger, acquisition, or takeover;
- a decision on whether or not to declare a dividend;
- any decision to change the capital structure of the SPE including a rights issue or a bonus issue;
- a change in company officers or control of the business;
- change of address of the registered office of the SPE or of any offices at which the register of the securities of the SPE is kept;
- a call of securities for redemption;
- penalties imposed on the SPE by a regulatory authority;
- an event or occurrence which has the potential of materially affecting the business or revenue or profits of the company and efforts to minimise its effect;
- alteration or amendment of the rights and privileges of any unlisted securities issued by the SPE;
- a tender offer for another entity’s securities;
- a new product or discovery;
- the public or private sale of additional securities;
- a change in capital investment plans; and
- a labour dispute or dispute with subcontractors or suppliers.

The above information must be communicated to the SEC in writing.

In some cases, the SPE may withhold information, for instance: where immediate disclosure would prejudice the ability of the SPE to pursue its corporate objectives. However, where there is any question of whether or not to disclose, the SPE should disclose.

Additionally, before the SPE lists its securities, it is required to submit the Trust Deed pursuant to which the securities are being listed for the approval of the SEC.

The SPE would be required to register its securities with the SEC. The SEC would then issue a certificate of registration in respect of securities registered. This applies to all public issuance of securities except securities with a maturity of one year. The SPE must also inform the SEC of a cancellation or redemption of the securities within 21 days of the event (Section 145, Act 929).

Disclosure by the Originator

An originator, on the other hand, has a duty to file its audited financial statements with the registrar of companies annually. It also has a duty to file any changes in the company's particulars contained in the Companies Register (Companies Act, 2019 (Act 992)).

Beyond this, the transaction documents may provide for peculiar disclosure requirements.

4.3 Credit Risk Retention

There are currently no credit-risk retention specific laws in Ghana.

However, in order to tackle credit risk, the SPE may mark to market to assess the current financial situation of the SPE. This is especially important where the SPE explores innovative measures such as the use of derivatives in its dealings with the originator to promote bankruptcy remoteness.

4.4 Periodic Reporting

Annual Reporting

For compliance, all companies are expected to file their annual report as well as their audited financial statements with the Registrar of Companies for every financial year (Section 127, Act 992). The SPE is also required to circulate these documents to its shareholders, bondholders, the SEC and the GSE within three months of the close of each financial year. The financial statements must adhere to Ghana National Accounting Standards issued by the Institute of Chartered Accountants (Ghana) (Regulation 54, LI1728). The failure of the SPE to fulfil this obligation shall attract a penalty of GHS200 for each day the default subsists (Regulation 62, LI1728).

Quarterly Reporting

The SPE is obligated to submit quarterly financial statements on its corporate securities listed to the SEC, GSE, bondholders and its shareholders within a month of the completion of each quarter. However, if the SPE circulates its annual report within two months of the end of a financial year then it will be exempt from the obligation of circulating the fourth quarter financial statements (Regulation 55, LI1728). The failure of the SPE to fulfil this obligation shall attract a penalty of GHS200 for each day the default subsists (Regulation 62, LI1728).

4.5 Activities of Rating Agencies

Rating Agencies (RAs) cannot operate in Ghana unless they are registered, licensed or authorised by the SEC.

The SEC maintains a register with a list of RAs that hold valid licences and their particulars. Where an RA carries on business without a licence, the SEC is empowered to reprimand or disqualify it. The SEC may also impose an administrative penalty of GHS6,000 (Section 209, Act 929) on any RA that operates without a licence or acts in violation of the restrictions in the licence.

Where the SEC is satisfied that an RA has obtained money without a licence or contrary to the terms of the licence of the person, the SEC has the power to instruct that RA to repay all the money obtained and the profits accruing to that

person; return assets acquired as a result of the illegally obtained moneys or deposits; or pay any interest or other amounts which may be owed by that person in respect of those moneys, to the respective persons from whom the moneys were obtained (Section 123 and Section 216, Act 929).

4.6 Treatment of Securitisation in Financial Entities

Financial Entities are highly regulated in Ghana. Apart from the generally applicable security industry laws, institutions in the financial sector of Ghana may be subject to Banks, the Bank of Ghana in accordance with the Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930), Non-Bank Financial Institutions Act, 2008 (Act 774), Payment Systems and Services Act, 2019 (Act 987), the Borrowers and Lenders Act 2020 (Act 773), Foreign Exchange Act, 2006 (Act 723), the Development Finance Institutions Act, 2020 (Act 1032), Insurance Act, 2021 (Act 1061) and/or the National Pensions Act, 2008 (Act 766) as amended.

The various laws provide for respective capital and liquidity requirements. In the absence of any direct law on securitisations, the general rules apply and there is no special treatment or concession for securitisation transactions on the backdrop of the peculiar sector rules.

4.7 Use of Derivatives

Ghana's financial system has not evolved to incorporate the extensive use of derivatives.

The SEC and the GSE are currently working on a comprehensive legal and regulatory framework that would make the development of a derivatives market possible.

4.8 Investor Protection

The general laws that protect investors within the context of issued securities are the Companies Act, 2019, (Act 992), Securities Industry Act, 2016 (Act 929) as amended, SEC Regulations 2003 (LI 1728) and the GSE Listing Rules.

In Ghana, investors are entitled to information on the material facts, risks and costs associated with any investment recommended or sold by the market operator, a representative or an investment adviser.

The penalties for non-compliance generally include the imposition of restrictions, imposition of administrative penalty units, or the suspension or revocation of a market operator's licence by the SEC. Additionally, transactions that violate Act 929 may be declared by the courts to be void or voidable and may give rise to both private and public enforcement, guaranteed unconditional transfer of dividends and profits (Section 39(2)(d), CIRA).

4.9 Banks Securitising Financial Assets

There are no direct laws for banks that securitise a bank's financial assets. The Bank of Ghana has regulatory oversight over banks pursuant to the Banks and Specialised Deposit-Taking Institutions Act, 2016 (Act 930).

Beyond this, a bank that participates in the securities sector of Ghana would also be subject to the regulation of the SEC under the Securities Industry Act, 2016 (Act 929) as amended, SEC Regulations 2003 (LI 1728).

Depending on the role played by the bank in a securitisation, the bank may require a licence or approvals. In acting as an originator, SEC approvals are required. However, a bank that intends to do business in the capital market

other than the business of trustee, custodian, primary dealer, nominee, registrar, issuing house and underwriter, is required to incorporate a subsidiary company and apply for the relevant licence from SEC (see Section 114, Act 929).

4.10 SPEs or Other Entities

Due to the non-existence of direct laws on securitisation in Ghana, there is room for flexibility regarding the form of the SPE. For the purposes of listing on the GSE however, it is important to note that the SPE would have to be incorporated as a PLC (GSE Listing Rules 4(6)(a)).

Generally, in securitisation transactions, an SPE is usually (but not always) established as an orphan entity which is not part of the same corporate group as any other transaction party. To achieve this orphan status, the equity in the SPE is often settled on a charitable trust.

In settling on the ideal form of the SPE, it is important to consider the fact that the corporate veil may be pierced pursuant to the provisions of legislation or under equitable grounds as decided by the Supreme Court in Morkor v Kuma [1999-2000] 1 GLR 72. Therefore, the court may disregard the separate legal personality principle where the separateness of the SPE and its holding company has not been sufficiently established or where their affairs are so entangled that upholding the separate personality principle would cause injustice to all creditors. Being a discretionary remedy, some factors that guide the court in applying this remedy include, inter alia, the following:

- the parent company and the SPE have common directors or officers;
- the parent corporation finances the SPE;
- the directors or executives of the SPE are subject to the control of the parent corporation;
- the formal legal requirements of the subsidiary as a separate and independent corporation are not observed; and
- there is a commingling of assets and business functions.

Where the veil is pierced, the originator and the SPE may be construed as a unit and transfer pricing concerns may arise in relation to the transfer of the financial asset (see Section 31, Act 896).

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Where the SPE seeks to make invitations to the public to purchase securities, the SEC has oversight in respect of securitisation transactions. It is therefore difficult for companies of this nature to avoid the regulation of the SEC.

If the SPE fails to seek the necessary approvals to issue to the public, a penalty is imposed and it is liable to pay the SEC an administrative penalty of GHS12,000.00 (see Section 206(2)(b), Act 929).

4.12 Participation of Government-Sponsored Entities

Currently, the only known government-sponsored SPEs engaged in securitisation are:

- Daakye Trust PLC – the underlying assets used in this securitisation are the levies paid in respect of the Ghana Education Trust Fund (GetFund); and
- ESLA PLC – this transaction aimed to resolve energy sector debts due to banks and trade creditors. The underlying asset in this transaction is the Energy Sector levies.

In the case of Daakye Trust, the SPE secured the general approvals for the transaction. However, the arrangers of the transaction saw no apparent need to secure a rating. This is attributable to the fact that the underlying assets were government cash flows, the originator was the government of Ghana, and the Ministry of Finance issued a guarantee. The investor reaction to the transaction was synonymous with government securities issued, with a perceived minimum risk attached.

4.13 Entities Investing in Securitisation

Generally, institutions involved in the financial sector invest in securitisations: pensions, banking, insurance and the securities sector. Specifically, banks, insurance companies, pension companies, mutual funds, unit trusts and the like are the kinds of entities that undertake such investments. Beyond these entities, there may be some high net worth individuals that explore investment in securitisation.

Rules for Investment by Pension Scheme

The National Pension Regulatory Authority (NPRA) Investment Guidelines for Pension Schemes provide that in investing in corporate debt securities, a pension scheme may not exceed a total allocation of 35%, a maximum of 5% per issuer and a maximum of 5% per issue. This has been put in place to protect the pensions paid to the pension schemes and to ensure a diverse portfolio.

4.14 Other Principal Laws and Regulations

Listing Rules of the Ghana Stock Exchange

The GSE may consider the admission of debt securities of the SPE if the security concerned has a total issue amount of not less than GHS1,000,000 face value and the SPE has at least 50 holders of such securities. Government securities are exempt from these requirements.

The debt security the SPE seeks to admit must have been created and issued under a Trust Deed duly approved by the SEC.

The Corporate Governance Code of the Securities and Exchange Commission

Every SPE that has its securities admitted to trading on the GSE must comply with the Corporate Governance Code for Listed Companies 2020.

The SEC may waive some or all of the provisions of this Code if it is satisfied that the SPE has its securities listed on a stock exchange outside Ghana; is incorporated outside Ghana; and is subject to corporate governance requirements in the country where its securities are traded or where it is incorporated.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Due to the fact that synthetic securitisation has not been attempted or regularised within Ghana, there is no express indication of whether or not it would be permitted. However, the position of the SEC has been a flexible one led by the dictates of the sector participants and the market.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

In Ghana, Insolvency is governed by the Corporate Insolvency and Restructuring Act (CIRA), 2020 (Act 1015). Under the CIRA, when insol-

vency occurs, the company may explore the option of administration, restructuring or liquidation.

The objective of the CIRA is to give a distressed company the chance to recover from insolvency and survive as a going concern. The CIRA does not apply to companies carrying on the business of banking, insurance, or any other business which is subject to sector-specific legislation, except where the legislation does not provide for a rescue provision (CIRA S1(3)).

There are no specific provisions for securitisation as it relates to insolvency in Ghana. Accordingly, the general insolvency laws contained in the CIRA may apply alongside the sector-specific legislation applicable to the company in question.

Stay of Proceedings

If a company undergoes administration, a creditor is not permitted to start or continue legal proceedings or an enforcement process against the company and its property. This may extend the timeframe within which a creditor may retrieve, claim or access any property or collateral.

In restructuring, the restructuring agreement may provide a moratorium period during which creditors will not sue the company.

If liquidation is explored, there is a stay of legal proceedings (see CIRA Section 32, Section 33 and Section 87).

The stay of proceedings may protect an originator in a securitisation transaction or an insolvent SPE from overwhelming creditor claims or enforcements.

Restoration Rule

A creditor who received money or property regarding a debt that the company owes them may be required to pay it back to the liquidator. The creditor in this case must have received the money or property within 21 days before the winding-up petition was filed.

This restoration rule does not include payments:

- made by the company if the payment is later made by the bank to meet cheques drawn by the company;
- regarding a debt incurred during the 21-day period;
- regarding a secured debt; or
- regarding the enforcement (against a third party) of a guarantee, indemnity, mortgage, charge or lien on the third party's property.

A liquidator is also at liberty to reverse a transaction entered into:

- in the ten years preceding the winding up order (while the company was insolvent); or
- in the two years preceding the winding up order (while the company was solvent or insolvent) (CIRA Section 122 and Section 123).

6.2 SPEs

The primary feature of an SPE in securitisation is the bankruptcy remoteness attached.

SPEs in securitisation transactions that have occurred in Ghana may be listed on the GSE. The SPEs are therefore subject to the Companies Act, 2019 (Act 992), Securities Industry Act, 2016 (Act 929) as amended, Securities and Exchange Commission (SEC) Regulations 2003 (LI 1728), Securities and Exchange Commission (Amendment) Regulations, 2019 LI 2387, the

GSE listing rules and the SEC Corporate Governance Code.

Some features of SPEs of this nature are highlighted as follows.

- The SPE would ordinarily be incorporated as a Public Company limited by shares under the Companies Act (see GSE Listing Rules 4(6)(a)).
- Ideally, there should be between five and 13 board members. Where this is not the case the board should explain why the number is appropriate in an annual report. Notwithstanding, the minimum number of directors is two with at least one being ordinarily resident in Ghana.
- The board shall have a majority of non-executive directors who are mostly independent. At the very least, two directors (25%) should be independent, one of whom may be the board chair (GSE Listing Rules 11).
- There should be independent external auditors.
- There should be no restriction on the transferability of shares or the number of shareholders and debenture holders.

Where an SPE seeks to issue securities to the public, SEC approval(s) is always required. The parties to the securitisation transaction present their proposed structure and transaction documents for review by the SEC to obtain the necessary approval(s).

To protect investors, the SEC reviews the transaction to ensure there are measures in place such that the insolvency of the originator is unlikely to affect the SPE. By extension, these measures minimise the risk of the SPE and the originator being consolidated in insolvency proceedings.

Some of these measures include:

- structuring the transaction to prevent the corporate veil from being lifted to construe the originator and issuer as one;
- restricting the powers of the board to commence voluntary liquidation;
- incorporating clauses in agreements with third parties that restrict liquidation petitions; and
- the effective transfer of financial assets considering the arm's length principle.

6.3 Transfer of Financial Assets

Depending on the financial asset being transferred, steps must be taken to file the transfer with the relevant regulatory authority. For example, regarding share certificates, the registrar of companies may have to be notified. Where the financial asset is cash, however, possession may suffice as an indication of a valid transfer of ownership.

The records of the collateral registry must also be updated, where applicable, to reflect the change in ownership of the asset.

Some options available to effect the transfer include:

- novation – the transferee assumes the rights and obligations of the transferor regarding the financial asset;
- legal assignment – the transferor assigns its rights to the transferee; and
- declaration of trust – the transferor acts as a settlor and establishes the trust with the transferee as the beneficiary.

In Ghana, novation and legal assignment appear to be the most explored option of transfer in securitisation transactions.

Where the property sold is overvalued and the company becomes insolvent within the next 12 months, the liquidator would have the power to reverse the transaction (CIRA Section 124).

The transferor must deal with the transferee at arm's length, charging market price (Income Tax Act, 2016 (Act 896) Section 31).

It must be noted that the transaction documents would have to be duly stamped or they may be inadmissible as evidence in court or for any purpose except in criminal proceedings (see Stamp Duty Act 2005 (Act 689) Section 32(6)).

Ultimately, the agreement and the terms stipulated may be used to determine whether a true sale is being effected. Where this is not the case, the SEC is unlikely to grant approvals to proceed with the securitisation in the interest of investors.

6.4 Construction of Bankruptcy-Remote Transactions

Securitisation in Ghana has not yet been extensively explored. Currently, the SEC is open and hopeful that more diverse modes of constructing bankruptcy-remote transactions will be explored, such as the use of derivatives. This may insulate the SPE against exposure that may exist in an actual transfer of the underlying asset.

6.5 Bankruptcy-Remote SPE

Limited recourse and non-petition provisions can be incorporated in the securitisation documents as safeguards for the SPE's financial stability.

Bankruptcy remoteness means the SPE is not liable to be put into insolvency proceedings, which would fundamentally upset the structure of the securitisation. The transaction documents can be drafted permitting only the trustee to institute insolvency proceedings against the SPE. To achieve this, the transaction parties must be unable to proceed directly against the SPE and only able to proceed against the securitised assets. It is also important that the SPE is, so far as legally possible, prevented from commencing insolvency proceedings itself.

The steps that can be taken to achieve bankruptcy remoteness may include:

- ensuring the SPE is operated on a solvent basis;
- ensuring the SPE is operated separately from the originator;
- appointing one or more directors (independent of the originator) whose vote(s) is/are required to pass a board resolution to place the SPE into insolvency proceedings;
- placing restrictions on the SPE that prevent it from incurring any liabilities outside those contemplated by the securitisation;
- including non-petition clauses in agreements between the SPE and third parties that prohibit the third parties from commencing insolvency procedures against the SPE; and
- including limited recourse wording in all significant transaction documents to restrict the recourse of a counterparty who takes enforcement action in respect of the SPE's assets, to the assets that the SPE holds and over which the counterparty has security.

7. Tax Laws and Issues

7.1 Transfer Taxes

Withholding Tax

In paying consideration for the realisation of the asset to the originator, the SPE may be required by law to withhold tax on the gross amount of the payment at the rate specified by the laws. (Section 116A the Income Tax Act, Act 896 as

amended by Income Tax (Amendment) Act 2023 (Act 1094)).

7.2 Taxes on Profit

Incorporated companies will be required to pay corporate income tax on the chargeable income of the business (Section 5, Act 896).

7.3 Withholding Taxes

Where the SPE is incorporated within Ghana, its chargeable income is subject to applicable taxes notwithstanding the location or residence of the originator or investor. Incomes that trace their source to Ghana are taxable unless the law grants an express exemption.

The following payments are recognised as having a source in the country:

- dividends paid by a resident company; and
- interest paid:
  - (a) where the debt obligation giving rise to the interest is secured by real property located in Ghana; and
  - (b) by a resident person (Section 105, Act 896).

A company is resident for tax purposes if it is incorporated in Ghana (see Section 101(4), Act 896). There may, however, be some peculiar tax arrangements applicable if the country of residence of the transfer recipient has a Double Taxation Agreement with provisions that apply to the taxes payable within the specified context.

7.4 Other Taxes

Other related taxes that may apply are the Pay As You Earn (PAYE), rent tax and value added tax for incidental services rendered by or to the company.

7.5 Obtaining Legal Opinions

It is advisable to obtain tax opinions in securitisation transactions. However, in recent years, the taxation regime of Ghana has undergone a number of changes that require stakeholders to constantly stay abreast of such events to make strategic business decisions.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Due to the novelty of securitisation as an area in Ghana, legal issues have not yet been raised relating to applicable accounting rules.

8.2 Dealing with Legal Issues

Legal opinions on such areas are not required, but it is ideal to procure legal opinions where any such circumstance arises.

Trends and Developments

Contributed by:
Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman,
Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi
B&P Associates

B&P Associates is a reputable law firm located at Labone, Accra, with 20 core team members including the managing partner and five non-lawyers. The firm keenly promotes the ease of doing business in Ghana, and provides top-notch, user-friendly legal advice to domestic and international investors. It provides clients with all forms of assistance to navigate the legal and regulatory landscape, as well as providing training and consultancy for international organisations on the Ghanaian investment scheme. The team is experienced in assisting companies set up and run successfully in Ghana with respect to business formation and financing, operational matters, as well as myriad corporate transactions, contracts, securities, joint ventures and shareholding agreements, corporate governance, and company secretarial services. The firm would like to acknowledge Audrey Nana Oye Addy for her contribution to the preparation of this publication.

Authors

Adelaide Benneh Prempeh is the founder and managing partner of B&P Associates. Adelaide is a top-ranked lawyer, whose expertise spans across sectors. She is a certified insolvency practitioner and an insolvency consultant to the International Finance Corporation (IFC) of the World Bank Group on the Ghana Investment Advisory Project. Adelaide was called to the English Bar in 2001 and in 2012, she was called to the Ghana Bar as a barrister and a solicitor of the Supreme Court of Ghana. She is a lecturer at the Ghana School of Law and a member of the Ghana Bar Association.

Michelle Nana Yaa Essuman is a senior legal associate with invaluable expertise in investment law, tax, finance and insolvency. She has assisted local and international clients in many intricate transactions and has rendered relevant regulatory advice in line with the transactions. Michelle is a professional-level candidate at the Ghana Investment and Securities Institute (Ghana). She is also a member of the Ghana Bar Association.

Contributed by: Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman, Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi, **B&P Associates**

Bessy Agyeiwaa Crentsil is a legal associate of B&P Associates. She has advised on matters with respect to the firm's practice areas including corporate and commercial, banking and finance, energy, projects and infrastructure, fintech regulation and insolvency. She is a member of the Ghana Bar Association.

David William Akuoko-Nyantakyi is a Ghanaian lawyer with expertise in corporate and commercial transactions, as well as banking and investment. He is a legal associate of B&P Associates and a member of the Ghana Bar Association.

B&P Associates

House No 99A
Fourth Norla Street
Labone
Accra
Ghana

Tel: +233 55 6607614
Email: info@bpaghana.com
Web: www.bpaghana.com

B&P ASSOCIATES

GHANA TRENDS AND DEVELOPMENTS

Contributed by: Adelaide Benneh Prempeh, Michelle Nana Yaa Essuman, Bessy Agyeiwaa Crentsil and David William Akuoko-Nyantakyi, **B&P Associates**

The Use of the "Ghana Card" as the Exclusive Identity Document for Transactions in the Securities Market

In a quest to increase the efficiency and security of the Ghanaian securities market, the Securities and Exchange Commission (SEC) issued a directive mandating the use of the National Identification Card (the "Ghana Card") as the sole identity document for all transactions within the securities market.

This landmark directive is a pivotal development which has implications for investors, market operators and the entire securities ecosystem.

This write-up discusses the directive, the role of identity verification, the rationale behind the directive, and its potential impact on investors, market operators, and the broader financial ecosystem.

Identity verification and its role in the securities market

Identity verification is very critical in securities trading. Market participants need a robust system for establishing the identity of individuals engaging in various transactions. The existence of such a system for confirming the identity of individuals participating in various transactions is the bedrock upon which market trust and integrity are built.

In the past, this has involved multiple identity documents and verification methods, which can be cumbersome, and also present certain security challenges.

Accurate identity verification serves as the foundation for trust and security within the financial market. Before individuals or companies buy securities, ensuring that the prospective vendors are who they claim to be can help to prevent fraud and unauthorised activities. For instance, when an investor attempts to trade in securities using another person's identity, an accurate identification verification system will expose them, halt the perpetuation of such fraudulent transactions and maintain the integrity of the securities market.

Additionally, accurate identity verification is a part of regulatory compliance. Financial institutions must adhere to strict laws that mandate confirming the identities of their clients. The Anti-Money Laundering Act, 2020 (Act 1044), for example, imposes a statutory obligation on accountable institutions to apply customer due diligence measures.

"Accountable institutions" has been defined to include "an entity or a person that conducts as a business... for or on behalf of a customer: accepting deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, bank draft, orders or by any other means; financing, whether in whole or in part or by way of short, medium or long-term loans or advances of trade, industry, commerce or agriculture; providing services in respect of financial guarantees and commitments; trading in foreign exchange, currency market instruments, transferable securities, or commodity futures..."

This helps prevent money laundering, terrorist financing, and other illicit financial activities. Accurate identity verification not only protects individual investors but also contributes to the overall stability and integrity of the financial system.

The introduction of the Ghana Card

Prior to the implementation and use of the Ghana Card, Ghana had numerous separate data-

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bases dispersed across various government and public entities. This resulted in the multiplicity of disparate identification systems, leading to inefficiencies and delays. Government agencies, businesses, and financial institutions faced challenges in authenticating citizens and their data due to this disjointed system.

Additionally, the absence of a unified identification structure contributed to the elevated costs associated with electronic business operations in Ghana and further hindered the government's capacity to deliver targeted services and generate revenue.

Recognising these challenges, the government acknowledged the necessity for a national ID solution and initiated the Ghana Card programme through the National Identification Authority (NIA).

The NIA was set up pursuant to the National Identification Authority Act, 2006 (Act 707) as a body corporate to issue national ID cards to both citizens and foreign nationals permanently resident in the country.

About the Ghana Card

Unlike other traditional identification cards, the Ghana Card is a versatile document that consolidates various identification systems into a unified platform and streamlines verification procedures in Ghana.

It contains basic identification information such as the name, date of birth, height, and personal identification number of the cardholder. It also has an expiry date.

Both citizens and non-citizens have the same card except for the distinguishing feature of the country codes in the Personal Identification Number (PIN). The PIN for Ghanaians starts with "GHA" whilst that for Nigerians, for example, will start with "NRG". The card of foreigners also has NON-CITIZEN in bold red on the front of the card.

The integration of biometric data enhances the accuracy and security of identification processes, reducing the risk of identity fraud and unauthorised access. Additionally, the card is designed to be interoperable with other databases and systems, promoting seamless integration across different sectors such as healthcare, finance and governance.

The government's initiatives to promote the use of the Ghana Card for various transactions

The Ghana Card is the primary ID card that Ghanaians use to access all services in the country – it serves as a valid ID to open a bank account, apply for a passport, mobile number, driver's licence and many other services.

- The Bank of Ghana (BoG), the entity mandated to regulate, supervise, and direct the banking and credit systems to ensure the smooth operation of a safe and sound banking system directed all banks, specialised deposit-taking institutions (SDIs), non-deposit-taking financial institutions, payment service providers, dedicated electronic money issuers, forex bureaux as well as the credit reference bureaux, to accept only the Ghana Card as the form of identification for transaction purposes.
- The Social Security and National Insurance Trust (SSNIT) also rolled out a programme to ensure that all contributors replace their unique scheme identification numbers with the Ghana Card identification numbers.

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- The Ghana Revenue Authority (GRA) and the Registrar-General's Department (RGD) also collaborated with the NIA to replace the Taxpayer Identification Number (TIN) of individuals with the Ghana Card PIN. This was in furtherance of the government's policy to use a unique identifier for all transactions where the identification of an individual is required.

The SEC Directive to all investors and market operators on the use of the Ghana Card as the only identity card for all transactions in the securities market (the "Directive")

The SEC, which was established by the Securities Industry Act, 2016 (Act 929) as amended, is the main capital markets regulator in Ghana. Its object is to regulate and promote the growth and development of an efficient, fair and transparent securities market in which investors and the integrity of the market are protected. In furtherance of its object, the SEC can exercise its discretionary powers within the ambit of Article 296 of Ghana's Constitution to issue directives that it deems necessary.

Sometime in 2022, the SEC issued one such directive stipulating the Ghana Card as the solitary identity document for securities transactions in the securities market.

Rationale for the Directive

The Directive is underpinned by many compelling motives. As succinctly stated in the Directive, its core objectives are to achieve uniformity in the identification of investors; align the securities market's operations to that of the entire financial sector; enhance market surveillance; and ensure the integrity and security of information.

- Achieve uniformity in the identification of investors – the implementation of the Ghana Card as a singular identity card ensures a uniform approach to how investors are identified. Every investor is required to use the same standardised identification, thus streamlining processes and offering a consistent method for investor identification in the securities market. This aligns with global best practices recommended by financial regulatory bodies such as the International Organization of Securities Commissions (IOSCO), of which Ghana is a member, and which stresses that the principles of securities regulation should be based on the following three objectives, namely: protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk.
- Align the securities market's operations with the entire financial sector – embracing a common identity solution aligns the securities market's operations with broader financial sector practices, thereby promoting cohesion and allowing for seamless interactions between the securities market and other financial institutions. This approach resonates with government initiatives to create an integrated financial ecosystem, fostering collaboration across different sectors.
- Enhance market surveillance – the adoption and use of a single identity document strengthens the capacity of regulatory authorities to conduct effective market surveillance. It enables authorities to monitor transactions more efficiently, detect irregularities, and take timely corrective measures. The SEC always emphasises the importance of robust market surveillance to uphold the integrity of the securities market and protect investor interests.
- Ensure the integrity and security of information – a singular identity document contributes significantly to the integrity and security of investor information. It reduces the risk

of data breaches and unauthorised access, thereby safeguarding sensitive information.

Impact of the Directive on investors and market operators

For investors who were admitted into Ghana's securities market before the Directive was issued, the Ghana Card was to become the sole identity card for all their transactions with market operators, effective 1 January 2023. Given that they were admitted into the securities market with identity cards other than the Ghana Card, they are mandated by the Directive to present their Ghana Cards for an update of their KYC records with their respective market operators.

The Directive, however, took immediate effect for all new investors who sought to undertake any transaction in the securities market after the Directive was issued.

Under the Directive, all market operators must take the requisite steps, including the use of digital channels to update the records of investors with the Ghana Card.

In light of this, investors must ensure that they possess a valid Ghana Card to participate in securities transactions, and market operators, such as brokerage firms and clearinghouses, must review their protocols to accommodate the use of the Ghana Card for identity verification.

Effect of non-compliance

The Directive is binding on investors and market operators in Ghana's securities market. Where a player breaches a provision of the Directive, the SEC may take any action(s) specified under the Securities Industry Act, 2016 (Act 929) as amended, and/or any other relevant law or any provision applicable under the Securities Industry Act, 2016 (Act 929) as amended. Such actions may include imposing an administrative penalty of five hundred penalty units (GHS6,000) on the defaulter.

Notwithstanding the above, the SEC has the power to grant a full or partial exemption or a waiver from compliance with the Directive. This must, however, be for good cause and may have accompanying conditions which must be fulfilled.

Benefits of the Directive

Adopting the Ghana Card as the exclusive identity document for transactions in the securities market in Ghana has several advantages.

- It reduces the likelihood of errors associated with managing multiple forms of identification, promoting consistency and accuracy in record-keeping and making the securities market more reliable and transparent.
- It positions Ghana's securities market within global best practices, fostering trust and collaboration with international partners.
- It simplifies and streamlines transaction processes. There is thus no need for multiple forms of identification, making transactions more efficient for both investors and market operators.
- It provides a standardised and secure means of verifying the identity of individuals involved in securities transactions. The risk of identity theft, fraud, and other illicit activities is significantly reduced, making the securities market more secure.
- It facilitates more effective oversight as regulators, such as the SEC, are able to monitor and audit transactions easily, ensuring compliance with established rules and regulations in the securities market.
- Market participants can adapt quickly to a standardised set of procedures, reducing

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complexity and hastening the pace of transactions.
- It minimises the administrative burden associated with managing various forms of identification, ultimately contributing to a more cost-effective and efficient securities market.
- It facilitates easier integration with technological advancements, such as digital platforms and biometric verification systems.

In sum, the use of only the Ghana card as the exclusive identity document for transactions in the securities market in Ghana promotes efficiency and security. It simplifies processes, reduces risks, and contributes to the overall robustness of the financial ecosystem.

Potential disadvantages – security and privacy concerns

The potential disadvantages of the use of the Ghana Card as the singular identity document hinge on issues of data security and privacy. Given that the Ghana Card will be key to many financial transactions, many people have raised security and privacy concerns and have questioned the adequacy of safeguards in place to protect personal data.

Processing a Ghana Card for persons involves the collection and storage of sensitive biometric data and as such, ensuring robust data protection measures must be a priority.

To this end, although Ghana has a data protection regime comprising the Data Protection Act, 2012 (Act 843), more robust data protection mechanisms and privacy policies must be put in place to address these concerns. Cybersecurity measures must also be undertaken to address any potential cybersecurity risks associated with the increased use of digital identity in securities transactions.

The directive by the SEC to make the Ghana Card the exclusive identity document for transactions in the securities market is a bold stride towards bolstering the security and efficiency of Ghana's securities market. Its successful implementation has the potential to reshape prevailing identity verification practices in the financial sector.

While it may present some security and privacy challenges, it is anticipated to yield long-term benefits, making securities transactions more secure and streamlined. The Ghana Card initiative reflects a crucial advancement within the broader narrative of identity management and underscores the government's commitment to modernising and enhancing the financial infrastructure in Ghana.

GREECE

Law and Practice

Contributed by:
Panagiotis (Notis) Sardelas, Matina Kagkelari and Anna Zlatoudi
Sardelas Petsa Law Firm

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Sardelas Petsa Law Firm is one of the leading Greek business law firms with a strong international dimension, known for its top-drawer specialised professional service in high-profile cross-border and domestic transactions and commercial disputes. It is noted for its high expertise and experience, and for its provision of business-oriented, practical and legally robust solutions in complex transactions. The firm provides comprehensive advice and support to domestic and international businesses, spanning a variety of legal disciplines, including banking, finance, capital markets, energy, M&A, real estate, privatisation, public procurement and litigation. It represents and advises foreign and Greek clients from all key sectors, including international and domestic financial institutions, funds, energy developers, real estate developers and managers, pharmaceutical and health sector companies, IT and telecommunications providers, food & beverage and retail goods and services companies, as well as public sector enterprises and entities.

Authors

Panagiotis (Notis) Sardelas is a partner at Sardelas Petsa Law Firm and an expert in the fields of banking and finance and capital markets, including the financing of real estate and energy projects. His 20-year practice includes advising clients, mainly financial institutions, on financings, restructurings and underwritings of ECM and DCM transactions, and acting for companies and investors on M&A transactions, mainly involving listed companies. He has played an instrumental role in the recent development of the Greek corporate bond market, and has considerable expertise in privatisations and state assets development, having acted for foreign investors and the Greek state in a significant number of landmark transactions.

Matina Kagkelari is a senior associate at Sardelas Petsa Law Firm, and head of the structured transactions and capital markets practice. She has more than 20 years' experience in capital markets, banking and finance law and regulation, including cross-border matters. She has been involved in numerous complex and structured DCM and ECM transactions, and in several securitisation transactions, mainly in the banking sector. Matina was previously a senior in-house adviser to a Greek systemic bank, and a senior lawyer at a leading law firm; she has also served as a deputy director of the legal services division at a non-systemic bank.

Anna Zlatoudi is a senior associate at Sardelas Petsa Law Firm, and head of the corporate law practice. She has with more than 20 years' experience in banking, capital markets, regulatory and compliance, corporate governance and regulatory affairs, most of them as senior in-house adviser to a Greek non-systemic bank. Anna has been involved in several securitisations and portfolio sale transactions. She holds a law degree from the University of Athens and her studies include an LL.M. in Labour Law from the University of Athens and an MBA from Hellenic Open University.

Sardelas Petsa Law Firm

8, Papadiamantopoulou str.
11528 Athens
Greece

Tel: +30 2107 296 550
Fax: +30 2107 296 549
Email: office@sardelaslaw.gr
Web: www.sardelaslaw.gr

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1. Specific Financial Asset Types

1.1 Common Financial Assets

Under Greek Law 3156/2003 (the "Securitisation Law"), all business claims originated in and resulting from the business activity of a commercial entity domiciled in Greece or a non-Greek resident having an establishment in Greece are eligible for securitisation, including future claims (as long as they are identifiable), conditional claims and claims towards consumers. Real estate properties can be also securitised; however, the relevant framework has not been tested in practice, as it is considered to be restrictive.

In addition, a special Greek law governs the securitisation of State receivables.

Non-banking securitisations are not common in Greece. Notable recent transactions outside the banking sector include the securitisation of Greek electricity supply contract receivables in the form of overdue invoices of up to 60 days, and the securitisation of Greek electricity supply contract receivables in the form of overdue invoices of at least 90 days.

The vast majority of claims securitised in Greece during recent years have arisen from non-performing loans (NPLs). The most common securitised banking receivables are those arising from mortgage loans, corporate loans, credit card and other revolving credit claims, consumer loans, leasing contracts, bond loans and shipping loans.

1.2 Structures Relating to Financial Assets

The usual transaction structure for all types of assets mentioned in **1.1 Common Financial Assets** is that stipulated in Article 10 of the Securitisation Law, pursuant to which the seller (originator) transfers its business claims to the purchaser (a special-purpose entity or SPE) by way of outright sale, together with the issue by the SPE and offer, by private placement, of notes, the repayment of which is funded by the proceeds of the transferred business claims or by loans, credits or financial derivative agreements.

Typically, in Greek securitisations a sale agreement governed by foreign law and an executory transfer (assignment) agreement governed by Greek law are signed between the seller and the SPE. A typical securitisation also involves the appointment by the SPE of a third servicer, who will actively manage the transferred claims and collect the proceedings therefrom.

In 2015, Greek Law 4354/2015 was introduced as an alternative to securitisation for the servicing, sale and transfer of NPL receivables. Its scope has been expanded to cover the transfer of performing loans as well. Greek Law 4354/2015 applied in parallel with the Securitisation Law and its provisions (with the exception of the tax provisions of Article 3A) were recently repealed and replaced by Greek Law 5072/2023.

The Securitisation Law, however, continues to be the preferred tool for the disposal of NPLs by credit institutions, as a Greek State guarantee scheme was put in place in December 2019, following EU Commission approval, for the senior tranches (ie, senior notes) of banking securitisations (including NPLs) (the "Hellenic Asset Protection Scheme" or HAPS, or "Hercules"), which was extended until October 2022. The HAPS programme has been reintroduced into Greek legislation by Greek Law 5072/2023. The current HAPS programme is up to EUR2 billion and expires on 31 December 2024.

1.3 Applicable Laws and Regulations

The securitisation of business claims and real estate properties in Greece is governed by the Securitisation Law, together with the general provisions on the "sale of assets" contained in Articles 513 et seq and 455 et seq of the Greek Civil Code.

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 (STS) 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 (the "EU Securitisation Regulation"), and any regulatory technical standards issued thereunder, would also apply.

Securitisations in the banking sector that aim for a significant risk transfer and accounting derecognition should meet the requirements of Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013, as amended by Regulation EU 2017/2401 (the CRR).

Banking securitisations aiming to qualify for the HAPS programme should also comply with the provisions of Greek Law 4649/2019, as most recently amended by Greek Law 5072/2023 (the "HAPS Law").

Greek Law 2801/2000 governs the securitisation of State receivables.

More general aspects of securitisation transactions are governed by the Greek Company Law 4548/2018, a legislative decree dated 17 July/13 August 1923 on some special provisions on *sociétés anonymes*, and by Greek Law 2844/2000 on the pledge registry.

The provisions of Greek Law 5072/2023, which transposed Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and replaced the relevant provisions of Greek Law 4354/2015, would also apply to the servicing of receivables transferred under the Securitisation Law, if the relevant servicing activities have been assigned to licensed Greek or EU credit servicers, within the meaning of Greek Law 5072/2023. Greek Law 5072/2023 does not apply to the transfer of claims under credit agreements transferred before 30 December 2023, nor to their respective servicing agreements.

1.4 Special-Purpose Entity (SPE) Jurisdiction

Under the Securitisation Law, the purchaser and transferee of the claims (and issuer of the notes) within a securitisation transaction is always an SPE and may be established either in Greece or abroad. Pursuant to Article 4 of the EU Securitisation Regulation, an SPE cannot be established in a third country that is listed as a high-risk jurisdiction.

In order to mitigate regulatory and accounting risks, securitisation SPEs in Greek securitisations are usually orphan entities and are typically established offshore, in countries where favourable double taxation avoidance treaties are in force, such as Ireland or Luxembourg, which ensures that payments from obligors to the SPE can be made free of withholding tax. The choice of jurisdiction is also driven by set-up and maintenance costs and confidence in the respective legal system's ability to ensure a ring-fencing of the transferred assets.

Greece is not a preferred jurisdiction for the incorporation of SPEs, as securitisation SPEs established in Greece should have the form of a company limited by shares (*société anonyme*), which cannot be an orphan vehicle, while its shares are mandatorily registered.

1.5 Material Forms of Credit Enhancement

The Securitisation Law does not include specific provisions on credit enhancement. The choice of the most appropriate form is left to the discretion of the parties involved.

The forms of credit enhancement most commonly used in Greek securitisations are:

- tranching (senior/subordinated note structures), where senior notes have a priority of payment over more junior notes, which also absorb losses before senior notes;
- over-collateralisation, when the receivables transferred are of a greater value than the notes issued;
- cash reserves and deposits; and
- limited recourse loans.

A special form of credit enhancement is the provision of a State guarantee to the most senior class of notes of banking securitisation transactions, pursuant to the HAPS Law.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer is an insolvency-remote special-purpose vehicle, the scope of which is exclusively the acquisition of business receivables and the issuance of the notes to fund the securitisation transaction.

The issuer must not be owned or controlled by the seller (whether through holdings of shares or control of the management), both for accounting reasons (consolidation implications) and for legal and regulatory reasons (including under the CRR and the EU Securitisation Regulation); please see also **1.4 Special-Purpose Entity (SPE) Jurisdiction**.

2.2 Sponsors

The term “sponsor” is not contained in the Securitisation Law.

According to the CRR and the EU Securitisation Regulation, a sponsor is a credit institution (whether located within the EU or not) or an investment firm as defined under Directive 2014/65/EU (MiFID II), other than the originator, that establishes and manages a securitisation that purchases exposures from third-party entities, or that establishes a 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 such activity in accordance with Directive 2009/65/EC (the “UCITS Directive”), Directive 2011/61/EU (AIFMD) or MiFID II.

2.3 Originators/Sellers

According to the Securitisation Law, in a securitisation of business claims, the originator/seller of the receivables can be any merchant residing or being permanently established in Greece, whereas in real estate securitisations the seller can only be the Greek State or another public sector entity, a credit institution, an insurance company or a *société anonyme* 100% owned by the above entities.

The HAPS Law applies only to securitisations originated by credit institutions.

The EU Securitisation Regulation imposes a "direct" obligation on the originator to ensure that it retains a 5% material net economic interest on the transferred assets (risk retention – see **4.3 Credit Risk Retention**).

2.4 Underwriters and Placement Agents

Underwriters – usually also referred to as managers and/or arrangers – are typically investment banks, which act as an intermediary between the issuer and investors in the offering of the notes. In Greek securitisations, the arrangers provide advice on the structure of the transaction and/or investor demand, and facilitate the marketing and sale of the notes.

2.5 Servicers

The servicer is the entity undertaking the servicing, the collection and, generally, the management of the transferred receivables. Under the Securitisation Law, the servicing of the securitised portfolio can either remain with the originator or it can be assigned to a credit or financial institution, which legally provides services according to its scope within the EEA, or to any third party, provided that it is either a guarantor to the transferred receivables or is entrusted with the management or collection of the receivables prior to their transfer.

It is noted that, under the Securitisation Law, if the SPE does not have an establishment in Greece and the transferred receivables are claims against consumers payable in Greece, the servicer must have an establishment in Greece.

The servicer is appointed by the SPE by a written agreement. The servicing agreement is registered in the public books of the pledge registry of the registered seat of the originator. If the servicer is replaced, a new servicing agreement will be entered into and will be registered in the same manner as the initial servicing agreement.

Under Greek Law 5072/2023, which repealed the relevant provisions of Greek Law 4354/2015, the credit servicer acting on behalf of a credit purchaser or a credit institution or a financial institution having its registered seat or established in EU, in respect of a creditor's rights, under credit agreements issued by credit or financial institutions having their registered seat or established in EU, must be a licensed servicing company. Credit servicers fall into the category of financial institutions, and may act as servicers of securitised claims under the Securitisation Law arising from credit agreements.

2.6 Investors

Investors purchase the notes issued by the SPE, and receive interest and principal payments from the notes.

According to the Securitisation Law, the notes issued by the SPE can be offered in any jurisdiction by private placement only – ie, to a limited number of persons not exceeding 150. Under the Securitisation Law, the minimum denomination of each note issued by the SPE is EUR100,000.

The notes issued are usually bought by institutional investors, such as credit institutions, financial institutions and investment firms.

Although not prohibited, the distribution of the notes to retail investors is subject to specific requirements under the EU Securitisation Regulation, MiFID II and Regulation 1286/2014 (the "PRIIPS Regulation"). In any case, such distribution is highly unlikely due to the aforementioned minimum nominal value of each note issued by the SPE.

2.7 Bond/Note Trustees

Greek law does not recognise the common law concepts of trusts or trustees. As an alternative, the Company Law imposes the organisation of the noteholders into a group and the appointment of a "bondholder agent" to act as the representative of the group of noteholders and exercise their rights on their behalf; according to the Company Law, such agent can only be a credit institution or a licensed servicer under the former Greek Law 4354/2015 (and now Greek Law 5072/2023), or entities such as an investment firm, an alternative investment fund manager or a central securities depository.

However, foreign trust arrangements are recognised in Greece. In this case, the role of the note trustee will be regulated by the law governing the securitisation transaction documents. A professional corporate entity is usually appointed as a trustee.

2.8 Security Trustees/Agents

As mentioned in **2.7 Bond/Note Trustees**, Greek law does not recognise the common law concept of trusts, but foreign trust arrangements are recognised in Greece. In this case, the role of the security trustee will be subject to the law governing the securitisation transaction documents. A security trustee's role is to hold benefit of the security interests and rights on behalf of and for the account of the investors and the secured parties. A security trustee is also entitled to enforce the collateral transferred to the trustee in the occurrence of a default event. A professional corporate entity is usually appointed as a trustee.

As an alternative to the trust structure, the Securitisation Law provides that, upon registration of the Greek law transfer (assignment) agreement in the public books of the pledge registry of the registered seat of the originator, a first ranking pledge on the transferred receivables and the collections relating to the receivables (which must be paid into a segregated bank account) is created directly in favour of the noteholders (and any other creditors of the issuer under the securitisation transaction documents, such as swap counterparties, liquidity providers, etc), by operation of law. Finally, the Company Law imposes the organisation of the noteholders into a group and the appointment of a "bondholder agent" (see **2.7 Bond/Note Trustees**).

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

A securitisation transaction customarily includes the following elements.

- A sale agreement (usually under English Law) between the seller and the SPE, which contains the contractual terms and conditions of the sale. This agreement typically includes the agreement to sell and purchase the receivables, the agreed consideration, the conditions precedent, completion and post-closing actions, representations and warranties, indemnity clauses and general clauses regarding the language and jurisdiction, whereas the parties usually choose to annex in pre-agreed form any documentation to be used on the execution of the agreement – namely the Greek law assignment agreement (see below) and any powers of attorney.
- A transfer (assignment) agreement under Greek law between the seller and the SPE, with the minimum content required by law – namely the counterparties, the purchase price (with reference to the respective clause in the sale agreement) and a short description of

the receivables and jurisdiction clauses. A list of the receivables (with the description of the receivable, its nominal value and its related rights) is annexed to the agreement.

In accordance with the Securitisation Law, a summary of the assignment agreement must be registered in the public registry book of Article 3 of Greek Law 2844/2000 kept with the pledge registry of the registered seat of the seller in order to effect a bankruptcy-remote transfer of financial assets to the SPE (see **6.1 Insolvency Laws**).

3.2 Principal Warranties

Principal warranties used in securitisation documentation typically include:

- corporate warranties of the seller and SPE regarding their good standing and their power to enter into the transaction; and
- warranties in relation to the underlying assets.

Any party breaching corporate warranties is typically obliged to indemnify the other party against any losses and damages, including any costs.

In the case of a breach of the warranties in relation to the underlying assets, the documentation typically provides for indemnification clauses, containing, among others, the procedure for bringing up a claim, limitations on the seller's liability and time limitations. A seller may also have the option to repurchase any receivable that does not meet the criteria set out in the sale agreement and replace it with another.

The warranties are enforced in accordance with the law governing the sale agreement (usually English law).

3.3 Principal Perfection Provisions

The principal perfection provision is the registration in the public registry book of Article 3 of Greek Law 2844/2000 kept with the pledge registry of the registered seat of the seller of a summary of the transfer (assignment) agreement.

This is enforced by:

- the execution and delivery by the seller and the SPE of a duly completed Greek assignment agreement in respect of the receivables and the related rights on the closing date; and
- the execution and delivery by the seller and the SPE of an executed notification form to the registry on the closing date – the sale agreement typically includes an obligation for the parties to deliver such an executed form.

The execution and delivery by the seller to the SPE on the closing date of a seller power of attorney, authorising the SPE to proceed with the registration on its own, is also customary in Greek transactions. Notarised powers of attorney may also be provided to the legal counsels of the transaction, by virtue of which the latter have the right to appear before the public registry and proceed with the registration on behalf of the parties.

3.4 Principal Covenants

The principal covenants in securitisation documentation in respect of a seller are as follows:

- to comply with all of its obligations under the documentation;
- to make any and all payments free and without deduction for any and all present and future taxes; and
- to notify the SPE if it becomes aware of any material breach by it of any representation or warranty, or if any legal proceedings

are instituted against any of the transferred receivables.

In the case of a breach, the seller will be liable for compensation, in accordance with the sale agreement.

The SPE's main covenant is to limit its scope of activities to the purposes of the securitisation.

3.5 Principal Servicing Provisions

The Securitisation Law does not include specific provisions regarding servicing, except for the servicer's obligation to deposit immediately all collections in a special account, held either with it (if the servicer is a bank) or with a credit institution seated in the EEA, which is segregated from the servicer's and/or the credit institution's assets.

The servicing agreement typically includes terms regarding the servicing fees, the procedures of servicing and the collection of monies, the key performance indicators to be taken into account for the evaluation of the servicer's performance, the undertakings and liabilities of a servicer, and clauses on the termination and replacement of the servicer.

A summary of the servicing agreement must be registered in the public registry book of Article 3 of Greek Law 2844/2000 kept with the pledge registry of the registered seat of the seller.

Enforcement of the terms of the servicing agreement is made under the law governing said agreement.

With respect to the servicing of bank loan receivables by licensed credit servicers, within the meaning of Greek Law 5072/2023, the latter provides the minimum content of servicing agreements, which should include the following clauses:

- a detailed description of the servicing activities assigned;
- the servicing fees and a reference that these cannot be passed through to the debtors of the receivables;
- the costs payable by the SPE;
- the authorisation of the servicer to represent the SPE towards debtors;
- covenants of the parties to comply with EU and national legislation, specifically data protection rules;
- the receivables under servicing, in aggregate (ie, the number and total amount of claims on the signing date) and a case-by-case reference (total claim amount), as well as the status of each loan receivable (performing, non performing);
- the related rights;
- undertakings for the fair and prudent handling of the debtors;
- the previous notification of the SPE before the assignment of the servicer of any servicing activities (outsourcing) to third parties; and
- the intermediary policy on the sale of loan receivables in a secondary market.

Under Greek Law 5072/2023, a copy of the servicing agreement must be submitted to the Bank of Greece (BoG), which is the competent authority responsible for the supervision of licensed credit servicers, within ten days of its signing.

3.6 Principal Defaults

Principal defaults used in securitisation documentation include the following:

- in the sale and purchase agreement: the breach of representations and warranties in relation to receivables;

- in the servicing agreement: the failure of the servicer to meet the Key Performance Indicators set, breach of undertakings, or non-compliance with laws; and
- in the trust deed: the failure of the trustee to apply monies according to the order of priority.

Specific defaults are provided for in servicing agreements of banking securitisations that intend to be compliant with the HAPS Law (see **4.12 Participation of Government-Sponsored Entities**).

Breach of contractual obligations by the servicer or the trustee may also lead to their substitution.

3.7 Principal Indemnities

In the case of a breach of corporate warranties, the breaching party is typically obliged to indemnify the other party against any losses and damages, including any costs.

In the case of a breach of warranties with respect to the underlying assets, the documentation usually provides indemnification clauses, as well as the option for the seller to repurchase the receivables that do not meet the set criteria.

Indemnities are enforced in accordance with the law governing the relevant agreement.

3.8 Bonds/Notes/Securities

According to the Securitisation Law, the board of directors of the Greek SPE is the competent body to resolve on the issuance of the notes and to define their characteristics. The board of directors may provide authorisations for the determination of additional issues, such as the number, the total nominal value, the offering details and the appointment of the servicer and the bondholder agent. The only restriction in the Securitisation Law is the minimum denomination of each note, which must be at least EUR100,000.

Typically, in Greek securitisations, the terms and conditions of the notes are included in a note trust deed governed by English law. The note trust deed provides for the number of notes to be issued by the SPE, their denomination and other basic terms, such as the covenant to pay, the pre-acceleration and post-acceleration application of monies received by the trustee, the interest rate and the interest payment dates, events of default and terms regarding the role of the trustee.

3.9 Derivatives

The Securitisation Law explicitly allows SPEs to enter into financial derivatives transactions for hedging purposes or for purposes related to securitisation.

Interest rate derivatives, such as interest rate swaps, are mainly used in Greek securitisation transactions, in order to mitigate the interest rate risk (eg, by exchanging fixed income from receivables against floating interest under the notes, or vice versa).

For more information regarding the laws and regulations that apply to the use of derivatives, please see **4.7 Use of Derivatives**.

3.10 Offering Memoranda

The Securitisation Law allows only private securitisations effected through the distribution of the notes to a limited number of persons not exceeding 150. Accordingly, no Offering Memoranda are required in this case. Instead, and in order to meet the transparency requirements of the EU Securitisation Regulation, a “transaction

summary" or overview of the main features of the securitisation has to be drafted.

Even though notes issued under the Securitisation Law may only be distributed via private placement, their listing is not prohibited. If the notes were listed on an EU regulated market or Multilateral Trading Facility (MTF), a Prospectus (within the meaning of the Regulation EU 2017/1129 – the "Prospectus Regulation") or an Offering Circular, respectively, would be issued.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

According to paragraph 8 of Article 10 of the Securitisation Law, a summary of the receivables transfer (assignment) agreement (and of any repurchase of receivables) has to be registered in the public books of the competent pledge registry (ie, the pledge registry of the registered seat of the originator), set up under Article 3 of Law 2844/2000. Pursuant to paragraph 16 of Article 10 of the Securitisation Law, the servicing agreement should also be registered with the pledge registry (see **2.5 Servicers**). The Greek Ministry of Justice has issued template forms regarding the above registrations.

In addition, the EU Securitisation Regulation has introduced a set of harmonised disclosure and transparency rules that have applied to all forms of EU securitisations since 1 January 2019 (other than securitisations existing prior to that date to the extent that they are grandfathered). The EU Securitisation Regulation has imposed specific disclosure requirements on the originator, the sponsor and the SPE, which were clarified by the implementation of technical standards, comprising formats and templates to help standardise the reporting procedures.

- Certain information should be disclosed to investors (and to potential investors, upon request) and to national competent authorities before pricing, including all documentation essential for the understanding of the transaction, as well as any offering document or prospectus and, where no prospectus has been drawn up, a "transaction summary" of the main features of the securitisation. Information on the underlying exposures and investor reports should also be made available on an ongoing basis (see also **4.4 Periodic Reporting**).
- The originator, sponsor and SPE should designate from amongst themselves one entity to fulfil the relevant information requirements. In private securitisations, such as the ones stipulated under the Securitisation Law, the required information is provided directly to investors and to the competent authorities, whereas information transparency in public securitisations is achieved through filings with a securitisation repository, or by registering an entity online to act as a securitisation repository.

4.2 General Disclosure Laws or Regulations

As mentioned above, the Securitisation Law only allows private securitisations, but the listing of the respective notes is not prohibited. If the notes are listed on ATHEX, the following legislation will also apply:

- the Prospectus Regulation and Greek Law 4706/2020, which specifies the implementation measures under the Prospectus Regulation;

- Greek Law 3556/2007, transposing Directive 2004/109 (the "Transparency Directive"); and
- Regulation EU 596/2014 (the "Market Abuse Regulation" or MAR).

4.3 Credit Risk Retention

The Securitisation Law does not provide for "credit risk retention". However, the risk retention requirements found in the relevant European legislation (namely the EU Securitisation Regulation and previously the CRR) are applicable to Greek securitisations.

More specifically, pursuant to Article 6 of the EU Securitisation Regulation, the originator, sponsor or original lender of a securitisation should retain, on an ongoing basis, a material net economic interest in the securitisation of not less than 5%, using one of five methods. The EU Securitisation Regulation exempts from the risk retention requirement securitisations where the underlying assets are obligations of or obligations guaranteed by central governments, central banks, regional governments/local authorities and multilateral development banks.

In addition, certain institutional investors must verify that the risk retention obligations have been complied with, as part of their due diligence obligations under Article 5 of the EU Securitisation Regulation.

The risk retention regulatory technical standards (RTS) under the EU Securitisation Regulation were published in the Official Journal of the EU on 18 October 2023 as Commission Delegated Regulation (EU) 2023/2175 of 7 July 2023, and came into force on 7 November 2023. From the date on which the RTS came into force, the relevant CRR RTS (namely EU Delegated Regulation 625/2014) were repealed (subject to the transitional provisions of the EU Securitisation Regulation for securitisations that remain grandfathered and that are subject to the previous rules).

According to Article 70 of Greek Law 4706/2020, in the case of a breach of the applicable requirements under the EU Securitisation Regulation (including the risk retention requirements), the national competent authorities – namely the BoG or the Hellenic Capital Markets Commission (HCMC), as provided for in the above law – may impose the administrative sanctions and measures provided for in paragraph 2 of Article 32 of the EU Securitisation Regulation on any natural or legal person. The same administrative sanctions may also be imposed in case of breach of the regulatory obligations laid down in the implementing acts of the EU Securitisation Regulation, as well as in the regulatory acts adopted by the above national competent supervisory authorities, pursuant to the EU Securitisation Regulation. Notably, among the above administrative sanctions, a fine of up to EUR5 million or up to twice the benefit derived from the violation, where this amount can be determined, is provided for. Despite the discretion provided by the EU Securitisation Regulation, Greece has not provided for any specific criminal sanctions.

4.4 Periodic Reporting

Article 13 of the Securitisation Law requires Greek SPEs to submit a valuation report on their real estate property and the liquidation value of all the assets thereof (including loan receivables) to the BoG and the HCMC, on an annual basis. This report must be audited by statutory auditors, under the International Financial Reporting Standards (IFRS). No specific penalties for a breach of such obligations are provided for in the Securitisation Law.

The EU Securitisation Regulation also imposes a number of periodic reporting obligations on

the originator, sponsor and issuer, to holders of securitisation positions, the supervisory authorities and investors, such as the submission of quarterly reports to investors, which must contain information on:

- the credit quality and performance of the underlying exposures;
- the trigger events affecting the priority of payments or the replacement of the parties involved;
- the cash flows generated by the underlying exposures and the liabilities of the securitisation; and
- risk retention.

Furthermore, there are reporting obligations on any inside information relating to the securitisation that the originator, sponsor or SPE is obliged to make public in accordance with MAR and, where the above do not apply, information on any significant event that can materially impact the performance of the securitisation, such as any material amendment to the transaction documents, any material breach of the obligations provided for in the transaction documents, or any material change in the structure or the risk characteristics of the securitisation or the underlying exposures.

Please see **4.3 Credit Risk Retention** regarding the penalties imposed for non-compliance with the periodic disclosure requirements under the EU Securitisation Regulation. Additional periodic disclosure requirements apply to banks under the CRR.

4.5 Activities of Rating Agencies

Rating agencies are governed by Regulation (EC) 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, as amended, and Greek Law 3867/2010. The HCMC is the Greek authority responsible for the registration and supervision of rating agencies established in Greece and the imposition of fines and other measures, along with the European Securities and Markets Authority (ESMA).

In some cases, the rating of the notes issued in the context of the securitisation transaction is necessary. For instance, under the Securitisation Law, mutual funds and investment holding companies established in Greece may only invest in notes that have been assigned an “investment grade” by an internationally accepted rating agency. Please see **4.12 Participation of Government-Sponsored Entities** regarding the rating of the senior notes of securitisation transactions under the HAPS Law.

4.6 Treatment of Securitisation in Financial Entities

Credit institutions and large investment firms have to calculate their regulatory capital as provided for under the CRR. Securitisation may be an important risk management tool for banks.

Simple, transparent and standardised (STS) securitisations within the meaning of the EU Securitisation Regulation draw a more beneficial capital treatment, which is an incentive for originators and investors.

Pursuant to the CRR, a bank may exclude the underlying exposures from its calculation of risk-weighted exposure amounts if the securitisation meets the regulatory criteria for significant risk transfer (STS). The CRR establishes standardised tests to assess whether the credit risk transferred is significant and, consequently, whether the bank’s capital requirements can be reduced. The SRT principle is applicable to both traditional and synthetic securitisations. Originators of

SRT securitisations should notify the European Central Bank (ECB) of their intentions at least three months in advance of the expected closing date of the transaction.

Insurance and reinsurance undertakings are subject to specific capital requirements pursuant to Commission Delegated Regulation (EU) 2015/35 of 10 October 2014, supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance ("Solvency II"), as amended and in force, when investing in securitisations. For this purpose, Solvency II originally divided securitisation positions into three categories for the purpose of calculating capital charges (type 1, type 2 and resecuritisation). The introduction of the STS categorisation under the EU Securitisation Regulation modified the Solvency II capital calibrations relating to securitisations and replaced the original categories with senior STS, non-senior STS, non-STS and resecuritisations, for which different capital requirements apply.

4.7 Use of Derivatives

According to the Securitisation Law, SPEs may enter into financial derivatives transactions for hedging purposes or for purposes related to securitisation.

Furthermore, Article 21 of the EU Securitisation Regulation provides that for STS securitisations the use of derivative contracts shall be limited to the purpose of hedging the SPE's interest rate or currency risk. These derivatives should be underwritten and documented according to common standards in international finance. The SPE shall not enter into derivative contracts for any other reason, and should ensure that the pool of underlying exposures does not include derivatives.

Derivatives are generally regulated by Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012, as amended (EMIR). An EU SPE entering into such contracts will be subject to obligations imposed under EMIR. For EMIR purposes, an SPE would be considered to be a non-financial counterparty (NFC).

EMIR provides, inter alia, for central clearing of derivatives, if certain thresholds are met, or for risk mitigation techniques, such as the exchange of collateral. Article 4 of EMIR provides for an exemption from the clearing obligation (and collateral posting obligation) for STS securitisations if the counterparty credit risk is adequately mitigated – ie, if the following additional criteria under Article 2 of the Commission Delegated Regulation (EU) 2020/447 are met:

- the counterparty ranks at least pari passu with the holders of the most senior notes (unless such counterparty is the defaulting or affected party); and
- the most senior notes are subject to a credit enhancement of at least 2% of the outstanding notes.

Under EMIR, as amended, financial counterparties are solely responsible, and legally liable, for reporting derivative transactions on behalf of both counterparties, for the details of OTC derivative contracts concluded with an NFC that does not exceed the clearing thresholds (NFC-), and for ensuring the correctness of the details reported.

Please see **4.3 Credit Risk Retention** regarding the potential penalties that could be imposed for non-compliance with the limitations provided for in the EU Securitisation Regulation as regards derivative transactions.

Pursuant to Greek Law 4209/2013, the HCMC supervises Greek NFCs in relation to their compliance with EMIR. In the case of a breach, penalties range from reprimands to administrative fines.

4.8 Investor Protection

Investor protection under the Securitisation Law is achieved through the registration of the transfer and the servicing agreements with the public pledge registry and the creation of the statutory pledges, the prohibition of creation of any other security interests over the receivables and the collection accounts, and the segregation of assets and bankruptcy-remoteness. In addition, the Securitisation Law provides for the formation of the noteholders' group and the appointment of a bondholder agent, which constitutes an additional protection for investors.

At an EU level, the EU Securitisation Regulation includes specific requirements aimed at protecting investors, such as:

- the pre-investment due diligence requirements for institutional investors (Article 5);
- the risk retention requirements (Article 6);
- the transparency requirements for the underlying exposures (Article 7); and
- the credit-granting requirements imposed on the originators, sponsors and original lenders, with the aim of ensuring the quality of the securitised assets (Article 9).

The ban on resecuritisations (Article 8) and the obligation to hold data in a securitisation repository (Article 17), where applicable, also serve as investor protection measures.

The EU Securitisation Regulation also aims to protect retail investors by including certain restrictions with regard to the sale of securitised positions to retail clients, including a requirement to perform a suitability test in accordance with MiFID II, which was implemented in Greece by Greek Law 4514/2018. MiFID II contains a number of requirements aiming to protect investors, including product governance, information and record-keeping. Additionally, in the case of offerings made to retail investors, a key information document (KID) may need to be prepared, in accordance with the PRIIPS Regulation.

4.9 Banks Securitising Financial Assets

Securitisations of Greek credit institutions are mainly governed by the provisions of the Securitisation Law, the CRR and the EU Securitisation Regulation.

4.10 SPEs or Other Entities

Please see **1.4 Special-Purpose Entity (SPE) Jurisdiction** and **2.1 Issuers**.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Pursuant to the Securitisation Law, SPEs may not engage in any other activity outside the scope of securitisation.

4.12 Participation of Government-Sponsored Entities

As discussed in **1.2 Structures Relating to Financial Assets**, the HAPS Law introduced the HAPS programme, which has recently been reintroduced by Greek Law 5072/2023 and now expires on 31 December 2024. The HAPS Law sets out the terms and conditions under which the Greek State may provide its guarantee for the senior notes issued in the context of bank securitisations. These transactions are otherwise regulated by Article 10 of the Securitisation Law.

Under the HAPS Law, at least two classes of notes, in terms of payment priority (ie, senior and

junior notes), should be issued, and the issuance of mezzanine notes is also possible.

It should also be noted that Greek banks are not allowed to include loans that benefit from State guarantees in their securitised portfolios. In addition, the Greek State, public entities and general government entities, including those directly or indirectly controlled by the State, may not acquire any junior or mezzanine bonds that are issued in the context of securitisations for which a Greek State guarantee has been provided or a request for a Greek State guarantee has been submitted, under the provisions of the HAPS Law.

The HAPS Law prescribes the priority of payments under the securitisations intended to be guaranteed under the HAPS programme. The servicing of the securitised claims is mandatorily assigned to a servicer, who at the time of entry into force of the State guarantee is not controlled by the transferor, pursuant to International Accounting Standard 10 (independent servicer).

The main conditions for the entry into force of the State guarantee are the transfer to private investors by way of sale, against positive value, of at least 50% +1 of the junior notes issued, and the transfer to private investors by way of sale at a positive price of an adequate number of junior notes and, if applicable, an adequate number of mezzanine notes, for the derecognition of the securitised claims in the financial statements of the transferor and its group, on a consolidated basis, in accordance with the IFRS. In addition, following the recent amendment of the HAPS Law, senior notes should be rated BB+, Ba1, BB+, BB (high) or higher by a recognised rating agency registered in the relevant register of the European Central Bank (the relevant rating provided in the initial text of the HAPS Law was BB-, Ba3, BB-, BBL or higher). Any second rating should be carried out by a rating agency registered in accordance with the provisions of Regulation (EC) 1060/2009. This second rating cannot be lower than BB+, Ba1, BB+ or BB (high).

The HAPS Law explicitly provides that the Greek State guarantee constitutes an express, irrevocable, unconditional and on first demand guarantee, pursuant to the provisions of Articles 213, 214 and 215 paragraph 1 of the CRR.

Several transactions for very large portfolios of bank loan and credit receivables have been concluded by the Greek systemic banks under the HAPS Law since 2019.

4.13 Entities Investing in Securitisation

Please see **2.6 Investors** and **4.12 Participation of Government-Sponsored Entities**.

As mentioned in **4.5 Activities of Rating Agencies**, under the Securitisation Law, mutual funds and investment holding companies established in Greece may only invest in notes that have been assigned an "investment grade" by an internationally accepted rating agency.

4.14 Other Principal Laws and Regulations

There are no other relevant principal laws or regulations.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations do not qualify as "securitisations" within the meaning of the Securitisation Law, because in synthetic securitisations

the ownership of the securitised receivables is not transferred to the SPE but remains with the originator. In synthetic securitisations, the risk of the securitised claims is transferred from the originator to the investors through a credit protection agreement, usually in the form of a financial guarantee or a credit derivative (such as a total return swap), whereby the originator agrees to pay the investor a credit protection premium and the investor agrees to pay the originator a credit protection payment, if a contractually agreed credit events occurs.

Synthetic securitisations are permitted under the EU legislation and are recognised by the Single Supervisory Mechanism and the BoG for the regulatory capital treatment of credit institutions. A number of synthetic securitisations have been concluded by Greek systemic banks during the last three years.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Under paragraph 19 of Article 10 of the Securitisation Law, upon perfection of the sale and transfer of the receivables by registration of the transfer (assignment) agreement with the pledge registry, the validity of the sale and transfer of the receivables (including any rights ancillary to the claims transferred) shall not be affected by the opening of any insolvency proceedings against the seller, the SPE, the servicer of the receivables or any third-party guarantor or beneficiary of other ancillary rights.

In addition, upon registration of the transfer (assignment) agreement with the pledge registry, a first-ranking pledge is created by operation of law over:

- the receivables for the benefit of the holders of the notes and other secured creditors under the securitisation transaction; and
- the proceeds of collections made by the servicer in respect of the receivables, which should be deposited in a separate bank account held with the servicer itself (if it is a credit institution) or with a credit or financial institution within the EEA.

This collection account is segregated from the servicer's or the relevant account bank's insolvency estate (as applicable). Secured claims are satisfied from the enforcement of the statutory pledge ahead of the claims of any statutory preferential creditors.

In addition, the Securitisation Law provides that, following the registration of the transfer of the claims, no security interest or encumbrance can be created over the receivables other than the aforementioned statutory pledge.

Finally, according to the Securitisation Law, any security interest granted for the account of the noteholders, any funds received by the servicer on behalf of the noteholders and any titles of securities deposited with the servicer are not subject to attachment, set-off or any other encumbrance sought by the servicer or by any of its creditors, nor are they included in the servicer's insolvency estate.

6.2 SPEs

In Greek securitisation transactions, the SPE is typically a newly established orphan entity, established offshore and keeping separate financial statements. Pursuant to the Securitisation Law, SPEs may not engage in any other activity outside the scope of securitisation; see **1.4 Special-Purpose Entity (SPE) Jurisdiction** and **2.1 Issuers**.

Substantive consolidation is not provided for in Greek insolvency law. Given that the SPE has a separate legal personality, if the Greek originator is subject to insolvency proceedings, the assets of the SPE (ie, the receivables, including future receivables) will not be included in the originator's bankruptcy estate and will be available exclusively for the satisfaction of the noteholders and other secured creditors under the securitisation transaction. As a matter of Greek law, the lifting of the corporate veil has been applied by courts in exceptional cases, outside the scope of securitisation. Such cases involved entities that were fully owned and controlled by their shareholders and operating as separate legal entities in name only.

6.3 Transfer of Financial Assets

Under the Securitisation Law, the transfer of receivables is effected and perfected upon the registration of a summary of the transfer (assignment) agreement in the public books of the pledge registry. In addition, the transfer agreement and its registration override any contractually agreed non-transferability of the respective receivables between the seller and the obligor of the receivables.

The above registration also operates as a deemed notification of the transfer to the relevant obligors of the securitised claims, without the need to give them individual notifications (as would otherwise be required under the general provisions of Articles 455 et seq of the Greek Civil Code on assignment of rights and claims).

Accordingly, by and upon such registration, the transfer of the receivables and related security interests to the SPE, like all other effects of the securitisation of the receivables, takes effect automatically in rem as against all persons, as far as Greek law is concerned. If the registration requirements are not complied with, the receivables continue to be a part of the seller's estate.

The registration of the transfer agreement with the public registry is also the only perfection requirement for the statutory pledge over the receivables and the collection account to take effect (see **6.1 Insolvency Laws**).

For the purposes of the registration, a specific form is used. A full list of the transferred receivables, including identification of the relevant contract, information on debtors, guarantors, outstanding amounts, maturity date, etc, is annexed to this form.

Upon registration, the pledge registry will issue a certificate of registration, on the basis of which the SPE (in practice, the servicer appointed on its behalf) will be able to effect annotation of the transfer of the relevant receivable in the public books of the competent land registry or cadastre in cases where the receivable is secured over real property, or the competent pledge registry in cases where the receivable is secured over a pledge, which is subject to publicity. Such annotations are not required for the perfection of the transfer of the relevant receivable (nor of the security interest securing that receivable): they are only required for the update of the public books of the public registry regarding the identity of the beneficiary of the security interest securing the relevant receivable. Usually, such annotations are made when enforcement steps are intended to be taken against the obligor of the securitised claim.

Legal opinions that are typically provided with respect to securitisation transactions confirm, inter alia, that the transfer of the claims under the relevant sale and transfer agreement constitutes a true and unconditional sale of the claims, and

that the transaction qualifies as a securitisation transaction for the purposes of the Securitisation Law. True-sale legal opinions need to be provided under the CRR for capital treatment purposes in the case of banking securitisations.

6.4 Construction of Bankruptcy-Remote Transactions

A securitisation is the typical way to construct a bankruptcy-remote transaction. Greek credit institutions may also achieve a bankruptcy-remote transaction through the issuance of covered bonds.

Covered bonds are a particular category of bonds, subject to a special legal and regulatory framework; until 2022, the issuance of covered bonds was regulated by the Greek Banking Law 4261/2014. Law 4920/2022 (the "Covered Bond Law") entered into force on 8 July 2022, transposing Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019. Covered bonds issued prior to such date continue in principle to be governed by Greek Law 4261/2014.

The label "European Covered Bond" may be used only for covered bonds that meet the requirements of the Covered Bond Law. Furthermore, the label "European Covered Bond (Premium)" may be used only for covered bonds that also meet the requirements of Article 129 of the CRR.

The Covered Bond Law supersedes the general provisions of the Greek Civil Code, the Greek Code of Civil Procedure and the Greek Insolvency Code. The Securitisation Law and the Company Law are also applicable, to the extent that the Covered Bond Law refers to these laws.

Finally, the Covered Bond Law authorises the BoG to enact secondary legislation in order to supplement the provisions of the Covered Bond Law. On the basis of such authorisation, the BoG Executive Committee Act 215/2023 was issued, which specifies and supplements the covered bond issuance and supervision framework.

Only the direct issuance of covered bonds by credit institutions is permitted under the Covered Bond Law.

The segregation of the cover pool is achieved through a statutory pledge over the cover pool assets. In the case of assets governed by a foreign law (such as claims from derivative contracts), a security interest must be created in accordance with such foreign law. The statutory pledge and the foreign law security interest secure claims of the holders of covered bonds and may also secure other claims that are connected to the issuance of the covered bonds (in accordance with their terms).

The claims constituting cover assets are identified by being listed in a document signed by the issuer and the bondholder agent who is acting for the account and on behalf of the bondholders, within the meaning of the Company Law. A summary of such document is registered with the pledge registry of the registered seat of the issuer.

According to Article 14 of the Covered Bonds Law, upon registration of the summary of the document listing the claims included in the cover pool, the issuance of the covered bonds, the establishment of the statutory pledge and the foreign law security interest and the entering into of all contracts connected to the issuance of the covered bonds are not affected by the

commencement of any insolvency proceedings against the issuer.

The remaining creditors of the credit institution will only have access to any remaining assets of the cover pool after the holders of the covered bonds and other secured creditors have been satisfied in full. According to Article 4 of the Covered Bond Law, holders of covered bonds have dual recourse both to the cover pool as secured creditors and to the remaining assets of the credit institution ranking as unsecured and unsubordinated creditors.

It is also noted that the cover assets may not be attached.

Pursuant to Article 7 of the Covered Bond Law, covered bonds do not automatically accelerate upon the insolvency of the issuer. Article 21 of the Covered Bond Law provides that, in case of the insolvency or reorganisation of the issuer, a special administrator shall be appointed, whose statutory duties include managing and liquidating the cover assets, including, if there is an opportunity to do so, transferring the assets comprising the cover pool to another bank that is a covered bond issuer, and ensuring that any receipts or recoveries received in respect of the cover pool are made available to pay the obligations and liabilities arising under the covered bonds and the other obligations that are secured by the statutory pledge.

The following applies under the current regime.

- In order for assets governed by the law of another EU member state to be included in the cover pool, credit institutions shall submit legal confirmation to the BoG that the lien established on such assets, under Article 14(2) of Law 4920/2022, is valid, effectual and enforceable according to the provisions of the relevant law.
- Assets that are secured by collateral assets outside the EU and that may, under Article 9(3) of Law 4920/2022, be included in the cover pool shall only be loans secured by ships. In connection with such collateral, credit institutions shall submit legal confirmation to the BoG that the collateral asset is a ship.
- Credit institutions should submit a legal opinion to the BoG confirming the enforceability of the derivative contract used by the parties to covered bond transactions.

6.5 Bankruptcy-Remote SPE

The securitisation documents include representations and warranties relating to the establishment, type and limited purpose of the SPE. The activities of the SPE are typically restricted in the transaction documents by negative undertakings, in order to ensure that they are limited to those required in connection with the securitisation.

Transaction parties contracting with the SPE typically agree on non-petition clauses not to commence insolvency proceedings against the SPE, and on limited recourse provisions limiting each party's claims against the SPE on the assets acquired by it. The transaction documents are typically governed by foreign (usually English) law.

7. Tax Laws and Issues

7.1 Transfer Taxes

According to Article 14 of the Securitisation Law, the transfer of claims under a securitisation transaction to or from the SPE is exempt from all direct or indirect taxes, stamp duty, commis-

sions or any other right in favour of the Greek State or any third party, other than a minimal registration duty for the registration of the assigning and of the servicing agreement with the pledge registry. This tax exemption also applies if the relevant SPE is established outside Greece.

In addition, notarial fees and duties in connection with the notarisation of any document or agreement in the context of the securitisation are capped.

7.2 Taxes on Profit

Pursuant to Article 14, paragraph 11 of the Securitisation Law and the Circular of the Ministry of Finance No 1042/26.01.2015 (paragraph 11, subparagraph 3), the income that the SPE earns from interest payments on the transferred receivables is considered income from business activity and is not subject to withholding tax.

Interest on the receivables received by the SPE will not be subject to Greek income tax, unless the SPE is a Greek tax resident or maintains a permanent establishment in Greece, to which the interest income is attributable. The mere purchase or ownership of receivables generated in Greece or governed by Greek law will not cause the SPE to be considered as a Greek tax resident if the place of management of its operations and the control of its business is not in Greece. Moreover, tax consolidation is not possible under the current Greek tax law rules; on such basis, the SPE will not be subject to Greek taxation if it is being consolidated with the seller for accounting purposes.

As mentioned in **1.4 Special-Purpose Entity (SPE) Jurisdiction**, in all securitisation transactions in Greece, SPEs were established in jurisdictions with bilateral double taxation treaties with Greece.

7.3 Withholding Taxes

Any applicable withholding taxes need to be assessed when the transaction is structured, in order for the parties to decide on the jurisdiction of incorporation of the SPE.

It should be noted that interest on the notes payable to Greek tax resident noteholders or noteholders with a permanent establishment in Greece to which the notes are attributable would be subject to a withholding tax of 15% if the relevant payment was made by a Greek tax resident entity or permanent establishment in Greece. Such withholding extinguishes the income tax obligation of noteholders that are individuals, whereas for all other noteholders interest on the notes is included in their taxable income for income tax purposes and any tax withheld thereon may be credited against any resulting tax.

According to the Securitisation Law, the payment of the principal of the notes and in general the exercise of rights arising from the notes issued are exempt from all direct or indirect taxes.

7.4 Other Taxes

The Securitisation Law contains significant provisions aimed at tax efficiency, including that the following are exempted from any direct or indirect tax, duty, contribution, levy, right or other encumbrance (being subject only to any applicable VAT or withholding tax and any charges that may be payable to the central securities depositary of the Athens Exchange):

- the transfer and collection of receivables;
- the transfer of real property to and from the SPE and its retransfer to the transferor/originator;
- the profits realised from the transfer of receivables; and

- the execution of loans, credit agreements and financial derivatives, any collateral agreements or, under certain conditions, real property.

No value-added tax will apply to the sale of the receivables, but it will apply to fees payable to the servicer or to other service providers involved in the securitisation transaction.

In addition, interest generated over the amounts deposited in a Greek proceeds collection account is subject to Greek withholding tax.

Finally, a levy of Greek Law 128/1975 is due on loans or credit receivables originated by credit or financial institutions (with the exception of bond loans, to which the levy of Greek Law 128/1975 is not applicable), unless interest under the facility remains unpaid for more than six months. The cost of this levy is contractually passed on to the borrowers of the respective loans/credits; accordingly, it is not a cost of the securitisation transaction, where the borrowers meet their payment obligations under the loan or credit receivables.

7.5 Obtaining Legal Opinions

Greek legal opinions for Greek securitisation transactions usually cover the tax treatment of:

- the sale and transfer of the receivables;
- the issuance and offering of the notes;
- the payments under the notes and of the transfer thereof;
- the income of the SPE on interest arising from the receivables; and
- the services provided to the SPE (see **7.1 Transfer Taxes**, **7.2 Taxes on Profits**, **7.3 Withholding Taxes** and **7.4 Other Taxes**).

Usual assumptions in Greek transaction opinions include the following:

- that the SPE does not or will not (other than as a result of the securitisation transaction) have a permanent establishment in Greece and that the central management and control of the SPE and of the SPE's business is and will at all times be exercised outside Greece;
- that obtaining a tax advantage for any person is not, has at no time been, and will not at any time be the main or one of the main purposes of the transaction parties in entering into the transaction; and
- that, wherever applicable, any transactions between associated persons are carried out at arm's length.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The criteria for a transfer of receivables to be treated as a true sale of assets for accounting purposes are determined in line with the accounting standards applied by the originator. Sellers in completed Greek securitisation transactions apply the IFRS. Section 3.2 of IFRS 9 deals with the derecognition of financial assets. The respective issues fall outside the scope of legal analysis.

8.2 Dealing with Legal Issues

Legal opinions do not typically cover accounting matters, but may include certain conclusions, qualifications or assumptions that may be used for the purposes of risk assessment.

Legal practitioners should pay attention to the transfer price and to any remuneration received by the seller from the SPE, and should confirm,

through the documentation, among others, that the seller has no control over the SPE and that the seller does not provide any undertaking to ensure the realisation of any of the securitised assets.

Trends and Developments

Contributed by:
Panagiotis (Notis) Sardelas, Matina Kagkelari and Anna Zlatoudi
Sardelas Petsa Law Firm

Sardelas Petsa Law Firm is one of the leading Greek business law firms with a strong international dimension, known for its top-drawer specialised professional service in high-profile cross-border and domestic transactions and commercial disputes. It is noted for its high expertise and experience, and for its provision of business-oriented, practical and legally robust solutions in complex transactions. The firm provides comprehensive advice and support to domestic and international businesses, spanning a variety of legal disciplines, including banking, finance, capital markets, energy, M&A, real estate, privatisation, public procurement and litigation. It represents and advises foreign and Greek clients from all key sectors, including international and domestic financial institutions, funds, energy developers, real estate developers and managers, pharmaceutical and health sector companies, IT and telecommunications providers, food & beverage and retail goods and services companies, as well as public sector enterprises and entities.

Authors

Panagiotis (Notis) Sardelas is a partner at Sardelas Petsa Law Firm and an expert in the fields of banking and finance and capital markets, including the financing of real estate and energy projects. His 20-year practice includes advising clients, mainly financial institutions, on financings, restructurings and underwritings of ECM and DCM transactions, and acting for companies and investors on M&A transactions, mainly involving listed companies. He has played an instrumental role in the recent development of the Greek corporate bond market, and has considerable expertise in privatisations and state assets development, having acted for foreign investors and the Greek state in a significant number of landmark transactions.

Matina Kagkelari is a senior associate at Sardelas Petsa Law Firm, and head of the structured transactions and capital markets practice. She has more than 20 years' experience in capital markets, banking and finance law and regulation, including cross-border matters. She has been involved in numerous complex and structured DCM and ECM transactions, and in several securitisation transactions, mainly in the banking sector. Matina was previously a senior in-house adviser to a Greek systemic bank, and a senior lawyer at a leading law firm; she has also served as a deputy director of the legal services division at a non-systemic bank.

Anna Zlatoudi is a senior associate at Sardelas Petsa Law Firm, and head of the corporate law practice. She has with more than 20 years' experience in banking, capital markets, regulatory and compliance, corporate governance and regulatory affairs, most of them as senior in-house adviser to a Greek non-systemic bank. Anna has been involved in several securitisations and portfolio sale transactions. She holds a law degree from the University of Athens and her studies include an LL.M. in Labour Law from the University of Athens and an MBA from Hellenic Open University.

Sardelas Petsa Law Firm

8, Papadiamantopoulou str.
11528 Athens
Greece

Tel: +30 2107 296 550
Fax: +30 2107 296 549
Email: office@sardelaslaw.gr
Web: www.sardelaslaw.gr

SARDELAS PETSA

LAW FIRM

Contributed by: Panagiotis (Notis) Sardelas, Matina Kagkelari and Anna Zlatoudi, **Sardelas Petsa Law Firm**

Securitisation in Greece: an Introduction

For the past two decades, the provisions of the Greek Securitisation Law 3156/2003 (the Securitisation Law) have remained substantially the same. During the past decade, the securitisation scheme has been used broadly by the banking system, mainly by the four systemic banks, in order to remove non-performing loans (NPLs) from their balance sheets, for either financial or regulatory purposes, and to meet the supervisory requirements for liquidity. Securitisation also proved to be a useful funding tool for other types of corporations (such as the main electricity provider in Greece).

Greek Law 4354/2015 (the NPL Law) initially regulated the sale and transfer (outside the scope of securitisation) and servicing of NPLs only by licensed servicers, and had certain provisions regarding consumers' protection, as well as certain regulatory obligations for licensed servicers; its introduction blurred the scenery. The scope of the NPL Law was later expanded to also include the sale of performing loans.

Although practitioners initially considered the Securitisation Law as non-interacting with the NPL Law, its introduction had an impact on securitisations: Greek Law 4389/2016 amended the NPL Law, in order to explicitly provide that the two schemes differ, and the provisions of the Securitisation Law maintain unaffected. Nevertheless, the scenery remained confusing, as the implementation of the legal framework from Greek courts was contradictory, especially on the servicing provisions.

Decision 1/2023 of the Greek Supreme Court (*Areios Pagos*) in plenary session finally resolved that a licensed servicing company has special authorisation, under the NPL Law, to conduct court and enforcement proceedings in order to collect the claims under its management, irrespective of the legal framework, on the basis of which the transfer of the receivables was made – ie, even when the transfer of receivables and the assignment of the servicing of the claims to the servicer was made under the Securitisation Law.

Greek Law 5072/2023 was enacted in December 2023, incorporating Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers into Greek law and repealing the NPL Law. Although Greek Law 5072/2023 did not amend the provisions of the Securitisation Law, it introduced some new provisions on servicing, and contained provisions for the reintroduction of the Hellenic Asset Protection Scheme (HAPS or "Hercules") with respect to securitisation transactions implemented by credit institutions.

Developments on servicing

Greek Law 5072/2023 repealed Articles 1–3 of the NPL Law. In essence, it reintroduced the provisions of the NPL Law for the sale of loan receivables and also incorporated the provisions of Directive (EU) 2021/2167.

Greek Law 5072/2023 does not apply to the transfer of claims under credit agreements transferred before 30 December 2023, nor to their respective servicing agreements.

The Greek legislature's scope was not to change the Securitisation Law to the extent it refers to sale and transfer agreements, but mainly to regulate in a stricter way the servicing of loan receivables by licensed credit servicers, and also to provide minimum consumer protection standards, at the same time aligning the legal framework with the case law. Therefore, Greek Law 5072/2023 has only supplemented the Securitisation Law regarding the servicing pro-

visions to the extent the servicing of the securitised claims is assigned to a credit servicer with a registered seat in an EU member state (Article 3, paragraph 4). More specifically, it contains provisions regarding:

- the minimum content of the servicing agreement, when the underlying assets are loan receivables;
- the relationship with the borrower, including the obligation of all parties to:
  (a) act in good faith, fairly and professionally;
  (b) provide information to borrowers that is not misleading, unclear or false;
  (c) respect and protect the personal information and privacy of borrowers; and
  (d) communicate with borrowers in a way that does not constitute harassment, coercion or undue influence;
- the procedure for the prior notification to borrowers of the assignment of servicing;
- the minimum requirements of any subsequent communications with the borrower;
- the competent supervisory authorities, namely the Hellenic Data Protection Authority for data protection issues, the Ministry of Finance for issues regarding consumers' rights and the Bank of Greece in any other case;
- the regulatory requirement for the servicers to install an online system providing personalised information to the borrowers (this requirement is to be fulfilled by the end of the first quarter of 2024); and
- the right of the servicers to refinance debt under certain provisions and qualifications.

The above provisions will have multiple implications for servicers. The supervisory authorities – which have the power to impose severe penalties and fines in case of breach – are expected to push servicers in the direction of immediate compliance, especially regarding obligations relating to consumer protection. Furthermore, given that the renewal of the servicers' licence procedure is expected to kick-off by the end of the first quarter of 2024, servicers will have to set up the online system and reorganise their business plans in order to meet the new regulatory requirements, which will bring new operating costs.

In this new landscape, certain servicers may not be able to comply with the requirements under the new legislation on time, which could lead to inevitable corporate transformations (mergers, acquisitions) or licence revocations in the sector, which will further result in the replacement of servicers in active servicing agreements.

Moreover, additional strict regulatory requirements apply to debt refinancing, which are not expected to be met easily by domestic servicers. The granting of new loans in order for servicers or buyers to provide new liquidity to corporate entities is not currently provided for in the law. Given that both the Securitisation Law and Greek Law 5072/2023 allow transactions where the underlying assets are performing loans, the legislature's choice to restrict the servicers' activities to debt refinancing only would lead the parties to focus on NPL portfolios in order to avoid a forthcoming dead-end with the borrowers of performing loans, the loan amount of which is not fully drawn.

Introduction of EU servicers

Greek Law 5072/2023 provides that credit servicers that have their registered seat in an EU member state and have obtained authorisation in accordance with Article 4(1) of Directive 2021/2167 (EU) in their home member State may provide services in Greece covered by their authorisation, following notification to the Bank

of Greece of the information of Article 13(2) of Directive 2021/2167 (EU), but only to the extent the respective services refer to NPLs. The new provisions are expected to open the Greek NPL market for EU servicers, and to enhance synergies between EU credit servicers and Greek servicers.

Re-introduction of HAPS

The HAPS programme was introduced by Greek Law 4649/2019 ("the HAPS Law") as a securitisation framework designed to remove NPLs from banks' balance sheets through special purpose vehicles (SPVs) that issue junior, mezzanine and senior securities tranches sold to investors. Senior tranches are held by banks and guaranteed by the Greek government, which gets market-priced fees for providing these guarantees to comply with EU state aid rules. NPLs are securitised at market value, triggering additional loan-loss provisioning if needed.

The second phase of HAPS (Hercules II) ended in October 2022. The European Commission published a new decision on 28 November 2023, approving the reintroduction of the HAPS programme for 12 months from the date of such publication (Hercules III). On the basis of this decision, the HAPS scheme was reintroduced by Greek Law 5072/2023 until 31 December 2024, with the following main amendments to the previous scheme:

- the amount of state guarantees to be provided is up to a nominal amount of EUR2 billion;
- the Senior Notes must be rated BB+, Ba1, BB+, BB (high) or higher by a credit rating agency that is recognised by the European Central Bank (ECB); and
- changes in the HAPS guarantee fee – the discount interest rate increased to 6.5% (from 4% in 2021) and the Spread Ratio Factor has been decreased from 56.9% to 41%.

The above changes reflect the will of the European Commission and the Greek government to make the guarantee scheme available to cherry-picked portfolios with high ratings (especially when the underlying assets are NPLs) and up to a maximum amount, which is limited, compared to that of the initial scheme in 2019, which amounted to EUR12 billion. The reduction of the Spread Ratio Factor makes the scheme less expensive and thus more attractive, in an amendment that is considered to be friendly to non-systemic credit institutions, but also to the systemic banks, in order for them to conclude any remaining transactions.

INDIA

Law and Practice

Contributed by:
Zubin Mehta, Mohit Bhatia, Milind Rai and Shubhra Baghel
Shardul Amarchand Mangaldas & Co

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Contributed by: Zubin Mehta, Mohit Bhatia, Milind Rai and Shubhra Baghel,
Shardul Amarchand Mangaldas & Co

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Authors

Zubin Mehta is a partner in the Mumbai office of Shardul Amarchand Mangaldas & Co and a member of the Banking & Finance practice. He advises banks, private credit funds, factoring entities, and corporations on a broad range of innovative capital raising, securitisation, and receivables purchase transactions. Zubin advises clients across a wide range of asset classes and structures, including structured finance and securitisation, and assisted clients in setting up their banking business in India, worked on areas pertaining to Financial Regulatory Services and FinTech, and cross-border structured finance.

Mohit Bhatia is a partner in the Mumbai office of Shardul Amarchand Mangaldas & Co and a member of the Banking & Finance practice. He advises banks, private credit funds, factoring entities, and corporations on a broad range of innovative capital raising, securitisation, and receivables purchase transactions. Mohit advises clients on structured finance and securitisation and assists clients in setting up their banking business in India and cross-border structured finance.

Milind Rai is an associate in the Mumbai office of Shardul Amarchand Mangaldas & Co and a member of the Banking & Finance practice. He advises banks, factoring entities, and corporates on securitisation, receivables purchase transactions, payment systems, and fintech.

Shubhra Baghel is an associate in the Mumbai office of Shardul Amarchand Mangaldas & Co and a member of the Banking & Finance practice. She advises banks, private credit funds, factoring entities, and corporations on capital raising, securitisation, and structured finance transactions.

Contributed by: Zubin Mehta, Mohit Bhatia, Milind Rai and Shubhra Baghel,
Shardul Amarchand Mangaldas & Co

Shardul Amarchand Mangaldas & Co

Express Towers, 23rd Floor, Nariman Point
Mumbai - 400 021
India

Tel: +91 22 493 355 55
Fax: +91 22 493 355 50
Email: sharon.dias@amsshardul.com
Web: www.amsshardul.com

1. Specific Financial Asset Types

1.1 Common Financial Assets

The financial assets most commonly securitised in India via pass-through certificates ("PTCs") include vehicle loans, two-wheeler loans, microfinance loans and mortgage-backed loans. Revolving credit facilities such as credit card receivables and synthetic securitisations (ie, securitisations through the use of credit derivatives or credit guarantees for hedging the credit risk of the loan portfolio, which remains on the lender's balance sheet) are not permitted in India.

The current framework for securitisation is for standard assets only (ie,, assets with a delinquency of up to 89 days) and securitisation of non-performing assets ("NPAs") through the special purpose entity ("SPE") route is under consideration by the Reserve Bank of India ("RBI").

Typically, in relation to NPAs, banks/non-banking financial companies transfer their NPAs to asset reconstruction companies (ie, entities regulated by the RBI) ("ARCs"), and subsequently, an ARC issues security receipts to eligible investors both onshore and cross-border basis, which is a different framework and not typically viewed as securitisation in industry parlance.

1.2 Structures Relating to Financial Assets

There are two broad structures for assignment of loans:

Securitisation

Securitisation of standard assets (which are not NPAs) are typically securitised as follows:

- The originator (the original lender) pools the assets in one or more homogenous tranches and transfers them on a 'true sale' basis to an SPE (typically set up as a trust in India), the purchaser of the underlying assets.
- The SPE issues PTCs to the investors, and the proceeds received from the investors are utilised as purchase consideration by the SPE to purchase the pooled assets from the originator.
- The SPE utilises the cash flows received from the borrowers of the underlying pooled assets to make periodic payments to the investors.
- The SPE appoints the servicer (typically the originator) to provide collection and payout services in relation to the receivables payable to the investors.

- Most PTC transactions are credit-enhanced through cash collateral or investment in the subordinate tranche by the originator.

In certain transactions, an arranger (typically an investment bank) will structure and put together the transaction.

Direct Assignment

Regulated entities in India, such as banks, non-banking finance companies and housing finance companies, are permitted to transfer (standard) loans from their books to similar regulated entities through novation, assignment, or loan participation. Under this structure, credit enhancement by originators is not permitted, and there is no requirement for setting up an SPE or issuing PTCs, as the (standard) loans are simply transferred from one entity to the other. However, regulated entities (such as bank/non-banking finance companies/housing finance companies) can transfer 'NPAs' by way of direct assignment only to an ARC, pursuant to which ARCs may float a scheme for issuing security receipts to qualified institutional buyers against such loans.

The direct assignment structure is usually not considered as securitisation in industry parlance. However, various market research platforms tend to club them with securitisations while discussing industry data on such activities in view of the transfer of loans from the originator's balance sheet and the common objective of providing capital relief to the originator. Based on market feedback, the RBI has recently released a discussion paper to enable the securitisation of NPAs through the SPE route.

1.3 Applicable Laws and Regulations

The principal applicable laws and regulations include:

- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI Act");
- Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, dated September 24, 2021, issued by the RBI ("Securitisation Directions");
- Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, September 24, 2021, issued by the RBI ("Transfer of Loans Directions");
- Master Circular on Asset Reconstruction Companies (dated February 20, 2022), issued by the RBI; and
- Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008 ("SEBI Regulations").

Additionally, there are various other laws which impact the securitisation structures, such as:

- The Indian Trust Act, 1882;
- Banking Regulation Act, 1949;
- Income Tax Act, 1961;
- The Indian Contract Act, 1872;
- The Indian Stamp Act, 1899; and
- Foreign Exchange Management Act, 1999 and the rules and regulations thereunder ("Exchange Control Regulations").

1.4 Special-Purpose Entity (SPE) Jurisdiction

SPEs are incorporated in India for securitisation of loans originated domestically by Indian entities without any particular priority being given to any State or Union Territory in India, specifically on account of making such securitisation transactions attractive. However, certain states in India have lower stamp duty rates on the assignment of loans for the purpose of undertaking securitisation, which can often be a consid-

eration when choosing a place for undertaking such securitisation transactions.

SPEs are not incorporated outside India in relation to loans originated in India as Exchange Control Regulations do not permit Indian originators to assign loans to SPEs outside India for the purpose of securitisation.

1.5 Material Forms of Credit Enhancement

Lenders and other facility providers (which must be regulated by at least one financial sector regulator, such as the RBI, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, etc) can provide supporting credit enhancement facilities and liquidity facilities to SPEs for securitisation transactions. However, the originator's exposure cannot exceed 20% of the securitised pool.

In India, credit enhancement is of two types:

- internal credit enhancement, which includes over-collateralisation, investment by the originator in subordinated tranches, excess spreads and credit-enhancing interest-only strips (subordinated in nature); and
- external credit enhancement, which creates exposure to entities other than the underlying borrowers. It primarily includes cash collaterals (ie, in the nature of fixed deposits) or first/second loss guarantees.

Credit enhancement can be provided only at the initiation of the securitisation transaction, and the same should be available to the SPE during the entire life of the securitisation notes. The Securitisation Directions also contain guidelines for reset and release of credit enhancement.

Liquidity facilities are provided to support the SPE in case of temporary cash flow mismatches faced by the SPE, between the receipt of cash flows from the underlying assets and the payments to be made to the investors. The purpose of liquidity facilities is not to:

- cover losses of the SPE;
- serve as permanent revolving funding; or
- to fund the final scheduled repayment of investors.

A liquidity facility provider will have priority of claim over the future cash flows from the underlying assets and thus will be senior to the senior tranche.

2. Roles and Responsibilities of the Parties

2.1 Issuers

Role and business of an Issuer (ie, SPE): the issuer is created for the specific purpose to acquire the pooled loan assets from an originator out of the funds collected by it from the issuance of PTCs to the investors. The structure of an issuer could be a trust or a company (if PTCs are unlisted), although issuers are commonly formed as trusts under the Indian Trusts Act, 1882.

Issuers are not commonly incorporated as a company because of regulatory, taxation and insolvency law considerations.

Responsibilities of the issuer:

- The trustee(s) of the issuer can only perform trusteeship functions in relation to the issuer and should not undertake any other business.

- The transaction between the originator and the issuer should not be a related party transaction and should be at arm's length.
- The issuer should be bankruptcy remote and non-discretionary.
- The issuer should make it clear to the investors in the issued securitisation notes that the securitisation notes are not insured and do not represent deposit liabilities of the originator, servicer or trustee(s).
- The issuer to ensure that the receivables acquired by it are duly assigned in its name, are legally realisable and are a genuine transaction amounting to a true sale.
- The SPE to ensure timely payment of interest and redemption amounts to the investors in terms of the offer document.
- If it is a listed issuance, the issuer must abide by the code of conduct provided in the SEBI Regulations.

2.2 Sponsors

Role and business of sponsor: The SEBI Regulations define a sponsor as (a) a person who promotes an issuer for the purpose of issuance of securitised debt instruments or (b) an ARC who promotes a trust which has issued security receipts.

Responsibilities of a sponsor: A sponsor should ensure that the securitisation transaction is structured to minimise the risk of the asset pool being consolidated with the sponsor's assets in the event of the sponsor's insolvency.

2.3 Originators/Sellers

Role and business of an originator: The originator pools its assets into different homogenous classes/tranches, taking into account the types of loans, maturity and interest rate risk, and transfers the pool of assets to the SPE for the purpose of securitisation and provides credit enhancement to the investors.

Originators under the Securitisation Directions are financial entities regulated by the RBI and may be scheduled commercial banks, all India term financial institutions (such as National Housing Bank and Export Import Bank of India), small finance banks, non-banking financial companies (including housing finance companies).

In respect of public issuance or listing of PTCs, the SEBI Regulations permit any person to be the assignor of debt or receivables to an SPE (which SPE shall mandatorily be a trust).

2.4 Underwriters and Placement Agents

Underwriter:

- The underwriter agrees to buy the securitised notes from the SPE in order to ensure adequate subscription. Underwriting is exercisable only when the SPE cannot issue the securitised notes at a price equal to or above the benchmark price determined and is permitted in the case of publicly listed issues of securitised debt instruments.
- In India, the originator or any third-party service provider can act as an underwriter. For listed securities, the underwriter can be any person registered as an underwriter with the SEBI and is typically involved in listed transactions.
- An originator may underwrite only investment grade senior notes issued by the SPE, subject to other conditions.

Placement agent: The involvement of a placement agent in securitisation is rare in India.

2.5 Servicers

A servicer is responsible for managing or collecting the asset pool or making distributions to the holders of the PTCs. Commonly, the originator itself is appointed as the servicer by the SPE. No special permission or authorisation is required to service the financial assets.

The servicer must hold the cash generated from the securitised assets for the investors and avoid mixing it with its own assets.

2.6 Investors

Role and businesses of the investors: Investors are the purchasers or subscribers of the PTCs issued by the SPE. The investors can be any Indian citizen or an entity such as insurance companies, NBFCs, mutual funds, or banks incorporated in India. Foreign portfolio investors are also permitted to invest in securitised debt instruments which are listed in the Indian securitisation market.

Responsibilities of investors:

- Since the investors will bear the risks on the PTCs held by them, they are required to conduct proper due diligence of the securitised assets and the entities involved in the securitisation process like the originator, the SPE and other third parties.
- The investors should also check whether the SPE and the originator are in compliance with the laws related to securitisation.

2.7 Bond/Note Trustees

Under Indian securitisations, conventional securitisation structures usually involve two trustee roles:

- trustees responsible for holding the advantages of the covenants and rights associated with the securitised assets on behalf of the investors; and
- trustees tasked with holding security established over the assets and related rights in favour of the secured investors.

Typically, the same trustee performs both roles. In a broad sense, the trustee's primary responsibility is to ensure that collections are remitted to the SPE and that investors receive their allocated share of these amounts according to the agreed-upon contractual priority.

2.8 Security Trustees/Agents

Please refer to our response at **2.7 Bond/Note Trustees** above.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

To ensure bankruptcy remoteness, the securitisation documents, listed in **3.8 Bonds/Notes/Securities**, should ensure the following:

- The assignment/transfer of the assets should be on an absolute ("true sale") basis to the SPE.
- The originator should provide representations and warranties concerning the nature, tenure, and security interest relating to the pool of transferred assets.
- The SPE should represent that it is a distinct legal entity capable of holding/owning assets and carrying on the securitisation business.
- The originator should covenant that:
  (a) the title of the transferred assets will vest completely with the issuer for the benefit of the investors;
  (b) the issuer will have the right to enforce the security interest available in respect of

the pooled assets;
(c) it will comply with the MRR and credit enhancement regulations, etc.

- The assignment agreement should contain covenants/conditions regarding the perfection of the assignment by way of payment of applicable stamp duty and registration.
- The documentation should ensure that:
  - (a) the originator should not have any claims over the securitised assets, indicating that the transfer is not made on a true sale basis;
  - (b) the intention of the parties to undertake a complete, valid, and absolute transfer of the legal ownership of the assets should be clear;
  - (c) the rights and obligations of the parties pursuant to the transfer should be expressly documented;
  - (d) the originator should not retain unusually high risk in the securitised assets;
  - (e) the assignment agreement should not allow for an increase in the credit enhancement positions after inception;
- The rights and control of the investors must be documented to account for all circumstances, including insolvency of all entities involved in securitisation, such as the originator SPE, etc.
- An independent legal opinion is obtained regarding the validity and legality of the securitisation transaction and the bankruptcy remoteness of the securitised assets.

3.2 Principal Warranties

Originators typically provide warranties regarding certain aspects of the securitised assets and the transaction structure. If there is a breach of warranties, the investor or the SPE may have the right to seek remedies, such as indemnity claims and compensation for losses incurred due to a breach of warranties. While the specific warranties can vary based on the transaction structure and the preferences of the parties involved, the following are some principal warranties commonly found under securitisation documents in India:

- Validity of transfer: the originator warrants that the transfer of the securitised assets to the SPE is valid, legally effective and in compliance with all applicable laws.
- Title and ownership: the originator warrants that it has good and marketable title to the securitised assets and that the assets are free from any encumbrances.
- Conformity with representations: the originator warrants that the securitised assets conform to the representations and warranties made in the transaction documents.
- Regulatory compliance: the originator warrants that the securitisation transaction complies with all applicable laws and regulations, including those issued by the RBI.
- Quality of assets: the originator may warrant that the securitised assets meet certain quality standards, such as credit quality, performance and other specified criteria.
- No undisclosed liabilities: the originator may warrant that the servicing of the securitised assets will adhere to specified standards and practices.

Under the Securitisation Directions, originators are required to hold capital against such representations and warranties if any of the following conditions are not satisfied:

- Any representation or warranty is provided only by way of a formal written agreement.
- The originator undertakes appropriate due diligence before providing or accepting any representation or warranty.

- The representation or warranty refers to an existing state of facts that is capable of being verified by the originator at the time the assets are sold.
- The representation or warranty is not open-ended and, in particular, does not relate to the future creditworthiness of the assets, the performance of the SPE and/or the securitisation notes the SPE issues.

Further, any exercise of a representation or warranty requiring an originator to replace assets (or any parts of them) sold to an SPE must be:

- undertaken within 120 days of the transfer of assets to the SPE; and
- conducted on the same terms and conditions as the original sale.

An originator that is required to pay damages for breach of representation or warranties can do so provided the agreement to pay damages meets the following conditions:

- The onus of proof for breach of representation or warranty remains at all times with the party so alleging,
- The party alleging the breach serves a written notice of claim specifying the basis for the claim.
- Damages are limited to losses directly incurred as a result of the breach.

Securitisation Directions require originators to notify the RBI of all instances when an originator has agreed to replace assets sold to SPE or pay damages arising from any representation or warranty.

3.3 Principal Perfection Provisions

When perfecting under securitisation transactions, the following formalities need to be complied with:

- if any immovable property secures the underlying assets, then the instrument evidencing the underlying assets and the underlying security interest needs to be registered with the relevant sub-registrar of assurances; and
- if the underlying assets are due from a company incorporated in India, and any charge has been created over assets of any company to secure the underlying assets, the transfer of the underlying assets would amount to a modification of charge and will have to be filed with the relevant registrar of companies.

Apart from the above, stamp duty and registration fees also need to be paid, which is dealt with in the responses to questions **4.14 Other Principal Laws** and Regulations and **6.3 Transfer of Financial Assets**.

3.4 Principal Covenants

Specific terms may vary based on the transaction structure, although some of the principal covenants are set out below:

- True sale and insolvency covenant: the originator usually covenants that the transfer of assets to the SPE shall be on a true sale basis and not as a secured loan and that it shall ensure that the originator will not file for bankruptcy against the SPE.
- Maintenance of assets: the originator may agree to maintain the quality of assets and take necessary steps to recover defaulted assets.
- Cash reserve account: specific requirements for establishing and maintaining a cash

reserve account to cover potential shortfalls in cash flows.
- Rating agency requirements: compliance with conditions set by rating agencies to maintain the credit rating of the securitised instruments.
- Change of control provisions: restrictions or requirements in the event of a change in control of the originator or the SPE.
- Reporting and information covenants: obligations related to regular reporting and disclosure of information to investors and other transaction parties.
- Regulatory compliance: covenants on compliance with applicable laws and regulations governing securitisation transactions in India.

3.5 Principal Servicing Provisions

Servicing provisions in securitisation documents in India outline the responsibilities and obligations of the servicer in managing and administering the underlying assets. The provisions are critical for the smooth operations of the securitisation transaction. Below are some of the commonly found provisions in servicing agreements:

- Servicing standards: specifies the standard of care and diligence the servicer must adhere to in managing and servicing the securitised assets.
- Collections and remittances: outline procedures for collecting payments from the underlying assets and remitting them to the designated accounts (such as the payment waterfall).
- Custody of documents: addresses the custody and safekeeping of important documents related to securitised assets (such as loan agreements, titles, and insurance policies).
- Defaulted assets and recoveries: defines the process for identifying and managing defaulted assets, including steps to be taken for recovery and rehabilitation.
- Reports and disclosures: specifies the frequency and content of reports the servicer must provide to various parties, including investors, trustees and rating agencies.
- Recordkeeping: requires the servicer to maintain accurate and complete records related to the securitised assets to protect against various risks.
- Change of servicer: outlines the process and conditions under which a change of servicer may occur, including the responsibilities for the transition.
- Servicer compensation: specifies the fees and expenses that the servicer is entitled to receive for its services, including any incentive structures tied to performance.
- Audit rights: grants the trustee(s) or other designated parties the right to audit the servicer's books and records to ensure compliance with the servicing standards.
- Regulatory compliance: ensures that the servicer complies with all applicable laws and regulations related to servicing the securitised assets.

Enforcement of these servicing provisions typically involves a combination of contractual mechanisms, legal remedies (pursued through courts or alternative dispute resolution mechanisms), and oversight by third-party entities. The SPE, acting on behalf of the investors, plays a crucial role in monitoring and enforcing compliance with servicing provisions. In the event of a breach, the SPE may take actions such as issuing notices, demanding cures, or even replacing the servicer in terms of the securitised documents.

3.6 Principal Defaults

Below are some of the principal default covenants commonly included in securitisation documents:

- Non-payment of principal or interest: Generally, a default occurs when the underlying obligors fail to make payments of the principal or interest as required. In such cases, the SPE may trigger its enforcement rights by issuing notices, demanding payments and, in severe cases, accelerating the repayment of the outstanding principal.
- Breach of representations and warranties: Default may occur if any party, such as the originator or servicer, breaches specific covenants in the transaction documents. In such cases, enforcement actions often involve indemnification by the originator for losses suffered by the investors, and the SPE may take legal action to remedy such breach.
- Breach of covenants: Defaults can occur if any party, such as the originator or servicer, breaches specific covenants outlined in the assignment agreement or the servicing agreement. In case of such violations, the SPE generally issues notices demanding cures and takes legal action to compel compliance.
- Bankruptcy and insolvency: Any insolvency event concerning any party to the transaction, such as the originator, servicer, or liquidity provider, may trigger a default under the transaction documents. In such cases, the enforcement measures would be in the form of appointing a receiver, acceleration of repayment or other protective measures to safeguard the interests of the investors.
- Failure to maintain credit enhancement: A failure to maintain the required credit enhancement levels results in a default, and the enforcement typically involves the SPE taking corrective actions, such as replacing the servicer or demanding remedies specified in the servicing agreement.

The SPE typically carries out enforcement on behalf of the investors. The SPE has a fiduciary duty to act in the best interest of the investors and is empowered to take various actions to enforce default provisions. Legal remedies may include the initiation of legal proceedings, such as filing a lawsuit or seeking specific performance, depending on the nature of the default itself.

3.7 Principal Indemnities

Indemnity provisions in India are contractual arrangements designed to protect one party from losses or liabilities potentially arising from certain specified events or breaches. Below are some common types of principal indemnities prevalent in the Indian context:

- Representation and warranty indemnity: The originator typically indemnifies the investors against losses arising from breaches of representations and warranties regarding the securitised assets' quality, legality and enforceability. The enforcement mechanics involve the investors notifying the originator of a violation, and the originator is then obligated to compensate the investors for resulting losses.
- Tax indemnity: The originator may provide indemnity to the investor for any adverse tax consequences arising from the securitisation transaction. Enforcement will typically involve the investors notifying the originator of any adverse tax claim and the originator reimbursing the investor for any resulting tax liabilities.
- Servicer indemnity: The servicer may indemnify the investors and other transaction parties against losses arising from the servicer's failure to perform its obligations. Enforcement

involves the SPE or the investors notifying the servicer of a breach and the servicer being obligated to remedy the breach or compensate for resulting losses.
- Title and ownership indemnity: The originator may indemnify the investors against losses arising from defects in title or ownership of the securitised assets. Enforcement involves the investors notifying the originator of a title defect and the originator compensating the investors for any resulting losses.
- Regulatory compliance indemnity: The originator may indemnify the investors against losses arising from failing to comply with applicable laws and regulations related to the underlying assets and the securitisation transaction. Enforcement typically involves the investors notifying the originator of a regulatory breach and the originator compensating the investors for any resulting losses.
- Third-party indemnity claims indemnity: The originator may indemnify the investors against losses resulting from third-party claims related to the securitised assets. In such cases, the investor will also notify the indemnifying party of a third-party claim, and the indemnifying party will have to compensate the investor for any resulting losses.

As stated above, enforcement of indemnities often involves a notice and cure process. The party seeking indemnification notifies the indemnifying party of a claim or loss, thus allowing the indemnifying party to cure the breach or provide compensation. Legal remedies may be pursued if the indemnifying party fails to fulfil its indemnity obligations. These can include filing a lawsuit or initiating alternative dispute resolution processes to seek damages.

3.8 Bonds/Notes/Securities

Securitisation transactions in India involve a comprehensive set of documentation to establish the terms and conditions governing the issuance of bonds, notes or other securities. The principal documents in a securitisation transaction typically include:

- Assignment agreement: An assignment agreement is typically executed between the originator and the trustee(s) under which the underlying assets are assigned to the SPE. This central document outlines the rights, obligations, and responsibilities of various parties involved in the securitisation transaction, including the originator, servicer, trustee(s), and investors. It covers issues such as cash flows, servicing standards and default scenarios.
- Trust deed: This document establishes the trust and outlines the terms under which the trustee(s) holds the securitised assets on behalf of the investors; it also sets out the rights and duties of the trustee(s).
- Offering circular or Information Memorandum: This document provides potential investors detailed information about the securitisation transaction. It includes information about the originator, the securitised assets, the transaction structure, risk factors and terms of the securities being offered.
- Servicing agreement: This document outlines the servicer's (typically, the originator) responsibilities, including collecting payments from the underlying assets, managing defaults, and providing regular reports to investors and other parties.
- Power of attorney: A power of attorney is executed by the originator to appoint the trustee as its attorney to perfect the trustee's title over the assets and take action against obligors/borrowers.

- Legal opinions: Legal opinions are provided by legal counsels involved in the transaction. They may cover various legal aspects, such as the validity of the transaction, enforceability of the documents and compliance with applicable laws.
- Rating agency documents: Documents related to the rating process (including rating agency reports and agreements) may be included to address the credit rating of the securities.

The principal subject matters covered in these documents include:

- Asset pool characteristics: description of the securitised assets (including their nature, quality and characteristics).
- Cash flow waterfall: the order in which cash flows from the securitised assets are distributed among different classes of securities and transaction parties.
- Conditions precedent and closing conditions: the conditions that must be satisfied before closing the securitisation transaction.
- Representation and warranties: statements by the originator regarding the assets being securitised and the transaction structure,
- Events of default and remedies: events that, if they occur, may lead to default and the remedies available to the trustee(s) or investors in case of default.
- Payment terms: terms related to the payment of principal and interest on the securities, including interest rates, payment dates and methods.
- Governing law and dispute resolution: the jurisdiction governing the transaction and the mechanisms for resolving disputes among the parties.
- Termination provisions: conditions under which the securitisation transaction can be terminated or unwound.

3.9 Derivatives

In securitisation transactions in India, derivatives may be used only for genuine hedging of asset and liability mismatches of interest rate and/or currency.

- Interest rate swaps: Interest rate swaps are used to convert fixed-rate cash flows into floating-rate cash flows, or vice-versa, depending on the interest rate exposure of the securitisation transaction.
- Currency swaps: Currency swaps help mitigate exchange rate fluctuation and reduce the impact of currency risk on cash flows. Currency swaps are primarily used to manage currency risk in transactions involving assets or liabilities denominated in foreign currencies.

3.10 Offering Memoranda

The offering memorandum is required when the issuer wants to invite investors to subscribe to the PTCs/securitised notes. It can be in the form of an electronic document issued as an offer document or a prospectus. It can also be in the form of an initial offer document, any offering circular, notice, advertisement, or any other document that purports to invite a subscription from a specified category of investors or the public. It may also be a document issued for inviting subscriptions for the security notes/receipts from qualified buyers on a private placement basis.

In general, the RBI Directions apply to the offering memorandum. However, the issuer also has to ensure compliance with the SEBI Regulations for a listed issuance.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

In India, the following are the major laws which directly govern securitisation-specific disclosures in India:

- the SARFAESI Act;
- Directions issued by the RBI, such as the Securitisation Directions and Transfer of Loans Directions; and
- Regulations issued by the SEBI, such as the SEBI Regulations.

Some of the disclosures required to be made are as follows:

- The disclosures are to be made in the offer document (such as maturity, characteristics of the underlying assets, credit quality, etc).
- Data on credit quality, the performance of individual underlying exposures, cash flows and collateral supporting a securitisation exposure, and information required to conduct comprehensive stress tests should be disclosed by the originator to the investor.
- Disclosure on fulfilment of the minimum holding period and minimum retention requirement should be made publicly available by the originator and appropriately documented. The rating and the rating rationale are to be publicly available.
- If it is a simple, transparent and comparable securitisation under the Securitisation Directions, the originator should demonstrate that it satisfies the applicable criteria.
- The originator's notes to annual accounts of the originators should indicate the outstanding amount of securitised assets as per books of the SPE and the total amount of exposures retained by the originator.
- Quarterly report to the RBI by the originator with details of the securitisation transactions and the issued securitisation notes.

4.2 General Disclosure Laws or Regulations

The originators, which are regulated entities, may be subject to other disclosure requirements applicable to them. If the PTCs are listed, the issuance will be subject to the listing regulations issued by the SEBI.

4.3 Credit Risk Retention

Minimum Retention Requirement (MRR)

The Securitisation Directions in India require the originator to retain a continuing stake in the performance of the securitised assets to ensure that the originators carry out proper due diligence of loans to be securitised. The MRR cannot change during the life of securitisation, and proper documentation is required to be executed:

- The prescribed MRR limits for securitising loans (other than residential mortgage-backed securities) are as follows:
  - (a) MRR of 5% of the book value of the loans being securitised for underlying loans with an original maturity of two years or less; and
  - (b) MRR of 10% of the book value of the loans being securitised for underlying loans with an original maturity of more than two years, as well as loans with bullet repayments.
- MRR of 5% of the book value of the loans being securitised, for residential mortgage-backed securities, irrespective of the original maturity.

The manner in which the MRR should be maintained is prescribed under the Securitisation Directions:

- Up to 5% of the book value of loans being securitised:
  - (a) First loss facility, if available.
  - (b) If first loss facility is not available or, if retaining the entire first loss facility adds up to less than 5%, then balance it out by retaining the equity tranche.
  - (c) If retaining the first loss facility and equity tranche does not sum up to 5%, balance it proportionately in the remaining tranches sold to investors.
- Greater than 5% of the book value of loans being securitised:
  - (a) First loss facility, equity tranche or any other tranche sold to investors, in any combination thereof.

In the case of direct assignment of loans, an MRR of 10% is required if investors do not conduct due diligence on each of the loans in the pool assigned.

Minimum holding period (MHP): The originator can transfer loans only after completion of the following MHP (applicable to individual loans in the underlying pool of securitised loans):

- three months for loans with original tenures of less than two years;
- six months for all other loans; and
- six months for loans acquired from other entities by a transferor.

Regulator: The Reserve Bank of India regulates compliance with these requirements by conducting audits and investigations. In case of non-compliance, the RBI has the power to undertake supervisory scrutiny and take suitable action as it may deem fit under the relevant statutes and directions issued by the RBI.

4.4 Periodic Reporting

In India, the RBI primarily governs periodic reporting of securitisation transactions. The reporting requirements are outlined in the Securitisation Directions, and compliance is essential to ensure transparency, monitoring and regulatory oversight of securitisation transactions.

Material Requirements

Periodic reporting: Originators, sponsors and securitisation entities are required to submit periodic reports to the RBI. These reports intend to cover various aspects of the securitisation transaction, including the performance of securitised assets, compliance with regulatory guidelines and other relevant details.

Asset-level reporting: Detailed information about individual assets within the securitised pool may be required (including data on asset characteristics and performance metrics).

Credit rating reports: Reporting may include submitting credit rating reports and updates, especially if credit ratings are involved in the securitisation transaction.

Penalties for Non-compliance

Penalties for non-compliance with reporting requirements can vary and are at the discretion of the RBI. Potential penalties may include monetary fines, restrictions on specific activities, or other regulatory actions to address non-compliance. The specific penalties are generally outlined in the regulatory framework, and the severity may depend on the nature and extent of the non-compliance.

4.5 Activities of Rating Agencies

Credit rating agencies (including the ones involved in assessing securitisation transactions) are regulated by SEBI. SEBI is the primary regulatory authority overseeing the securities market in India, and it has issued the Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 ("Credit Rating Regulations") and other guidelines governing the activities of credit rating agencies. The Credit Rating Regulations aim to ensure transparency, accountability and integrity of the credit rating process.

The material requirements of Credit Rating Regulations include the following:

- Registration: Credit rating agencies must be registered with SEBI to conduct rating activities. SEBI issues certificates of registration to credit rating agencies meeting the specified criteria.
- Code of conduct: Credit rating agencies are required to adhere to a code of conduct prescribed by SEBI (ie, maintain independence, avoid conflict of interest and ensure fair and transparent rating processes).
- Rating process: The regulations outline the processes and methodologies that credit rating agencies must follow in assigning credit ratings (such as the disclosure of credit rating methodologies, rating symbols, and factors considered in the rating process).
- Rating committees: Credit rating agencies are required to establish rating committees responsible for assigning and reviewing credit ratings. SEBI regulates the composition and functioning of these committees.
- Disclosure requirements: The rating agencies must disclose information about their rating processes, methodologies, and any material changes. They are also required to disclose their rating track record periodically.
- Confidentiality and non-discrimination: Credit rating agencies are obligated to maintain confidentiality of non-public information and avoid discrimination in the treatment of different issuers and instruments.

SEBI monitors the activities of credit rating agencies through periodic inspections and reviews aiming to assess compliance with regulatory requirements. SEBI has the authority to conduct investigations into the affairs of the credit rating agencies in case of any suspected violations or irregularities.

Further, SEBI has the authority to impose monetary penalties on credit rating agencies for non-compliance with regulatory requirements. The penalty amount may depend on the nature and severity of the violation. In case of serious non-compliance, SEBI may suspend or cancel the registration of a credit rating agency's certificate.

4.6 Treatment of Securitisation in Financial Entities

Holdings in securitisation transactions are subject to capital and liquidity rules that apply to banks, insurance companies and other regulated financial entities. The regulatory framework, including guidelines issued by the RBI, outlines specific requirements regarding the capital treatment of securitisation exposures.

Capital treatment for banks:

- Capital requirements: Banks are required to maintain capital against all securitisation exposure amounts, including those arising from the provisions of credit risk mitigants to a securitisation transaction, investments in asset-backed or mortgage-backed securities,

retention of a subordinate tranche and extension of a liquidity facility or credit enhancement.
- MHP: The Securitisation Directions require banks to satisfy the requirements of a an MHP during which the bank is required to retain the economic interest in the securitised assets.
- Risk-weighted assets: Banks are required to assign risk weights to their assets based on the credit risk associated with them. Securitisation exposures are subject to risk weighting, and the risk weights depend on factors such as the credit rating of the securitised instruments and whether the securitisation meets certain criteria.
- Credit enhancement: Securitisation Directions regulate credit enhancement mechanisms, such as over-collateralisation or guarantees that may impact risk-weighted assets.

4.7 Use of Derivatives

The regulations governing use of over the counter (OTC) derivatives include the Securitisation Directions, Guidelines for computing exposure for counterparty credit risk arising from derivative transactions dated November 10, 2016, Master Direction–Risk Management and Inter-Bank Dealings dated July 1, 2016, Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 and Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 and require that such derivatives must be entered into with authorised dealer banks for hedging genuine underlying risks and should be co-terminus with the underlying arrangement. Further, naked derivatives are not allowed, and the exposure must be equal to the underlying value.

Any person guilty of contravention of the above-mentioned regulations shall be punishable with a fine, which may extend to INR100,000 and where a contravention or default is a continuing one, with a further fine which may extend to INR10,000 or every day after the first, during which the contravention or default continues. Further, applicable penalties under Exchange Control Regulations may also apply.

4.8 Investor Protection

The Securitisation Directions and prudential guidelines issued by the RBI and SEBI Regulations protect investor interest in securitisation transactions. The regulatory framework is designed to ensure transparency and fairness and safeguard investor interests. The regulations aim to protect investors from various risks arising from securitisation transactions (such as credit, counterparty, legal, and market risks).

4.9 Banks Securitising Financial Assets

Banks engaging in securitisation transactions are subject to various laws and regulations to ensure prudential norms, risk management and regulatory compliance. The principal laws and regulations impacting banks involved in securitisation include the Securitisation Directions, SARFAESI Act, Prudential Norms on Income Recognition, Asset Classification and Provisioning and other guidelines issued by the RBI.

The material content and impact of such legislation(s) include the following:

- Capital conditions: This requires banks to maintain capital against all securitisation exposure amounts, including those arising from the provision of credit risk mitigants to a securitisation transaction.
- Derecognition conditions: These conditions set out the framework to determine whether a sale results in the assets being de-recognised from the bank's books.

- Servicing conditions: These set out the parameters of servicing when banks perform servicing facilities with respect to the transferred assets. For example, in their capacity as servicers, banks should not have any obligations to support any losses incurred by the SPE (except to the extent contractually provided in the servicing agreement).
- Due diligence requirements: Banks can invest in securitised notes only if the originator has explicitly disclosed to the purchasing banks that it has adhered to the MRR and MHP requirements and will adhere to MRR on an ongoing basis.
- Credit monitoring and valuation: Banks are required to have board-approved policies detailing the valuation of the securitisation notes in which they have invested.
- Permitted securitisation structures: The RBI specifies the forms and structures of permitted securitisation structures.

4.10 SPEs or Other Entities

SPEs

Please refer to our response at **2.1 Issuers**.

Originators

The RBI Directions and the SEBI Regulations are the major legislations applicable to determine the form of the originators. Please refer to our response at **2.3 Originators/Sellers** for further details on who can be originators.

Servicer

Please refer to our response at **2.5 Servicers**.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

SPEs are formed only for the limited purpose of implementing the securitisation structure in relation to the specific receivables assigned to the SPE by the originator. Such SPEs do not engage in activities such as lending, investment banking, private equity, etc, which the RBI or SEBI would otherwise regulate. However, the trustee(s) may be permitted to invest proceeds in certain permitted investments to maintain liquidity management.

The RBI is the supervisory and regulatory body that will determine any non-compliance with the Securitisation Directions. In case of non-compliance, the RBI has the power to undertake supervisory scrutiny and take suitable action as it may deem fit. Additionally, in case of a listed issuance of PTCs, SEBI will also have supervisory and regulatory powers.

4.12 Participation of Government-Sponsored Entities

The banks and NBFCs in India owned or controlled by the government also participate in securitisation transactions, especially to meet the priority sector norms promulgated by the RBI, as banks and NBFCs in India must allocate a percentage of their lending to priority sectors such as agriculture, small and medium enterprises, education, housing, social infrastructure.

The regular participants in securitisation transactions in India are also banks and NBFCs, which are subject to the same regulations.

4.13 Entities Investing in Securitisation

A diverse range of entities invest in securitisation, including financial institutions, banks, non-banking financial companies, mutual funds, insurance companies and other qualified institutional buyers.

The material rules for investments in securitisations for the abovementioned entities include:

- Prudential norms and risk management: The RBI and SEBI prescribe prudential norms and risk management guidelines for entities investing in securitisations. These norms address issues such as exposure limits, credit enhancement and due diligence.
- Credit rating requirements: Investments in securitisation often require credit ratings. Regulatory guidelines often mandate a minimum credit rating for the instruments to ensure a certain level of credit quality.
- Asset liability management norms: Banks and financial institutions are subject to asset liability management norms prescribed by the RBI to ensure prudent risk management.

4.14 Other Principal Laws and Regulations

Some of the other principal laws and regulations relevant in securitisation transactions are:

- Transfer of Property Act, 1882 (ToPA): The transfer of actionable claims (which includes receivables arising out of unsecured debt) has to be effected only by the execution of an instrument in writing, in accordance with the provisions of ToPA. Further, the creation and registration of mortgages are also governed by the provisions of ToPA.
- Stamp laws: The securitisation documents should be adequately stamped to be admissible as court evidence. Further, a securitisation involving the transfer of mortgage-backed assets may attract an ad valorem stamp duty, which could range from 0.1%% to as high as 8.5% of the value of the transaction, depending on the stamp laws of the state in which the mortgaged property is situated. However, various States have issued notifications in this regard, capping the amount of the stamp duty payable on the assignment of loans in securitisation transactions.
- Registration Act, 1908: It requires certain documents to be compulsorily registered, such as any document pertaining to a transfer of immoveable property or interest in an immovable property has to be compulsorily registered with the relevant registrar of land records in the area where such property is located.
- Income Tax Act, 1961: Taxation laws may apply at various securitisation stages. Please see section 7 below on taxes.
- Companies Act, 2013: If the SPE is incorporated as a company, it must ensure compliance with the Companies Act, 2013 and its relevant rules.
- Indian Trust Act, 1882: SPE incorporated as a trust will have to comply with the provisions of this act.
- Indian Contract Act, 1872: This act provides the criteria for a contract to be valid and enforceable, including the requirement of a lawful consideration. Any contract between the parties under a securitisation transaction should be valid and enforceable under the Indian Contract Act of 1872.
- Foreign exchange laws: The RBI regulates foreign investment in India; therefore, foreign portfolio investors investing in PTCs should comply with the the Exchange Control Regulations.
- SEBI regulations: Entities regulated by SEBI and listed issuance of PTCs should comply with the applicable regulations promulgated by the SEBI.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations, under which the credit risk of an underlying pool of exposures is trans-

ferred using credit derivatives or credit guarantees to hedge the credit risk of the pool of assets that remain on the lender's balance sheet, are not permitted in India.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Insolvency laws Affecting Originators

The Insolvency and Bankruptcy Code, 2016 ("IBC") governs the insolvency regime in India. However, the RBI governs the insolvency of originators, such as banks. In the case of an NBFC, the RBI can apply to the relevant authority to initiate insolvency of a particular NBFC.

The Securitisation Directions require the bankruptcy remoteness of the securitised assets from the originator's insolvency. As creditors of the originators may claim rights over the securitised assets in an insolvency proceeding initiated against the originators, the assets must be transferred to the SPE on a 'true sale' basis. Therefore, when the securitised assets are legally isolated from the originator, the securitised assets held by the SPE will not form part of the insolvency proceedings of the originator.

While bankruptcy remoteness of the securitised assets can be ensured in the aforesaid manner, under the IBC, if the originator is going insolvent, then the transfer of assets by the originator to the SPE can be set aside as a 'preferential transfer' or an 'undervalued transaction' if the transaction is executed during the look-back period (ie, two years prior to the admission of insolvency proceedings for related party transactions and one year for other transactions).

Insolvency laws Affecting SPEs

Under the IBC, insolvency proceedings will be initiated against the trustee(s) for the SPE's assets. When incorporated as a trust, the SPE does not enjoy the legal fiction of being a separate legal entity and will, therefore, be wound up as per the terms of the trust deed.

6.2 SPEs

SPEs are typically structured in a form of trust. However, SPEs can also be structured in the form of a company (provided that the PTCs are proposed not to be listed). SPEs play a crucial role in achieving bankruptcy remoteness and isolating securitised assets from the risks associated with the originator's financial condition. The structure of the SPE is carefully designed to meet regulatory requirements and address potential risks, including those related to insolvency proceedings.

Some of the desirable aspects of a SPE include:

- Independent directors: If the SPE is structured as a company, having one or two independent directors is common. Independent directors bring an additional layer of oversight and governance to an SPE, contributing to its credibility and independence.
- No operations outside securitisation: The SPE is typically structured to have no operations outside securitisation transactions. This focuses on holding and managing the securitised assets without engaging in unrelated business activities or having any comingling interest.
- Debt structure: The SPE's capital structure is designed to align with the securitisation transaction. It may issue different classes of securities representing different risk tranches, with priority of payments based on each tranche.

- Bye-laws (Trust Deed / Articles of Association): The bye-laws, ie, the trust deed when the SPE is structured as a trust and articles of association when the SPE is structured as a company, outline the SPE's governance structure, decision-making process and powers. These documents often include provisions to ensure that the SPE operates in accordance with the securitisation transaction terms.
- Orphan SPE: An SPE is often structured as an 'orphan SPE', meaning it is legally and financially independent of the originator and its affiliates. This independence is critical for bankruptcy remoteness.

In relation to potential risks and bankruptcy remoteness, legal and structural protections are often put in place to mitigate the risk of substantive consolidation of the SPE's assets and liabilities with those of the originator or another affiliated entity. Clear legal separation, proper documentation and adherence to regulatory guidelines are critical in maintaining the independence of the SPE.

Further, ensuring that the securitisation transaction meets the 'true sale' criteria is essential. If the transfer of the assets to the SPE is not considered a true sale, there may be a higher risk of substantive consolidation in the event of the originator's insolvency. In this regard, legal opinions are often obtained to confirm the bankruptcy remoteness of the SPE. These opinions often address issues related to substantive consolidation and other risks.

6.3 Transfer of Financial Assets

Certain key considerations and steps are necessary to ensure that the transfer of financial assets from the originator to the SPE is valid and enforceable. The process typically involves the following:

- Drafting and execution of legal documentation: A comprehensive assignment agreement is drafted, detailing the terms of the transfer, representations, warranties and covenants of the parties involved.
- True sale criteria: The transfer must meet the 'true sale' criteria. A true sale involves complete ownership and control over the securitised assets from the originator to the SPE. Key considerations include:
  - (a) Legal isolation of assets from the transferor's bankruptcy risk.
  - (b) Absence of any recourse or buyback obligations by the originator.
  - (c) Effective transfer of the economic benefits and risks associated with the assets.
- Legal due-diligence: Legal due diligence ensures that the transfer complies with all applicable laws and regulations (including review of the relevant transaction documents, perfection requirements and regulatory compliances).
- True sale opinions: Parties often obtain legal opinions, commonly referred to as 'true sale' opinions, from legal counsels. These opinions confirm that, in the legal counsel's view, the transfer constitutes a true sale and is enforceable against the transferor and its creditors.
- Stamp duty and registration: Parties to a securitisation transaction are also required to pay stamp duty and registration fees, which differ from state to state depending on each state's stamp duty and registration legislation. However, stamp duty is exempted if any bank or financial institution executes the assignment agreement in favour of an ARC acquiring financial assets for asset reconstruction or securitisation.

While the steps outlined above are designed to achieve a true sale, risks such as characterisation of the transaction of the transfer, regulatory changes or unexpected legal developments should be continually assessed.

6.4 Construction of Bankruptcy-Remote Transactions

Achieving bankruptcy remoteness in securitisation transactions involves careful structuring to isolate the financial aspects to be financed from the insolvency risk of the originator. While obtaining insolvency opinions is not as common in India as in other jurisdictions, various legal and structural mechanisms are employed to enhance bankruptcy remoteness. Some of the means and considerations for achieving bankruptcy-remote transactions in India include:

- Structuring the SPE: The creation of the SPE is a fundamental step in securitisation transactions. The SPE is designed to hold and manage the securitised assets independently of the originator. The SPE's legal and financial separation helps mitigate the impact of the originator's insolvency on the securitised assets.
- True sale criteria: Meeting the 'true sale' criteria is critical. A true sale involves a genuine transfer of ownership and control over the securitised assets from the originator to the SPE.
- Non-recourse and non-bankruptcy remoteness provisions: Drafting contractual provisions that explicitly limit the recourse of the investors or the SPE to the securitised assets is essential. Non-recourse provisions prevent investors from seeking recovery from the originator's general assets in the event of default.
- Bankruptcy remote provisions: Including bankruptcy remote provisions in the transaction documents helps to isolate the securitised assets further. These provisions may restrict the SPE from filing for bankruptcy or limit the liability of the creditors of the originator to reach the securitised assets in the event of the originator's insolvency.
- Regulatory compliance: Adhering to regulatory guidelines issued by the RBI and SEBI is critical. Compliances ensure that the securitisation structure aligns with the regulatory expectations, contributing to its legitimacy and effectiveness.

6.5 Bankruptcy-Remote SPE

Given that most SPEs are typically structured as a trust, specific provisions are included in the trust deed to address the bankruptcy remoteness and protection of the investor. In this context, limited recourse and non-petition provisions are applied within the framework of a trust. These provisions are typically framed as below:

- Limited recourse provisions: Limited recourse provisions limit the recourse available to the investor to the specific assets that have been securitised. In other words, investors have recourse only to the cash flows and assets in the securitised pool. This is achieved by the trust deed defining the specific assets that form part of the trust estate, typically representing the securitised assets. Limited recourse provisions would then restrict the investors' recourse to only those trust assets. By restricting the recourse to the securitised assets, limited recourse provisions mitigate the risk of the SPE's bankruptcy affecting assets outside the securitised pool. This becomes crucial for maintaining the bankruptcy remoteness of the transaction.
- Non-petition provisions: Non-petition provisions in the trust deed would typically prohibit the SPE or the investors from filing for bankruptcy or insolvency proceedings against

the trust. Such provisions help maintain the bankruptcy remoteness status of the SPE.
- Trustee's role and independence: The trust deed designates a trustee responsible for managing the trust estate. Ensuring the trustee's independence from the originator is crucial for maintaining the autonomy of the SPE and preventing a conflict of interest.

7. Tax Laws and Issues

7.1 Transfer Taxes

Any income arising from an SPE from, inter alia, on the acquisition of a financial asset from the originator is tax-exempt under Indian tax laws. Please note that the securitisation should be in accordance with the SEBI Regulations.

7.2 Taxes on Profit

Indian tax laws provide for a complete tax pass status on all the income arising to SPE from the activity of securitisation, meaning that any income earned from underlying financial assets is tax-exempt in the hands of the SPE and taxed directly in the hands of the investor as if such income arises directly in the hands of the investor.

7.3 Withholding Taxes

The income distributed by the SPE to its Indian tax-resident investors is subject to tax withholding as per the rates set out below:

- 25% in case of individuals or Hindu undivided families; and
- 30% for other categories (such as companies, partnerships, etc).

In the case of non-resident investors, taxes are required to be withheld as per applicable tax rates in force, depending on the nature of income distributed by the SPE.

For instance, if the SPE receives dividends from an investee company and, onwards, pays dividends to non-resident investors, taxes may be withheld at the rate of 20% (plus applicable surcharge and cess) under domestic tax law. Similarly, interest from notes or loans will be taxed at the rate of 20% or 40% plus applicable surcharge and cess, depending on the currency in which the borrowing was made under domestic tax law. Such tax rates will be subject to benefits under the relevant tax treaty, if any. As such, if the rates specified in the relevant tax treaty are lower than the domestic tax rates on such India-sourced income, the lower tax rate under the tax treaty will apply.

The investors can claim a credit of the taxes withheld by the SPE on the income they earn, which can be adjusted against the taxes due on their total income subject to taxes in India.

7.4 Other Taxes

Securitisation transactions will not attract Goods and Service Tax ("GST") under the applicable laws, as it is beyond the ambit of "supply" under such laws.

However, any service fee charged for collection, for payment as a servicing agent, will be liable to GST in the hands of the service provider. Further, any service between related parties, even if it is free of cost, for example, management fees by trusts floated by ARCs to such ARC(s), will be liable to GST on any fee in the hands of the service provider.

A reasonable open market value should be ascribed to paying GST for free-of-cost transactions. If the receiver is eligible for full input credit

of the GST paid, then any value can be ascribed to the transaction.

7.5 Obtaining Legal Opinions

Practitioners commonly give tax opinions covering the following aspects:

- Tax treatment of income on transfer of assets/property (subject to securitisation).
- Tax treatment of securitisation transactions, such as receipt of financial assets by the SPE.
- Tax treatment of the income from underlying assets in the hands of the SPE.
- Tax withholding obligations in the hands of the SPE.
- Tax treatment of returns in the hands of the investor.

The material conclusions in such tax opinions will be similar to the discussion on tax treatment of such transactions, as discussed above (see sections **7.1 Transfer Taxes** to **7.4 Other Taxes above**).

Typically, such tax opinions carry qualifications regarding accounting matters related to securitisation transactions.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The following legal issues may arise in connection with accounting rules that apply to securitisations in India:

- the treatment of the transfer of underlying financial assets as a "true sale" for accounting purposes; and
- whether the SPE is consolidated into the originator's group for accounting purposes.

8.2 Dealing with Legal Issues

Legal and tax opinions in this regard do not generally cover accounting matters. However, legal opinions may be provided on true sale and compliance with Securitisation Directions, such as compliance with MRR and credit enhancement compliances, but may include certain qualifications or assumptions.

IRELAND

Law and Practice

Contributed by:
Andrew Traynor, Aisling Burke, Ian McNamee and Sinéad Gormley
Walkers

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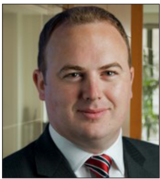
Authors



Andrew Traynor is a partner and co-head of Walkers' Finance and Capital Markets group. He advises on securitisation, structured finance and fund finance transactions including ABS, CMBS, CLOs, securitisations, credit risk transfer (CRT)/significant risk transfer (SRT) and other structured products. He is a market-leading practitioner in the bank capital management space with extensive experience on both cash/true sale and synthetic securitisations, credit risk mitigation and other risk transfer transactions. Andrew has over 20 years' experience acting for market participants across Europe, North America and Asia including on numerous award winning and market-first transactions.

Aisling Burke is a partner in the Tax group in Walkers' Irish office. Aisling advises financial institutions, investment funds, asset managers, investors, issuers and arrangers on financial services taxation including advice on cross-border financing, establishment of investment fund platforms, real estate structures, debt issuance programmes, derivatives and securitisation transactions. Aisling also advises on tax structuring, inward investment and the tax aspects of M&A. Aisling has extensive experience of dealing with the Irish Revenue Commissioners in contentious and non-contentious matters. Aisling is admitted to the Roll of Solicitors in Ireland and is an AITI Chartered Tax Adviser.

Ian McNamee is based in Walkers' Irish office where he is a partner in the firm's Finance and Capital Markets group. Ian's principal practice areas are structured products, capital markets, distressed investment, finance, fund financing and structured finance.

Sinéad Gormley is a senior knowledge lawyer in Walkers' Irish office in the firm's Finance and Capital Markets group. She previously held a senior in-house position with a domestic bank, advising on a broad range of capital markets and structured finance transactions, with a particular focus on SRT and securitisations.

Walkers

The Exchange
George's Dock
IFSC
Dublin 1
Ireland

Tel: +353 1 470 6600
Fax: +353 1 470 6601
Email: info@walkersglobal.com
Web: www.walkersglobal.com

1. Specific Financial Asset Types

1.1 Common Financial Assets

A wide range of asset classes have been securitised by Irish special purpose entities (SPEs): residential mortgages; commercial mortgages; auto loans; consumer loans; SME loans; corporate loans; shipping assets; aircraft lease rentals; trade, credit card and hire purchase receivables; commodities; royalties; carbon assets; and non-performing loans (NPLs).

Irish SPEs can be successfully deployed for the full range of securitisation products, including:

- ABS;
- CMBS;
- RMBS;
- CDOs;
- CLOs;
- distressed debt/NPLs;
- LPNs;
- repacks;
- SRT/CRT;
- US life settlements;
- ILS/catastrophe bonds; and
- receivables transactions.

1.2 Structures Relating to Financial Assets

The structure of a securitisation is generally determined by desired regulatory capital treatment or investor requirements.

Typically, the issuer is established as an off-balance sheet, tax neutral SPE which is funded exclusively by debt. Its key counterparties will include a local corporate services provider (CSP), an arranger, note trustee, security trustee (secured deals), paying agent, registrar, transfer agent, servicer, originator and investment advisor (as applicable).

It should have at least two independent directors who are tax resident in Ireland. The CSP typically provides the SPE's independent directors, company secretary, registered office and various other services.

The SPE is resident in Ireland for tax purposes; typically a designated activity company (DAC) or a PLC (retail) acquires, holds and manages qualifying assets and has no other business.

The assets held or managed by the SPE is its first transaction must have an aggregate value at least EUR10 million. The SPE must notify the Revenue Commissioners of its intention to be a "qualifying company" within eight weeks of commencing activities – see further **7.2 Taxes on Profit**.

1.3 Applicable Laws and Regulations

The principal measures applicable to securitisations are as follows (each as amended, as applicable):

Corporate and Tax

- Companies Act 2014 (the Companies Act);
- Taxes Consolidation Act 1997 of Ireland (the TCA 1997);
- EU (Preventive Restructuring) Regulations 2022;
- Regulation (EU) 2015/848.

Markets and Securities

- Regulation (EU) 2017/2402 (the SR) and related technical standard (RTS);
- EU (General Framework for Securitisation and Specific Framework for Simple, Transparent and Standardised Securitisation) Regulations 2018 (the Irish Securitisation Regulations);
- Regulation (EU) 2017/1129 (the PR), related RTS and guidance published by the Central Bank of Ireland (CBI) and the European Securities and Markets Authority (ESMA);
- EU (Prospectus) Regulations 2019 (the Irish Prospectus Regulations);
- Listing rules of The Irish Stock Exchange plc, trading as Euronext Dublin in respect of a listing on Euronext Dublin's regulated market or Global Exchange Market (the GEM), as applicable;
- Regulation (EU) 596/2014 (MAR), related technical standards and guidance published by the CBI and ESMA;
- EU (Market Abuse) Regulations 2016 (the Irish Market Abuse Regulations);
- Directive 2004/109/EC (the TD), related technical standards and guidance published by the CBI and ESMA;
- Transparency (Directive 2004/109) Regulations 2007 (the Irish Transparency Regulations);
- Part 2 (Transparency Requirements), Part 3 (Market Abuse Requirements) and Part 4 (Prospectus Requirements) of the Central Bank (Investment Market Conduct) Rules 2019;
- Part 23 (Public Offers of Securities, Financial Reporting by Traded Companies, Prevention of Market Abuse etc) and other relevant parts of the Companies Act regarding offers of securities;
- Regulation (EU) 1060/2009 on credit rating agencies (the CRA Regulation)
- Regulation (EU) No 909/2014 on central securities depositaries (the CSDR);
- Regulation (EU) 648/2012 (EMIR) (as amended in particular, by Regulation (EU) 2019/834 (EMIR Refit) and Regulation (EU) 2019/2099 (EMIR 2.2)) and related technical standards;
- Regulation (EU) 2015/2365 on securities financing transactions (SFTR).

Regulatory and AML/CFT

- Regulation (EU) 575/2013 on capital requirements (the CRR);
- Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the CJA 2010);
- EU (Anti-Money Laundering: Beneficial Ownership Of Corporate Entities) Regulations 2019;
- Credit Reporting Act 2013 (the CRA 2013);
- Part V (Supervision of Regulated Business) as it relates to credit servicing of the Central Bank Act 1997 (the CBA 1997);

- EU (Credit Servicers and Credit Purchasers) Regulations 2023;
- Regulation (EU) 1075/2013 (the FVC Regulation) and Section 18 of the Central Bank Act 1971 (Section 18 CBA 1971);
- Protected Disclosures Act 2014 (the PDA 2014).

Consumer and Personal Data

- Consumer Credit Act 1995 (the CCA 1995);
- EU (Consumer Mortgage Credit Agreements) Regulations 2016 (the MC Regulations);
- Consumer Rights Act 2022 (the CRA 2022);
- Regulation (EU) 2016/679 (the GDPR); and
- Data Protection Acts 1988 to 2018 (the DPAs).

1.4 Special-Purpose Entity (SPE) Jurisdiction

Ireland is firmly established as the leading European centre of excellence for SPEs for financial investment transactions including warehousing, securitisation, significant risk transfer/capital relief trades (SRT/CRT), repacks, receivables financing and distressed asset investment as well as a broad range of other structured finance deals.

Ireland is an onshore jurisdiction and a member of the EU and the OECD with a long-standing, trusted and transparent securitisation tax regime and an extensive network of 76 double tax treaties, which may allow for the return generated by underlying assets to be paid to an SPE with zero or reduced foreign withholding tax, no Irish stamp duty and clear VAT rules which exempt certain activities and services for VAT purposes.

It has a respected, stable and robust legal system which facilitates structured finance transactions. It has the appropriate infrastructure with an excellent choice of experienced legal and accounting professionals and CSPs. Efficient listing of securities can also be undertaken on Euronext Dublin.

Ireland is a common law jurisdiction. Its legal concepts will therefore be familiar to investors and promoters. Establishing an SPE in Ireland is a straightforward and inexpensive process.

As at the end of Q2 2023, there were over 3,300 active Irish SPEs holding combined assets of almost EUR1.1 trillion. This accounts for 31.8% by number of euro-area market securitisation SPEs.

1.5 Material Forms of Credit Enhancement

The type and level of credit enhancement is typically driven by rating requirements to reduce credit risk/default risk on the underlying portfolio. Commonly utilised forms include:

- subordinated notes or loan;
- deferred purchase price;
- over-collateralisation;
- excess spread;
- liquidity facilities, credit default swaps or guarantees; and
- reserves in the form of cash and highly liquid investments.

Credit enhancement from the originator must be on arm's length commercial terms – see the "Claw-Back" section of **6.1 Insolvency Laws**.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer is an SPE established solely for the purposes of the transaction. It does not have

any other business or employees. It purchases the underlying assets and issues securities to investors who ultimately bear the economic risk on the portfolio.

See **6.2 SPEs** and **4. Laws and Regulations Specifically Relating to Securitisation**.

2.2 Sponsors

The sponsor, often an originator, typically establishes and manages the securitisation and may be a credit institution, a large corporate or a fund.

See:

- **4.3 Credit Risk Retention** as to retention obligations;
- "Securitisation Regulation" section of **4.1 Specific Disclosure Laws or Regulations** as to transparency and STS notification obligations;
- "SR Article 9(1)" section of **4.9 Banks Securitising Financial Assets** as to obligations concerning credit granting; and
- "Irish Securitisation Regulations" section of **4.1 Specific Disclosure Laws or Regulations** as to the CBI Notification.

2.3 Originators/Sellers

The originator/seller is the entity which, either directly or through an affiliate, advances or acquires the financial assets which will be sold to the SPE and may also act as servicer. It is typically a bank, insurer or other corporate with a significant book of receivables. It may also be a separate entity established to aggregate assets for sale to the SPE.

See:

- **4.3 Credit Risk Retention** as to retention obligations and the "sole purpose test";
- "Securitisation Regulation" section of **4.1 Specific Disclosure Laws or Regulations** as to transparency and STS notification obligations;
- "Irish Securitisation Regulations" section of **4.1 Specific Disclosure Laws or Regulations** as to the CBI Notification; and
- **4.9 Banks Securitising Financial Assets** regarding credit granting and consumer law.

2.4 Underwriters and Placement Agents

Underwriters and placement agents are typically investment banks. It is not required to appoint underwriters and/or placement agents but it is usual to do so for public deals being widely marketed to a diverse investor base. They assist in structuring and marketing and, in a constrained fundraising environment, the underwriter will agree to purchase notes if third-party investors cannot be found.

A placement agent must comply with the market soundings regime of the MAR when disclosing information on a prospective issuance to potential investors.

2.5 Servicers

The servicer is responsible for the day-to-day administration of the assets. It is often the originator/an affiliate. Specialist servicing companies are becoming more commonplace.

Servicers engaging in "the business of a credit servicing firm" for the purposes of the CBA 1997 must be authorised by the CBI. A separate authorisation is required by "credit servicers" of in-scope NPLs which were not authorised as credit servicing firms as at 30 December 2023 or otherwise exempt pursuant to the EU (Credit Servicers and Credit Purchasers) Regulations 2023.

See **4.3 Credit Risk Retention**.

2.6 Investors

Investors are generally financial institutions, insurance companies, pension funds, private equity investors and funds. Investors may have responsibilities under the terms of the notes and note purchase agreement or by virtue of being regulated.

See:

- "As Investor" section of **4.9 Banks Securitising Financial Assets**.
- "As Investor" section of **4.3 Credit Risk Retention**.

2.7 Bond/Note Trustees

The trustee role is performed by professional trustee companies. It may be divided between the functions of note trustee and security trustee or be combined in a single role of trustee. The note trustee holds the benefit of the issuer's covenant to pay and other contractual undertakings on behalf of the noteholders. The security trustee holds the benefit of the transaction security for the investors and key service providers. The note trustee and the security trustee represent noteholders vis-à-vis the issuer.

Most securitisations use trustees but it is not required. The covenant to pay, contractual undertakings and transaction security can be given to noteholders directly. However, this may limit the liquidity of the notes and complicate transfers. Some listing venues require that a trustee or independent agent to be appointed to represent noteholders.

2.8 Security Trustees/Agents

See **2.7 Bond/Note Trustees**.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

A bankruptcy-remote transfer is generally effected by a transfer agreement between the issuer, the originator and, in order to obtain the benefit of the contract only, the trustee. An Irish court will look at the substance of the transaction to examine whether it is a sham or if it is consistent with a sale. Key provisions include:

- agreement to sell and purchase;
- conditions precedent;
- originator's declaration of trust over proceeds deriving from the asset portfolio;
- warranties;
- perfection events;
- non-petition/limited recourse;
- indemnities;
- eligibility criteria;
- covenants;
- deemed collections; and
- repurchase provisions.

3.2 Principal Warranties

Originator representations and warranties include status, capacity, authority, licensing and solvency. A breach of any of the foregoing would breach the relevant transaction document, may trigger an event of default and may entitle the issuer to seek rescission and/or damages. The originator provides asset warranties addressing title and compliance with selection criteria and origination rules. A breach of asset warranty may trigger a repurchase obligation.

The issuer represents and warrants as to corporate status, capacity, authority, licensing, solvency and beneficial ownership of the portfolio. A breach of any such warranty may trigger a note event of default.

3.3 Principal Perfection Provisions

See **6.3 Transfer of Financial Assets**.

Perfection of Security

The particulars of security created by an Irish company must be registered with the Irish Registrar of Companies within 21 days of creation subject to exceptions. Failure to so register renders the security void as against any liquidator or creditor of the company.

The holder of a fixed charge over the book debts of a company must notify the Revenue Commissioners of the creation of such charge within the same 21-day period.

Where security is created by assignment, notice of such assignment must be delivered to the obligor. It will otherwise take effect in equity only. Securitisation documents customarily incorporate notice to the SPE's transaction counterparties.

3.4 Principal Covenants

An issuer covenants, amongst other things, to:

- comply with the provisions of the notes and transaction documents and take reasonable steps to ensure compliance by other transaction parties;
- provide the trustee with such information, certificates and opinions as it requires and copies of specified documents;
- prepare and deliver all specified reports;
- maintain any listing;
- maintain its tax status;
- preserve the portfolio assets and not deal with them other than as permitted;
- not engage in any other business;
- not have employees;
- make the CBI Notification (defined below); and
- perfect its security.

See "Non-consolidation" section of **6.2 SPEs** regarding separateness covenants.

Originator and servicer covenants include compliance with applicable laws and maintenance of authorisations.

Depending on the type of transaction, the issuer or originator will be designated as responsible for compliance with the reporting requirement under Article 7 of the SR. Where the issuer is so designated, it will delegate performance to one or more transaction counterparties.

Breach of covenant will constitute a breach of the transaction documents which may trigger an event of default.

3.5 Principal Servicing Provisions

The servicer is responsible for day-to-day administration including collections and enforcement. The transaction documents typically provide for replacement of the servicer upon insolvency or material breach of obligations.

Where the originator is servicer, it is required to treat the portfolio assets in the same manner as equivalent assets on its balance sheet.

3.6 Principal Defaults

Standard events of default are issuer failure to pay principal or interest within any applicable grace period, issuer breach of transaction documents, issuer insolvency and illegality. Default under the notes typically entitles the noteholders to instruct the trustee to declare the notes immediately due and payable and to enforce the transaction security.

3.7 Principal Indemnities

The scope of indemnification is a matter of negotiation and risk appetite.

The issuer usually provides full indemnities to the trustee, agents, CSP and managers/arrangers in respect of losses and costs incurred in the performance of their roles.

Indemnities received by the issuer include:

- from the originator/seller in relation to losses incurred on assets not complying with eligibility criteria at the time of purchase; and
- from its agents, the CSP and the servicer in respect of losses incurred by the issuer as a result of the relevant party's failure to comply with its obligations.

A trustee, prior to taking action in relation to the transaction, may require pre-funding, indemnification and/or additional security from the noteholders.

3.8 Bonds/Notes/Securities

Securitisation notes are constituted by a trust deed made between the issuer and the trustee. The trust deed schedules the form(s) of notes and their terms and conditions, which together govern the relationships between the issuer, the trustee and the noteholders.

Principal provisions include payment, priority, default and remedies, modification, liability and indemnity and responsibility for compliance with regulatory requirements, such as reporting under the SR.

Typically, notes of each class in a securitisation are represented by a single global note. The global note is prepared in "classic" form or "new" form and deposited with, respectively, a common safekeeper or a common depositary. The common safekeeper/common depositary is the legal owner of the note. Noteholders are beneficial owners and hold their interests via a clearing system. A global note sets out the limited conditions (eg, clearing system closure) in which it may be exchanged for definitive notes.

3.9 Derivatives

Interest rate and/or FX swaps are used to hedge the risk of interest rate and/or currency mismatch as between the receivables and payments to be made to noteholders and other transaction counterparties.

See:

- **5.1 Synthetic Securitisation Regulation and Structure**; and
- "Insurance" section of **4.11 Activities Avoided by SPEs or Other Securitisation Entities**.

3.10 Offering Memoranda

A typical securitisation involves the preparation by the issuer of a prospectus or a listing particulars. Private deals may have an offering circular or information memorandum for the purposes of providing deal information to prospective investors.

A prospectus is required in connection with the listing of securities on a regulated market for the purposes of Directive 2014/65/EU (MiFID II) (such as Euronext Dublin's regulated market) or an offer of securities to the public, in each case, falling within the scope of the PR. See "Prospectus Regime" section of **4.2 General Disclosure Laws or Regulations**.

An issuance of listed notes falling outside the prospectus regime – a "private" securitisation – requires the listing particulars conforming with

the rules of the exchange on which the notes will be listed. The exchange-regulated market in Ireland is the Euronext Dublin's GEM, which is multilateral trading facility (MTF) for the purposes of MiFID II.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

The specific disclosure measures for securitisation are (each as amended, as applicable):

- SR and related technical standards;
- Irish Securitisation Regulations; and
- FVC Regulation and Section 18 CBA 1971.

EU Securitisation Regulation

The SR imposes harmonised rules on due diligence, risk retention and disclosure for all securitisations (as defined therein). It provides a framework for simple, transparent and standardised (STS) securitisations, including STS synthetic securitisation and securitisation of non-performing exposures (NPEs).

Transparency requirements–SR Article 7

SR Article 7 requires the originator, sponsor and SPE to make available detailed information relating to the securitisation to the holders of a securitisation position, national competent authorities (NCAs) and, upon request, potential investors. They may designate one entity amongst themselves – commonly, the SPE – to undertake this reporting but remain jointly responsible for compliance. Obligations include making available:

- on a quarterly (or monthly in the case of ABCP securitisations) basis, detailed information on the underlying exposures and investor reports;
- all underlying documents that are essential for understanding the transaction;
- a transaction summary for private deals;
- the STS notification (if applicable);
- without delay, inside information required to be disclosed under MAR; and
- where the MAR does not apply, details of significant events that may materially impact performance.

Technical standards issued under SR Article 7 specify the precise information required and templates to be used for this purpose. The information must be made available simultaneously and at the latest one month after the due date for the payment of interest.

For public deals, disclosures must be made via a securitisation repository registered with ESMA. The means of disclosure for private deals is not prescribed. Per the latest ESMA Q&A on SR (July 2023), in the absence of any instructions or guidance from NCAs, reporting entities can use any arrangements that meet the conditions of the SR. Barring further guidance from the CBI, it is logical to assume that parties reporting to the CBI should use the same channels of communication as are used for CBI Notifications.

Amendments to the disclosure regime are expected following the publication of the European Commission's (the Commission) Report on the Functioning of the SR, which considered, amongst other things:

- whether the information required by the disclosure templates for underlying exposures is useful and proportionate to investors' needs; and

- a dedicated reporting template for private securitisations.

Additional transparency requirements – STS securitisations

Originators and sponsors of STS securitisations are subject to additional pre-pricing transparency requirements, including making available to potential investors historical default and loss performance data on substantially similar exposures to those being securitised and liability cash flow models.

For STS securitisations of residential loans or auto loans or leases:

- the originator and sponsor may publish information on the environmental performance of the assets financed by the securitisation; or
- the originator may publish information on the principal adverse impacts (PAI) of the assets financed on "sustainability factors" for the purposes of Regulation (EU) 2019/2088 (the Sustainable Finance Disclosures Regulation or SFDR).

A final report on draft RTS on the content, methodologies and presentation of information on PAI was submitted to the Commission in May 2023 and awaits endorsement (and/or amendment). The RTS, when in force, will continue to allow originators and sponsors to choose between disclosure on environmental performance and PAI.

STS securitisations must be notified by the originator(s) and sponsor (or sponsor only for ABCP transactions) to ESMA pursuant to SR Article 27(1). Notifications for traditional securitisations are made via ESMA's online notification portal, and until further notice, via email for synthetic securitisations. Typically, the originator or sponsor makes this notification and sets out how the securitisation transaction fulfils the STS requirements. An optional process is also available whereby an authorised third-party verifier can attest compliance with STS criteria.

Synthetic Risk Retention Disclosure

Where risk retention for the purposes of SR Article 6(3) is achieved using a synthetic or contingent means, this must be disclosed and described in the offering document, prospectus, transaction summary or overview for the transaction.

Irish Securitisation Regulations

Where an originator, sponsor or SPE is located in Ireland, the Irish Securitisation Regulations require such party to notify the CBI of a securitisation within 15 working days of the first issue of securities (the CBI Notification). This notification must include:

- the securitisation's International Securities Identification Number;
- whether the person making the notification is originator, sponsor or SPE (or, if none of the foregoing, the person's name, address, corporate status and legal entity identifier (if any)); and
- the name and address of the entity designated to comply with SR reporting obligations.

The CBI Notification must be submitted in the manner set out on the CBI's Securitisation Regulation webpage. Firms supervised/regulated by the CBI must use their pre-existing channels of communication. SPEs subject to the CBI's financial vehicle corporation (FVC) registration regime must use the channels prescribed for that regime. All other in-scope entities must notify via email to securitisation@centralbank.ie.

FVC Regulation and Section 18 CBA 1971

See "FVC Regulation and Section 18 CBA 1971" section of **4.4 Periodic Reporting**.

4.2 General Disclosure Laws or Regulations

Relevant general disclosure measures include the following (each as amended, as applicable):

- PR and related technical standards and Irish Prospectus Regulations;
- MAR, Directive 2014/57/EU on criminal sanctions for market abuse and Irish Market Abuse Regulations;
- TD and Irish Transparency Regulations;
- SI 366/2019 (the Market Conduct Rules);
- CSDR;
- PDA 2014;
- Companies Act;
- SFTR;
- EMIR;
- beneficial ownership regulations; and
- proposed European Single Access Point (ESAP) Regulation.

Prospectus Regime

An Irish issuer seeking to list debt securities on a regulated market or offer securities to the public must publish a prospectus and have it approved by the appropriate NCA – the CBI in Ireland. A number of exemptions exist, including for:

- offers addressed solely to qualified investors;
- offers addressed to fewer than 150 natural or legal persons per EU member state, other than qualified investors;
- offers with a denomination per unit of at least EUR100,000; and
- secondary issuances representing less than 20% of the number of securities already admitted to trading on the relevant regulated market.

A securitisation issuer rarely makes an offer of securities to the public in the true sense. The obligation to publish a prospectus is usually triggered by listing the notes on a regulated market. The prospectus must then satisfy both prospectus law and the applicable stock exchange rules.

A prospectus must contain the necessary information which is material to an investor for making an informed assessment of:

- the assets and liabilities, profits and losses, financial position, and prospects of the issuer and any guarantor;
- the rights attaching to the securities; and
- the reasons for the issuance and impact on the issuer.

Risk factors in a prospectus must be specific to the issuer or securities, ranked in order of materiality, and material to making an informed investment decision. Detailed requirements are contained in Delegated Regulations (EU) 2019/979 and (EU) (2019/980) (each as amended).

The Commission has adopted proposed amendments to the PR pursuant to the Listing Act which forms part of the Capital Markets Union. The Listing Act aims to reduce the financial and administrative burden for issuers seeking to access the capital markets. Changes include increasing the exemption for secondary issuances from 20% to 40% for the "regulated market trigger" and extending it to the "offer to the public trigger"; and removing the obligation to rank risk factors. The text of the proposed Regulation containing these changes was adopted by the Economic and Monetary Affairs Committee of the European Parliament (the Parliament) in October 2023 and will be progressed via the ordinary legislative procedure.

Market Abuse Regime

The market abuse regime prohibits insider dealing, unlawful disclosure of inside information and market manipulation in respect of financial instruments:

- admitted to trading on a regulated market or for which admission to trading has been sought;
- traded on organised trading facilities;
- traded or admitted to trading on MTFs (such Euronext Dublin's GEM) or for which admission to trading has been sought; and/or
- the value or price of which depends, or has an effect, on any of the above.

Issuers must make public as soon as possible inside information which directly concerns the issuer in a manner which enables complete and timely assessment by the public. Disclosures cannot be combined with marketing information and must be available on the issuer's website for at least five years. Disclosure can be delayed in limited circumstances; for the duration of such delay, the information must remain confidential.

The Listing Act will also amend the MAR, including as regards disclosure, conditions for delaying disclosure and market soundings.

Transparency Regime

The Irish Transparency Regulations specify minimum requirements for disclosure of periodic financial information and ongoing information by issuers whose securities are admitted to trading on a regulated market. Issuers of retail debt securities must prepare annual financial reports in the European single electronic format (ESEF).

See "Securitisation Regulation" section of **4.1 Specific Disclosure Laws or Regulations.**

PDA 2014

The PDA 2014 requires, amongst other things, that the following types of employer establish channels for the reporting by their workers of "relevant wrongdoing":

- public employers;
- private employers with at least 50 workers; and
- private employers who are subject to specified EU laws.

Relevant wrongdoing includes breaches of EU law in the area of financial services, products and markets and prevention of anti-money laundering (AML) and counter-terrorist financing (CTF).

Proposed ESAP Regulation

Proposals were adopted in November 2023 for a Regulation on a European single access point (ESAP). Information that is required to be published pursuant to, amongst other measures, the PR, the TD, and the MAR, must be submitted to a designated collection body for publication on ESAP. The platform is expected to operate from mid-2027.

See "EMIR Regime" and "SFTR Regime" sections of **4.7 Use of Derivatives.**

4.3 Credit Risk Retention

SR Article 6 requires that an originator, sponsor, original lender, or in the case of an NPE securitisation and subject to certain conditions, the servicer (the retainer) holds, on an ongoing basis, a material net economic interest of not less than 5% in the securitisation, which may not be subject to risk-mitigation techniques, for the duration of the transaction. The retention requirement for NPE securitisations is calculated by reference to the discounted purchase price of

the NPEs rather than their nominal value. Investors must verify compliance pre-investing.

An entity is not an "originator" for the purposes of SR Article 6 where it meets all of the criteria of the "sole purpose test" in Article 2(7) of the 2023 RTS (defined below).

The risk retention requirement is satisfied where the retainer holds any of the following:

- a vertical slice of the securitisation representing at least 5% of the nominal value of each tranche sold or transferred to investors;
- where the securitisation is of a revolving pool of assets, an interest in the pool equal to at least 5% of the nominal value of the securitised assets;
- randomly selected assets equal to at least 5% of the nominal value of the securitised assets provided that:
  - (a) the selected assets and the securitised assets together number at least 100; and
  - (b) the selected assets would otherwise have been securitised;
- the first loss tranche of the structure equal to at least 5% of the nominal value of the securitised assets; and
- the first 5% loss exposure on each securitised asset.

The Commission, in October 2023, adopted Delegated Regulation (EU) 2023/2175 (the 2023 RTS) which further specify the risk retention requirements pursuant to SR Article 6(7) and replace Delegated Regulation (EU) No 625/2014. The 2023 RTS address, amongst other things, the methods of risk retention, treatment of NPE traditional securitisations and the impact of fees on the retained net economic interest.

Sanctions

Possible sanctions for negligent or intentional contravention of the SR or Irish Securitisation Regulations include:

- administrative fines for corporates of up to 10% of annual turnover;
- bans from participating in the management of any originator, sponsor or SPE; and
- temporary withdrawal of authorisation from the entity responsible for confirming compliance with STS requirements.

Sanctions may be imposed on regulated financial service providers under the Central Bank Act 1942 (as amended) for contraventions of the Irish Securitisation Regulations. Criminal liability may also attach to relevant parties.

4.4 Periodic Reporting

See:

- "Securitisation Regulation" and "Irish Securitisation Regulations" sections of **4.1 Specific Disclosure Laws or Regulations**;
- "Transparency Regime" section of **4.2 General Disclosure Laws or Regulations**; and
- "Sanctions" section of **4.3 Credit Risk Retention**.

FVC Regulation and Section 18 CBA 1971

Irish SPEs which are FVCs must report statistical data to the CBI on a quarterly basis under the Regulation (EU) No 1075/2013 (the FVC Regulation). An FVC is an undertaking whose principal activity meets both of the following:

- it carries out securitisations and is insulated from the risk of bankruptcy or other default of the originator; and
- it issues securities, securitisation fund units, other debt instruments and/or financial

derivatives and/or legally or economically owns assets underlying the issue of securities, securitisation fund units, other debt instruments and/or financial derivatives that are offered for sale to the public or sold on the basis of private placements.

Many Irish SPEs are FVCs. The CBI extended reporting obligations to non-FVC SPEs incorporated in Ireland (via Section 18 CBA 1971), which must provide quarterly balance sheets and annual profit and loss data.

CRA 2013

The CBI operates a centralised repository (the Central Credit Register or CCR) for information on in-scope credit arrangements including loans, mortgages and hire purchase agreements originated in the state. The CRA 2013 requires, amongst other things, that in-scope lenders (including SPEs that acquire loan portfolios) provide monthly detailed and ongoing information on the performance of in-scope credit arrangements to the CBI.

A person who provides false information to the CBI or uses information accessed from the CCR for a non-permitted purpose (including any director, manager or officer who consented or connived in the offence) may be liable to a fine (of unspecified amount) and/or up to five years imprisonment. The CBI's sanctions regime applies in respect of breaches by regulated entities of the CRA 2013.

Financial reporting, including audited annual financial statements, is also required under Irish company law.

4.5 Activities of Rating Agencies

The CRA Regulation and related measures established a regulatory framework for credit rating agencies (CRAs) in the EU with the aim of reducing reliance on external credit ratings, in particular by EU financial institutions, within EU law. It requires, amongst other things, that CRAs:

- be registered with and supervised by ESMA;
- are independent and properly identify, manage and disclose conflicts of interest;
- maintain effective internal control structures; and
- apply sound rating methodologies.

EU financial institutions can only use for regulatory purposes credit ratings that have been issued (i) by a CRA registered with ESMA; (ii) in a third country and endorsed by a registered CRA; or (iii) by a third-country CRA certified by ESMA; and, in the case of (ii) and (iii), subject to compliance with certain conditions.

Securitisation issuers must seek ratings for each tranche from at least two CRAs and consider appointing a CRA with less than 10% of the total market share. Issuer directors typically consider this at a board meeting.

CRAs must make every effort to comply with ESMA's Guidelines on Internal Controls for Credit Rating Agencies. These guidelines outline non-binding principles to support compliance with CRA Regulation requirements regarding internal controls.

EMSA may impose fines of up to EUR750,000 upon CRAs in respect of negligent or intentional infringement of specified provisions of the CRA Regulation. Periodic penalties may be imposed in respect of continuing infringements or to secure compliance with obligations. The CRA also incorporates a civil liability framework through which investors and issuers may claim

damages in respect of certain infringements by CRAs.

The CRA Regulation may be further amended by the proposed Regulation on ESG rating activities. The Commission's impact assessment on the proposed measure recommends, amongst other things, incorporation of ESG factors into creditworthiness assessments and requiring CRAs to disclose how their methodologies address ESG factors.

4.6 Treatment of Securitisation in Financial Entities

The prudential treatment of a securitisation position is principally determined for credit institutions and investment firms under the CRR and for insurers and reinsurers under Directive 2009/138/EC (Solvency II). This response focuses on the CRR.

As Originator

An originator which is a credit institution or an investment firm can exclude securitised exposures from the calculation of its risk-weighted exposure amounts (RWEAs) and expected loss amounts (ELAs) under the CRR if the securitisation complies with specified structuring and documentation conditions and either:

- significant credit risk on the securitised exposures has been transferred to third parties; or
- the originator applies a 1,250% risk weight to all securitisation positions it holds in the securitisation, or deducts the securitisation positions from its common equity tier 1 capital.

Significant risk transfer (SRT) can be achieved where either:

- the RWEAs of the originator-held mezzanine positions are not greater than 50% of all mezzanine positions in the securitisation; or
- if there are no mezzanine positions, the originator holds no more than 20% of the exposure value of the first loss tranche and can demonstrate that such exposure value is greater by a substantial margin than a reasoned estimate of the expected loss on the underlying exposures.

The NCA may refuse preferential treatment if it considers that it not justified on the basis of the credit risk being effectively transferred; but may allow the treatment where the originator demonstrates that the reduction in own-funds requirements achieved by the securitisation is justified by a commensurate transfer of credit risk to third parties.

As Investor

Preferential treatment may be available for positions in STS securitisations that satisfy the requirements of CRR Article 243. Changes introduced to the CRR as part of the EU's COVID-19 Recovery Package include the extension of preferential treatment to positions in qualifying traditional NPE securitisations (other than where the external ratings-based approach is applied) and to qualifying senior positions in STS on-balance-sheet securitisations.

The European Supervisory Agencies' (ESAs) advice on the review of the securitisation framework (ESA Securitisation Advice) recommends, amongst other things, a reduction in the risk weight floor for senior tranches which are retained by an originator acting in the capacity set out in SR Article 2(3)(a) and which comply with prescribed eligibility criteria supporting lower risk. It remains under consideration by the Commission.

Positions held in STS securitisations meeting the requirements in Article 13 of the Delegated Regulation 2015/61 (as amended) qualify as Level 2B high quality liquid assets under the CRR, up to a maximum of 15% of the holder credit institution's liquidity buffer. The ESAs have not proposed changes in this regard.

See also **4.3 Credit Risk Retention**.

4.7 Use of Derivatives

The principal rules on derivatives are contained in:

- EMIR and related technical standards;
- EU (European Markets Infrastructure) Regulations 2014 (the Irish EMIR Regulations);
- SFTR; and
- EU (Securities Financing Transactions) Regulations 2017.

EMIR Regime

The EMIR regime imposes obligations on parties to derivative contracts, according to whether they are "financial counterparties" (FCs), such as investment firms and credit institutions or "non-financial counterparties" (NFCs) or their third-country equivalents.

Broadly, EMIR's requirements in respect of derivative contracts are:

- mandatory clearing by FCs and NFCs whose transactions in over-the-counter (OTC) derivative contracts exceed EMIR's prescribed clearing threshold (NFC+s), of OTC derivative contracts declared subject to the clearing obligation through an authorised central counterparty (a CCP);
- application of risk-management procedures in respect of uncleared OTC derivative contracts; and
- reporting and record-keeping requirements in respect of all derivative contracts.

An SPE in an STS traditional securitisation under the SR is prohibited from using derivatives other than for the purposes of hedging interest rate risk and/or currency risk and from including derivatives in the pool of underlying exposures.

NFC+s are generally subject to more stringent requirements under EMIR than NFCs. NFCs may exclude from their threshold calculations OTC contracts that are objectively measurable as reducing risks directly relating to the NFC's commercial activity or treasury financing activity – the "hedging exemption". EMIR Refit, amongst other things, introduced a new method for NFCs such as SPEs to determine whether clearing thresholds have been exceeded.

Enforcement

The Irish EMIR Regulations empower the CBI to:

- issue directions and contravention notices;
- appoint assessors to investigate suspected contraventions; and
- impose sanctions, including monetary penalties of up to EUR2.5 million.

Criminal liability may also attach.

The first CBI enforcement action under the Irish EMIR Regulations concluded in November 2023 and resulted in the imposition of a monetary penalty of €192,500 for failure to report over 200,000 derivative trades over a 2.5 year period.

EMIR 3.0

Proposals to amend EMIR (EMIR 3.0), which aim to, amongst other things, reduce reliance by EU parties on non-EU CCPs, include a new obligation for FCs and NFC+s to hold active accounts

at EU CCPs for the purpose of clearing a minimum proportion of:

- interest rate derivatives denominated in euro and zloty;
- short-term interest rate derivatives denominated in euro; and
- credit default swaps (CDS) denominated in euro.

The minimum proportion for each derivative will be specified in an RTS.

It is also proposed to amend the hedging exemption so that only OTC contracts which are not cleared through a CCP authorised or recognised under EMIR should be included in the threshold calculation.

The Parliament and Council of the European Union (the Council) are considering the text of the proposals at the time of writing (December 2023).

SFTR Regime

An SPE constituting an NFC under SFTR may be subject to additional trade reporting obligations in respect of its securities financing transactions (SFT). An SFT is a transaction which deploys assets for funding, liquidity, collateral management or execution of investment strategies and includes repurchase transactions, securities or commodities lending or borrowing, buy-sell back or sell-buy back transactions and margin lending, in each case, not falling within the scope of EMIR. If in scope for SFTR, a counterparty to an SFT must report the details of that transaction, as well as any modification or termination thereof, to a registered or recognised trade repository no later than the working day following the conclusion, modification or termination of the transaction. A counterparty to an SFT may delegate its reporting obligation.

SFTR also imposes conditions on the reuse of financial instruments received as collateral, viz:

- the recipient has advised the provider of the risks involved in:
  - (a) consenting to the use of collateral under a security collateral arrangement; or
  - (b) concluding a title transfer collateral arrangement; and
- the provider has:
  - (a) given prior express consent to a security collateral arrangement; or
  - (b) expressly agreed to provide collateral in a title transfer collateral arrangement.

Enforcement

Sanctions available to the CBI include:

- issuing orders and contravention notices; and
- imposing administrative sanctions of at least three times the amount of the profits gained or losses avoided because of the infringement.

4.8 Investor Protection

Investors are afforded protection under the following regulations:

- SR disclosure requirements allow investors to diligence and monitor securitisations;
- PR disclosure requirements aim to provide “necessary information which is material to an investor” making investments;
- the MAR aims to prevent insider dealing and market manipulation; and
- the Irish Transparency Regulations provide minimum disclosure standards for information concerning issuers of securities admitted to trading on regulated markets.

ESAP will further enhance investor protection.

See **4.1 Specific Disclosure Laws or Regulations**, **4.2 General Disclosure Laws or Regulations** and **4.4 Periodic Reporting**.

4.9 Banks Securitising Financial Assets

As Originator

A bank securitising its assets must consider rules governing the origination and servicing of those assets which vary depending on asset class and type of borrower. Banks typically warrant compliance with relevant measures up to the date of transfer with breach of warranty triggering a repurchase obligation. Of particular relevance for banks are credit-granting criteria under the SR and consumer and data protection laws; some key elements of which (each as amended, as appropriate) are noted below.

SR Article 9(1)

Originators, sponsors and original lenders must apply the same "sound and well-defined" credit-granting criteria both to exposures that will be securitised and to non-securitised exposures pursuant to Article 9(1) of the SR, subject to limited exceptions. An originator which acquires exposures for its own account and subsequently securitises must verify that the original lender complied with this requirement, or where the acquired exposures are NPEs, that sound standards were applied in their selection and pricing. This verification should be undertaken by the originator at the time of acquisition.

Consumer protection

The Irish consumer protection regime was substantively revised by the CRA 2022, which transposed, amongst other things, Directive (EU) 2019/770 (the Digital Content Directive) and Directive (EU) 2019/2161 (the Omnibus Directive). It also amended and extended the Consumer Protection Act 2007, which prohibits unfair, misleading, aggressive and prohibited commercial practices and applies to all Irish law consumer contracts.

Parts 4 and 6 of the CRA 2022 replaced the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 to 2000. The new measures apply to, amongst other things, contracts for the supply of services to consumers, including loans. The CRA 2022 also extended the UTCC's "grey list" of terms presumed to be unfair and introduced a new "black list" of terms which are always unfair. Contractual terms which are unfair are unenforceable against consumers.

The Consumer Protection Code 2012 specifies how regulated entities must deal with "personal consumers" and "consumers". Regulated entities must know their customers, assess their suitability for products or services and include prescribed information in their terms; and comply with requirements for post-origination ongoing information, complaints resolution and arrears handling.

Mortgage loans are principally governed by the CCA 1995 and the MC Regulations. The CCA 1995 imposes rules on advertising, provision of information and mandatory warnings. The MC Regulations include obligations to verify a borrower's creditworthiness before lending, to explain prescribed information and to act in the borrower's best interests when advising on mortgage loans.

The Code of Conduct on Mortgage Arrears 2013 concerns management of arrears and pre-arrears in respect of a borrower's principal dwelling or sole Irish residential property.

Data protection laws

Personal data of borrowers must be safeguarded as per the GDPR, the DPAs and SI 336/2011 (the Irish ePrivacy Regulations).

As Investor

An institutional investor (as defined in the SR) (other than an originator, sponsor or original lender) is subject, pursuant to SR Article 5, to extensive due diligence requirements prior to investing in a securitisation position and to ongoing monitoring obligations for the duration of its investment. This includes pre-investment verification:

- that the securitisation's underlying exposures were made in accordance with appropriate credit-granting criteria and processes;
- of compliance with the risk retention and (where applicable) transparency requirements of the SR; and
- in the case of NPEs, that sound standards were applied in their selection and pricing.

Ongoing monitoring duties include:

- establishment of appropriate and proportionate written procedures to monitor compliance with the verification and due diligence requirements of SR Article 5;
- stress-testing of cash flows and collateral values of underlying exposures or, where insufficient data is available, of loss assumptions;
- ensuring internal reporting to the investor's management body of material risks arising from the position so that such risks are adequately managed;
- demonstrating to competent authorities a comprehensive understanding of the securitisation position and underlying exposures; and
- implementing written policies and procedures for risk management of such position.

See **4.6 Treatment of Securitisation in Financial Entities**.

4.10 SPEs or Other Entities

See the "Claw-Back" and "Consolidation" sections of **6.1 Insolvency Laws** and the "Form and Structure" section of **6.2 SPEs** for considerations as to the form of SPE. See the second paragraph of **7.1 Transfer Taxes** and **7.2 Taxes on Profit** in relation to use of Section 110 companies.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Securitisations are structured such that SPE activities are not characterised as banking, writing insurance, carrying on business as a retail credit firm or MiFID II-governed activities.

Banking

Engaging in banking business and acceptance of deposits or other repayable funds from the public requires:

- an appropriate licence or authorisation from the CBI under the Central Bank Act 1971 (as amended) or the European Central Bank under Regulation (EU) 1024/2013, respectively; or
- a passported authorisation/licence.

Failure to hold the appropriate licence or authorisation is an offence punishable by a fine and/or up to five years' imprisonment.

Insurance

An insurance company operating in Ireland must hold an authorisation from the CBI or appropriate authority in its home member state if passporting into Ireland. Provided that certain conditions are met, a synthetic securitisation may be structured using a credit derivative under which credit protection is provided by an SPE to an

originator or third party (a beneficiary) in respect of losses on an asset portfolio.

Retail Credit Firms

A person who provides cash loans, a deferred payment or similar financial accommodation directly or indirectly to, or enters into a consumer-hire agreement or hire-purchase agreement with, natural persons (other than professional clients under MiFID II or another regulated financial services provider) must be authorised as a "retail credit firm" under the CBA 1997 (as amended, in particular by the Consumer Protection (Regulation of Retail Credit and Credit Servicing Firms) Act 2022).

Certain activities are excepted from this regulation, including the purchase loans originated by another party (unless credit is subsequently provided) and the provision of credit on a once-only/occasional basis. The provision of this credit must not involve a representation, or create an impression that the credit would be offered to other persons on the same or substantially similar terms.

Failure to obtain authorisation is an offence punishable by a fine. For regulated entities, the CBI's administrative sanctions regime may also be applied in respect of any breach of the retail credit provisions under the CBA 1997.

MiFID II

An entity which is 'investment firm' and which provides 'investment services' (each, as defined in MiFID II) must be authorised or recognised for such purposes pursuant to MiFID II. Investment services include portfolio management and execution of orders. An SPE will appoint a portfolio or collateral manager to provide these services in relation to its assets as required.

See **3.5 Principal Servicing Provisions** in relation to credit servicing.

4.12 Participation of Government-Sponsored Entities

Irish government-sponsored entities have not yet participated in the securitisation market. Subject to their internal rules, there is no restriction on doing so.

4.13 Entities Investing in Securitisation

The diverse investor base for securitisations includes credit institutions, pension funds, insurance undertakings and investment funds.

In addition to the rules on due diligence (see the "As Investor" section of **4.9 Banks Securitising Financial Assets**) and capital treatment (see the "As Investor" section of **4.6 Treatment of Securitisation in Financial Entities**), entities investing in securitisations are also subject to a ban on resecuritisation of their securitisation positions pursuant to SR Article 8.

Additional rules may be applicable to investors who are regulated.

4.14 Other Principal Laws and Regulations

Schedule 2 Firms

Unregulated entities which perform certain activities listed in Schedule 2 to the CJA 2010 (including commercial lending, factoring and financial leasing) must register as "Schedule 2 firms" with the CBI as competent authority for the AML regime in Ireland.

Registration is not required where:

- the entity is engaged only in trading for its own account or the account of customers

who are members of its group, in certain financial instruments; and
- its annual turnover is less than EUR70,000 and its Schedule 2 activities are below specified thresholds.

A Schedule 2 firm must:

- perform certain AML/know your customer activities as relevant in accordance with robust AML policies and procedures; and
- advise the CBI of any change to its Schedule 2 activities, ownership or corporate information, of any subsequent authorisation or licensing and of any other material matter.

Many Irish SPEs are Schedule 2 firms.

Homogeneity RTS

The simplicity component of the STS designation requires, amongst other things, homogeneity of underlying assets in accordance with the conditions and factors set out in the Homogeneity RTS ((EU) 2019/1851). In November 2023, the Commission adopted final draft amendments to the Homogeneity RTS to extend its scope to synthetic STS deals and align conditions for homogeneity of assets across all STS securitisations. Grandfathering will be available for securities issued and positions created and notified to ESMA before these amendments enter into force. The Homogeneity RTS will enter into force on the twentieth day following publication in the Official Journal of the EU. Publication has not occurred at the time of writing.

EBA Guidelines on STS Criteria

The EBA consulted on draft guidelines in respect of STS criteria for on-balance sheet securitisation in mid-2023. The text consulted on aligns closely to the guidelines for non-ABCP securitisations and provides similar or identical guidance in respect of STS criteria for on-balance sheet deals.

EU Green Bond Regulation (EUGB Regulation)

The EUGB Regulation entered into force on 20 December 2023 and the majority of its provisions apply from 21 December 2023. It prescribes uniform requirements for debt issuers that wish to apply the designation "EuGB" or "European green bond" to their bonds. The designations will only be available for "public" issuances, with derogations for debt issued or guaranteed by sovereigns and public bodies.

The measure adopts a "green proceeds" approach, with issuance proceeds to be invested prior to maturity in accordance with Article 3 of Regulation (EU) 2020/852 (the Taxonomy Regulation), subject to a degree of flexibility for sectors and activities not currently within the scope for the Taxonomy Regulation.

To reduce the risk of greenwashing, independent external reviewers will assess issuers' pre-issuance green bond factsheets and post-issuance annual reports on the allocation of proceeds. Issuers will also be required, at least once during the lifetime of the bond, to publish a bond impact report on the environmental impact of the use of the bond proceeds.

Modified requirements apply to securitisations, with the originator being responsible for complying with the majority of obligations specified for issuers, "proceeds" being the funds raised from sale of the underlying assets to the SPE and a sharing of obligations between originators in a multi-originator structure.

CSDR

The CSDR seeks to enhance the safety and efficiency of the settlement system in the EU by regulating central securities depositaries (CSDs) and introducing settlement rules for market operators, including electronic book-entry format for securities admitted to trading or traded on trading venues and settlement discipline.

Proposals to amend the CSDR aim to improve settlement discipline, allow CSDs to provide banking-type ancillary services, simplify passporting and set an end-date for grandfathering of authorisation/recognition of CSDs under their respective national rules.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are permitted in Ireland and are used primarily to transfer the credit risk of exposures held on-balance sheet by credit institutions to third parties. They are also used to arbitrage between a higher spread received on an underlying asset and a lower spread paid on related structured securities. Synthetic securitisation has not been common amongst credit institutions in Ireland in recent years, despite it being a leading jurisdiction for off-balance sheet credit-linked note (CLN) issuers and synthetic securitisations for European banks as evidenced by the increasing number of Irish law-governed securitisations and derivative deals relating to European loan books and esoteric assets in a post-Brexit environment.

Following the inclusion of SRT transactions in the STS regime in April 2021, Ireland has seen additional deal flow and a broader issuer base with numerous debt issuers coming to market throughout 2023. However, the industry is facing significant challenges in the implementation of the Basel III output floor. In short, a bank using internal models will be required to calculate risk weighted assets using the standardised approach and then multiply the amount obtained by 50% from 1 January 2025, increasing over a five-year period to 72.5%. This will lead to higher risk weights for the retained senior tranches. The trilogues for the amending legislation (CRR III and CRD VI) completed in June 2023 and are expected to be adopted by the Parliament and the Council by Q1 2024. See “As Investor” section of **4.6 Treatment of Securitisation in Financial Entities**.

Regulation

Synthetic securitisations are regulated in the same manner as traditional securitisations, as described in **4. Laws and Regulations Specifically Relating to Securitisation**.

See “As Investor” section of **4.6 Treatment of Securitisation in Financial Entities** and **4.11 Activities Avoided by SPEs or Other Securitisation Entities. 4.7 Use of Derivatives** also applies to credit derivatives in synthetic securitisations. EMIR provisions on margining may also apply where the issuer’s transactions in OTC derivative contracts exceed EMIR clearing thresholds.

Structures

A synthetic securitisation may be structured to transfer the credit risk of underlying exposures to third-party investors via:

- a direct contractual arrangement between an originator and investors in the form of a:
  - (a) CDS;
  - (b) financial guarantee;
  - (c) insurance policy (where an authorised insurer is investor); or

(d) a combination of these arrangements; or
- the issue by an SPE of CLNs.

In a direct structure, the originator buys credit protection on the underlying exposures directly from investors. Upon the occurrence of certain specified loss-producing credit events (eg, payment default) the investors pay an amount equal to the loss suffered (subject to any de minimis or excess) to the originator. In return, the originator pays a periodic fee to the investors.

In a typical SPE CLN structure, the originator transfers the credit risk on the underlying exposures to an SPE via a CDS or financial guarantee/credit protection deed. The SPE issues CLNs, transferring the credit risk on to third-party investors, and uses the proceeds to fund payments to the originator in respect of credit events under the CDS or guarantee/credit protection deed; and the periodic fee from the originator to pay the CLN coupon.

A synthetic structure may be funded, where the investor makes an upfront payment in the amount of the credit protection (eg, CLN issuance); or unfunded, where no upfront payment is made and the originator is exposed to the credit risk of the investor (eg, insurance policy).

See "Insurance" section of **4.11 Activities Avoided by SPEs or Other Securitisation Entities**.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Issuers and originators in Ireland are subject to the general insolvency law, which incorporates the Preventative Restructuring Directive ((EU) 2019/1023) (PRD). In addition, well-established structures insulate the underlying assets from the balance sheet (and insolvency) of the originator. See **6.3 Transfer of Financial Assets**.

While there has been an increase in synthetic securitisations in recent years, Irish securitisations of receivables are typically structured as "true sales". True sale transactions are subject to two principal risks in originator insolvency:

- recharacterisation of the sale as a secured loan; and
- claw-back.

Both true sale and synthetic securitisations may be impacted by rules on consolidation of assets, avoidance of certain contracts and examination of companies.

Recharacterisation as Secured Loan

True sale

A purported true sale may in certain circumstances be recharacterised by an Irish court as a secured loan. In determining the legal nature of a transaction, a court considers its substance as a whole, including economic features and the parties' intentions; and irrespective of any labels.

Recharacterisation was considered by the High Court in Bank of Ireland v ETeams International Limited [2017] IEHC 393 (subsequently upheld by the Court of Appeal in Bank of Ireland v ETeams (International Ltd) [2019] IECA 145), which endorsed the principles set out in the English cases of Re: George Inglefield [1933] Ch.1, Welsh Development Agency v Export Finance Co. Limited [1992] BCLC 270 and Orion Finance Limited v Crown Financial Management Limited [1996] BCLC 78.

Re: George Inglefield prescribed three indicia distinguishing a sale from a security transaction.

- A security provider is entitled, until the security has been enforced, to recover its secured asset by repaying the sum secured; whereas a seller is not entitled to recover sold assets by returning the purchase price.
- If a secured party realises secured assets for an amount less than the sum secured, the security provider is liable for the shortfall; whereas a purchaser bears any loss suffered upon a resale.
- If a secured party realises secured assets for an amount greater than the sum secured, it must account to the security provider; whereas a purchaser is not required to account to the seller for any profit made upon a resale.

None of the above is necessarily inconsistent with a sale; a transaction may be a sale notwithstanding that it bears all three features. The following are generally considered as being consistent with a sale:

- a seller acting as servicer for, or retaining some credit risk on, sold assets;
- a seller repurchase obligation on breach of asset warranties; and
- extraction of profits for the seller via the waterfall after transaction expenses have been met.

A sale transaction will be upheld unless it is:

- in substance, a security arrangement (eg, transaction documents do not indicate a sale); or
- a sham (eg, transaction documents do not reflect the parties' intentions).

Consequences of recharacterisation

As noted in **3.3 Principal Perfection Provisions**, a security interest created by an Irish company will generally be void unless registered within 21 days of creation. It is not typical in Ireland to make precautionary security filings. Consequently, a true sale which is recharacterised as a secured loan would constitute an unregistered security interest of the originator and render the issuer its unsecured creditor as regards the assets.

The issuer would rank pari passu with other unsecured creditors and behind the claims of secured and preferential creditors and insolvency-related costs and fees.

Claw-Back

Several provisions of Irish company law entitle a liquidator to seek to set aside pre-insolvency transfers.

Unfair preference

Any transaction in favour of a creditor of a company which is unable to pay its debts as they become due which occurs during the six months prior to the commencement of its winding-up, and with a view to giving that creditor a preference over other creditors, constitutes an unfair preference and is invalid. This is subject to an exception for certain acts carried out in connection with a scheme of arrangement (SOA) under Part 10 of the Companies Act, which will not be deemed to constitute unfair preference on the basis of detriment to the general body of creditors unless there are other reasons for so deeming. Case law indicates that the company must have a dominant intent to prefer one creditor over its other creditors.

An originator certifies its solvency at closing, preventing any question of unfair preference arising as regards the securitisation.

The six-month period is extended to two years for transactions in favour of "connected per-

sons" (defined in Section 2(1) of the Companies Act)).

Invalidity of floating charge

Subject to limited exceptions, a floating charge on the property of a company created during the 12 months before the commencement of its winding-up is invalid unless it is proved that the company, immediately after the creation of the charge, was solvent. A floating charge created in connection with an SOA will not be declared to be invalid on the basis of detriment to the general body of creditors unless there are other reasons for so doing. The 12-month period is extended to two years if the chargee is a connected person.

Disclaimer of Onerous Contracts

A liquidator may, with leave of the court, at any time within 12 months of the commencement of the liquidation, disclaim any property of a company being wound up which consists of unprofitable contracts or any property that is unsellable or not readily saleable.

Consolidation

Irish courts have a limited jurisdiction to consolidate assets where satisfied that it is just and equitable to do so.

An Irish court may order that two or more "related companies", which are being wound up, are treated as one company and wound up accordingly. In deciding whether to so order, it must consider:

- any intermingling of businesses;
- involvement of one company in the management of the other;
- conduct towards each other's creditors; and
- responsibility of one company for the circumstances giving rise to the winding-up of the other.

An Irish court may also order the related company to contribute to the whole or part of the provable debts in the winding-up. The court must consider, as regards the related company, amongst other things:

- its involvement in the management of, and conduct towards creditors of, the company being wound up; and
- the likely effect of a contribution order on its own creditors.

There is no reported judicial authority in Ireland addressing the circumstances in which a court would exercise these discretions. The use of an orphan SPE and compliance with separateness covenants reduces the likelihood of an issuer or originator being made subject to such orders.

Examinership

Examinership is a protection procedure under the Companies Act to facilitate the survival of Irish companies in financial difficulty.

The court can appoint an examiner on petition by the company, its directors, contingent creditors, prospective creditors or members holding at least 10% of the voting share capital where the court is satisfied that:

- there is a reasonable prospect of the survival of the company and all or part of its undertaking as a going concern; and
- in cases involving a cross-border element, the proposed examiner has sufficient experience to perform the role.

Non-petition provisions in transaction documents seek to prevent this as regards an issuer.

During the period of protection, the examiner formulates proposals to assist the survival of the company or the whole or part of its undertaking as a going concern. The court can approve the proposals when at least one class of creditor, which would receive a payment on liquidation, has accepted them and the court is satisfied, amongst other things, that the proposals are fair and equitable to members or creditors who do not support them and whose interests would be impaired by their implementation.

An examiner is appointed for 70 days, which can be extended to 100 days to enable the examiner to complete their work. The protection period could be longer if the court's approval of a compromise/SOA were to be appealed, but cannot exceed 12 months.

There is an automatic stay of action against a company under examinership. Further, a creditor-counterparty is prohibited from withholding performance of, terminating, accelerating or modifying:

- an executory contract solely because of the appointment of, or a petition to appoint, an examiner or interim examiner to such company; or
- an essential executory contract (for the purposes of the PRD) solely because the company is unable to pays its debts for the purposes of the Companies Act.

Credit Institutions

Where an insolvent originator is a bank, Irish and EU rules on resolution and recovery and the Central Bank Acts 1942 to 2018 are also relevant.

6.2 SPEs

Form and Structure

An Irish SPE is structured as a bankruptcy-remote orphan company and formed as a private limited company (an LTD), a designated activity company (a DAC) or a public limited company (a PLC). Its issued share capital is held on trust by a professional trustee for charitable purposes.

The form chosen will depend on the type of securities to be issued and whether or not they will be listed. An LTD can issue unlisted notes falling within the "excluded offer" exemption under the PR. A DAC can issue both listed and unlisted notes falling within the excluded offer exemption. Only a PLC may offer securities to the public, other than pursuant to an excluded offer and/or list securities other than debentures. Most securitisations involve the issuance of listed debt securities by a DAC.

The board of directors of the SPE should comprise at least two independent persons. A CSP will usually provide the SPE's independent directors, company secretary, registered office and various reporting services. Ideally, a minimum of four board meetings should be held per year in Ireland, with the majority of the directors being physically present. The SPE's contractual relations are structured on a non-petition, limited recourse and arm's length basis. Its constitution may also contain restrictions.

Non-consolidation

SPV separateness clauses, such as follow, are used to minimise the risk of consolidation on originator insolvency:

- maintain its books, records and assets separately from those of any other entity;
- act solely in its own corporate name and through its own officers/agents;

- manage its business and daily operations independently and correct any known misunderstanding regarding its separate identity;
- enter into all transactions on an arm's length basis;
- observe all corporate formalities;
- discharge all expenses and liabilities incurred by it out of its own funds, and allocate fairly and reasonably any shared overheads; and
- limit its activities to securitisation.

Non-issuer transaction parties will be bound by limited recourse and non-petition provisions in respect of the issuer.

6.3 Transfer of Financial Assets

Requirements of Valid Transfer – Perfection

An Irish securitisation of receivables is typically structured as a true sale via assignment from the originator directly, or through an intermediary vehicle, to the issuer. A true sale may also be achieved by declaration of trust, sub-participation or novation. These methods are generally employed only where an assignment is not feasible and are not discussed below.

A valid legal assignment of a debt must be:

- absolute;
- in writing and signed by the assignor;
- for the entire amount of the debt; and
- expressly notified in writing to the debtor.

Assignments not meeting the above requirements take effect in equity only. Both legal and equitable assignments can execute a true sale. Most Irish securitisations use equitable assignments (achieved by omitting notification to the obligors). The issuer (or trustee) may, upon the occurrence of certain trigger events (eg, originator insolvency) perfect the assignment by notifying the obligors.

Additional perfection requirements apply for certain asset classes.

Prior to perfection, an equitable assignee is exposed to the following risks:

- its rights are subject to any prior equities that have accrued to the underlying obligor, including rights of set-off;
- an underlying obligor can exercise rights of set-off which accrue after the date of the assignment;
- it must join the assignor to any action concerning the debt;
- repayment of the debt to the assignor constitutes a valid discharge; and
- it ranks behind any third-party bona fide purchaser for value without notice which takes a legal assignment.

True Sale

See "Recharacterisation as Secured Loan" section of **6.1 Insolvency Laws**. A legal opinion confirms the effectiveness of the sale; and subject to certain factual assumptions and qualifications, that such sale is not liable to be recharacterised as a secured loan.

6.4 Construction of Bankruptcy-Remote Transactions

If assignment is not possible, an originator may declare a trust over the assets in favour of the SPE. The SPE obtains an equitable interest in the assets and remains subject to the risks set out in the "Requirements of Valid Transfer – Perfection" section in **6.3 Transfer of Financial Assets**.

See also **5. Synthetic Securitisation**.

A trust is validly constituted where there is certainty as to the intention to create the trust, the subject matter and the beneficiaries. A legal

opinion will confirm that the trust satisfies these requirements subject to certain factual assumptions.

6.5 Bankruptcy-Remote SPE

The securitisation documents set out the order of priority in which the issuer's financial obligations – taxes, fees and expenses, note principal and interest etc – are to be paid. Securitisation notes are issued on a non-petition/limited recourse basis and securitisation counterparties will agree to be bound by equivalent provisions under the securitisation documents to which they are party.

See:

- **3.1 Bankruptcy-Remote Transfer of Financial Assets**;
- "Consolidation" section of **6.1 Insolvency Laws**; and
- **6.2 SPEs**.

7. Tax Laws and Issues

7.1 Transfer Taxes

Irish stamp duty is a tax on instruments and can apply on instruments of transfer (including agreements to transfer) which are executed in Ireland or which relate to Irish situated assets. The current rate of stamp duty on non-residential property is 7.5%, or 1% in the case of shares in an Irish incorporated company. However, a number of exemptions from the charge to stamp duty are available in respect of various financial assets. For example, an agreement for the sale, or a transfer on sale, of debts is exempt from stamp duty where the sale is in the ordinary course of business of the seller or the purchaser and does not relate to Irish real estate or shares in an Irish company. This is commonly relied on in the case of the acquisition of loans by Irish SPEs which are in the business of buying and/or selling loans/receivables. In addition, loan capital (meaning debenture stock, bonds or funded debt, or any capital raised by a company which has the character of borrowed money as defined) is exempt from stamp duty on transfer/sale. The exemption applies where the loan capital:

- is not convertible into Irish shares or marketable securities;
- does not carry similar rights to shares;
- has not been issued at a discount of more than 10% of its nominal value; and
- is not index linked in terms of repayment or interest.

Other common exemptions include the transfer of shares in a non-Irish incorporated company, swap agreements, forward agreements, financial futures agreements and options (each as defined). Specific exemptions also apply in the case of stock borrowing and stock repos. The transfer of a mortgage is also outside of the charge to Irish stamp duty. Irish SPEs are also typically structured so as to take advantage of the Irish securitisation tax regime set out in Section 110 of the TCA 1997 (Section 110). The issue or transfer of securities issued by a Section 110 company is exempt from Irish stamp duty where the money raised by those securities is used in the course of its business. In circumstances where a stamp duty exemption is not available, non-Irish situate assets may occasionally be transferred by way of instrument executed outside of Ireland. Alternatively, it may be possible to effect a novation, or to transfer economic exposure only by way of sub-participation and not give rise to a stamp duty charge.

Value Added Tax (VAT)

Irish VAT at the standard rate (23%) can apply on the supply of services (which can include the supply of intangible assets – eg, financial assets). However, financial services consisting of transferring or otherwise dealing in existing stocks, shares, debentures and other securities are exempt from VAT.

7.2 Taxes on Profit

Where the SPE qualifies as a Section 110 company, it would be subject to Irish corporation tax at the rate of 25% on taxable profits. Section 110 companies can take advantage of Ireland's favourable securitisation tax regime, which permits certain financial transactions to be carried out in a tax efficient manner where certain conditions are met. Section 110 provides for the taxable profits of a Section 110 company to be computed on the same basis as a trading company. This generally allows for the cost of funding and other revenue expenditure, incurred wholly and exclusively for the purposes of its business, to be tax deductible.

In addition, a Section 110 company can deduct profit participating interest (and interest which exceeds a reasonable commercial rate of return) in computing its taxable profits (subject to conditions). Accordingly, while a Section 110 company is subject to corporation tax at the higher 25% rate, the tax is levied on the company's net taxable profit which is generally maintained at a negligible level by matching deductible expenditure with income through the sweep-out mechanism of a profit participating loan or note.

A qualifying company, for the purposes of Section 110, is one which is resident in Ireland for tax purposes and which, among other things, carries on in Ireland a business of holding, managing, or both the holding and managing of qualifying assets (financial assets, commodities and plant and machinery) and apart from activities ancillary to that business, carries on no other activities. It is also a requirement of Section 110 that the first assets held or managed by the SPE have an aggregate value of not less than EUR10 million. This requirement is a "day-one test". An SPE will not be a qualifying company for Section 110 if any transaction is entered into by it otherwise than by way of a bargain made at arm's length (except in relation to the payment of profit participating interest).

Exceptions to Anti-avoidance Rules

Deductions for profit participating interest are disallowed under Section 110 except in the following circumstances:

- the interest is paid to an Irish tax resident person or a person who is otherwise within the charge to Irish corporation tax;
- the interest is paid to certain pension funds or other tax-exempt bodies that are resident in a "relevant territory" (ie, an EU member state or double tax treaty country); or
- under the laws of a relevant territory, the interest is subject to a tax and that tax corresponds to Irish corporation tax or income tax and applies generally to profits, income or gains received in that territory by persons from sources outside that territory.

The anti-avoidance rules generally do not apply to transactions where the debt is issued as a quoted Eurobond or wholesale debt instrument (see **7.3 Withholding Taxes**) and the investors are third-party persons otherwise unconnected with (through the sale of assets or holding of shares or voting power or significant influence) the Section 110 company.

An interest restriction applies in respect of the payment of profit participating and/or excessive interest by Section 110 companies investing in Irish real estate-related assets.

ATAD

Similar to all EU member states, Ireland implemented a number of corporation tax measures as a result of the EU Anti-Tax Avoidance Directive (ATAD).

Hybrid mismatch legislation came into effect in Ireland on 1 January 2020. However, a noteholder should not in general be treated as an associated enterprise of a Section 110 company merely as a result of holding notes, meaning that in many cases payments of interest by a Section 110 company should not come within the scope of hybrid mismatch provisions. Reverse hybrid mismatch provisions came into effect on 1 January 2022 but should not impact an SPE structured as a Section 110 company.

An interest limitation rule (ILR) came into effect in Ireland in respect of accounting periods commencing on or after 1 January 2022. Subject to certain exceptions, the fixed ratio rule links a taxpayer's allowable net interest deductions directly to its level of earnings, by limiting the net deduction to 30% of tax-adjusted EBITDA. A restriction only applies if the borrowing costs of a relevant entity exceed interest-equivalent taxable revenues by more than 30% of EBITDA or (if greater) the de minimis amount of EUR 3 million in respect of an accounting period of 12 months. In practice, an orphan SPE which qualifies as a "single company worldwide group" can apply the "equity ratio" provision and thereby disapply the ILR, irrespective of whether the SPE has exceeding borrowing costs in excess of the higher of 30% of its tax-adjusted EBITDA or EUR3 million.

Minimum Tax Directive

On 22 December 2021, the Commission published a proposal for a directive to implement the OECD's draft Global Anti-Base Erosion Model Rules (the "GloBE Rules") in the EU (the "Minimum Tax Directive"). The Minimum Tax Directive introduces a minimum effective tax rate of 15% for MNE groups and large-scale domestic groups which have annual consolidated revenues of at least EUR750 million, operating in the EU's internal market and beyond. The Minimum Tax Directive contains an income inclusion rule (IIR) and an undertaxed profit rule (UTPR), which allow for the collection of an additional amount of top-up tax if the effective tax rate on income of an in-scope group is under 15%. The Minimum Tax Directive also contemplates jurisdictions introducing their own domestic minimum top-up tax, in which case any top-up tax can be collected by that jurisdiction.

Similar to all EU member states, Ireland is transposing the Minimum Tax Directive into domestic legislation with the rules becoming effective for accounting periods commencing on or after 31 December 2023, with the exception of the UTPR, which will apply for tax years commencing on or after 31 December 2024.

If an SPE is regarded as part of an MNE group (or large-scale domestic group) which has consolidated revenues of more than EUR 750 million a year in at least two out of the previous four years, it may be within the scope of the Minimum Tax Directive. A "group" is defined for the purposes of the Minimum Tax Directive as a collection of entities which are related through ownership or control as defined by the acceptable financial accounting standard for the preparation of consolidated financial statements by the ultimate parent entity, including any entity that may have been excluded from the consolidated financial

statements of the ultimate parent entity solely based on its small size, on materiality grounds or on the grounds that it is held for sale. A number of entities are excluded altogether from the application of the Pillar Two legislation.

7.3 Withholding Taxes

Irish withholding tax applies at the rate of 20% to payments of yearly interest which have an Irish source and are made to Irish resident persons or non-Irish resident persons.

A number of exemptions from withholding tax are available to Section 110 companies such as the quoted Eurobond exemption for securities which are quoted on a recognised stock exchange (subject to conditions). There is also no obligation to withhold tax in respect of interest paid by a Section 110 company to a person who is tax resident in an EU member state (other than Ireland), or in a country with which Ireland has signed a double tax treaty. In addition, Section 110 companies can take advantage of the "wholesale debt" exemption, which, inter alia, applies to debt instruments which are issued in denominations of not less than EUR500,000 and which mature within two years (subject to conditions).

Where interest is profit dependent (or represents more than a reasonable commercial return), a Section 110 company is only entitled to claim a tax deduction for the interest if certain conditions are met (see discussion in the "Exceptions to Anti-avoidance Rules" section of **7.2 Taxes on Profit**). If these conditions are not met, the interest would be recharacterised as a non-deductible distribution and 25% dividend withholding tax may apply (subject to certain exceptions).

Outbound Payments

From 1 January 2024, new taxation measures will apply in respect of outbound payments. Outbound payments for these purposes include payments of interest, royalties and distributions. The measures only apply to transactions between entities that are associated. The measures apply to outbound payments to jurisdictions on the EU list of non-cooperative jurisdictions, as well as to payments to "no-tax", and "zero-tax" jurisdictions. Where applicable, withholding tax at the standard rate applicable to a payment of interest, dividends or royalties as appropriate will apply.

It is not expected that the measures should apply to payments by an Irish company such as an SPE to non-associated entities.

7.4 Other Taxes

The activities of a Section 110 company are often exempt activities for the purposes of Irish VAT. However, if the Section 110 company's investments are located outside of the EU, partial VAT recovery may be available. There are specific exemptions from Irish VAT in relation to investment management and corporate administration services provided to a Section 110 company. Since 1 March 2023, a Section 110 company that holds plant and machinery does not qualify for these exemptions. However, legal and audit services provided to a Section 110 company in Ireland will be subject to VAT. To the extent that a Section 110 company receives taxable services from outside of Ireland the company will be obliged to register for VAT and self-account for Irish VAT on those services on the reverse-charge basis at the standard rate (23%).

7.5 Obtaining Legal Opinions

Legal opinions are generally provided by counsel to the issuer in a securitisation. The opinion typically addresses, in an Irish tax context:

- whether the issuer meets the conditions to qualify for the Irish securitisation tax regime;
- whether interest on the relevant debt securities is deductible for Irish tax purposes and can be paid by the issuer free from withholding tax;
- whether stamp duty arises in connection with the entry into of the transaction documents; and
- certain VAT confirmations (eg, that the services of the investment manager and CSP to the issuer are exempt from Irish VAT).

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The accounting analysis is undertaken by accountancy professionals. Key considerations are balance sheet treatment of the securitised assets and consolidation for accounting purposes of the SPE into the originator's group. Securitised assets may be considered on-balance sheet for accounting purposes and off-balance sheet at law.

8.2 Dealing with Legal Issues

No legal advice is provided on accounting matters.

Trends and Developments

Contributed by:
Vincent McConnon, William Foot, John Adams, Emily Ashford,
Michelle Holligan and Nicole Burke
Matheson

Matheson was established in 1825 in Dublin, Ireland. With offices in Cork, London, New York, Palo Alto and San Francisco, 800 people now work across Matheson's six offices, including 121 partners and tax principals and over 540 legal, tax and digital services professionals. Matheson services the legal needs of internationally focused companies and financial institutions doing business in and from Ireland. Their clients include over half of the world's 50 largest banks, seven of the world's ten largest asset managers, seven of the top ten global technology brands and they have advised the majority of the Fortune 100 companies.

Authors

Vincent McConnon is a partner in the finance and capital markets department at Matheson. Vincent's experience covers a range of structured finance work, including, substantial experience in various types of asset-backed securitisations, covered bonds, corporate bond issuances, collateralised loan obligation transactions, green bonds, project and infrastructure finance, loan portfolio disposals, noteholder consent solicitations, MTN programmes, securitisation terminations and other structured finance products. Prior to joining Matheson, Vincent worked in the securitisation practice of a Magic Circle law firm in London for several years.

William Foot is a partner in the finance and capital markets department at Matheson. William advises financial institutions, asset managers, originators, private equity firms, investment banks, arrangers, issuers, trustees and investors on a range of debt capital markets, securitisation and structured finance transactions. William's industry experience includes senior in-house legal roles at a major CLO manager and other regulated entities, where he specialised in securitisation, private equity, credit risk mitigation and EMTN matters, as well as providing regulatory advice relating to MiFID, AIFMD, CRR, EMIR and the Securitisation Regulation.

John Adams is a professional support lawyer in Matheson's finance and capital markets department. John has a broad range of experience in various aspects of banking and finance law. He has particular expertise in debt capital markets, securitisations, structured finance, loan sales, derivatives, financial regulation and syndicated lending. As well as extensive experience as a private practice lawyer working on transactions and other matters, John's industry experience includes senior in-house legal roles at an Irish pillar bank.

Emily Ashford is a senior associate in the firm's Finance and Capital Markets Department, working within the Structured Finance Team. Emily has assisted on a range of finance and structured finance transactions, including a variety of asset-backed securitisations and collateralised loan obligation transactions. Her experience includes advising financial institutions in relation to a variety of asset-backed securitisation transactions including RMBS, auto loan ABS and consumer loan ABS; advising leading financial institutions on the establishment of Irish debt issuance programmes and issuances from such programmes; and advising in relation to the termination of securitisation transactions.

Michelle Holligan is a senior associate in the finance and capital markets department at Matheson. Michelle advises several leading international investment banks, asset managers, arrangers, private equity firms, issuers and financial services providers on all aspects of securitisation, debt capital markets and structured finance transactions. Michelle regularly advises on the establishment of Irish investment vehicles for the purposes of acquiring and/or originating a range of financial assets across Europe and the USA.

Nicole Burke is an associate working in the finance and capital markets department at Matheson. Nicole has experience advising on a broad range of structured finance transactions, including trade receivables securitisations, collateralised loan obligation transactions, asset backed commercial paper programmes, synthetic securitisation transactions, corporate bonds issuances and separately managed account structures. Nicole's industry experience includes an in-house legal role at a major CLO manager, where she worked on a variety of transactions such as CLOs, risk retention structures, separately managed accounts and provided regulatory advice on the Securitisation Regulation, MiFID II, AIFMD, CRR and EMIR.

Contributed by: Vincent McConnon, William Foot, John Adams, Emily Ashford, Michelle Holligan and Nicole Burke, **Matheson**

Matheson

70 Sir John Rogerson's Quay
Dublin 2
Ireland

Tel: +353 1 232 2000
Fax: +353 1 232 3333
Email: dublin@matheson.com
Web: www.matheson.com

Introduction

Securitisation markets across Europe faced challenges in 2023. Headwinds included high interest rates, inflation and other macroeconomic factors – not to mention a number of significant geopolitical events. Notwithstanding that, the securitisation markets have proved resilient and at the time of writing there are some early promising signs for 2024.

Meanwhile, regulatory evolution continued apace in 2023. This article will explore some of the main legal and regulatory developments that impacted the securitisation market in Ireland in 2023 and that are likely to impact the securitisation market in 2024. As a hub for securitisation activity in the EU, the legal framework in Ireland tracks both EU and domestic Irish legislation. The impact of new and proposed EU laws and regulations on Irish issuers of securitisation debt, and which will be of interest to market participants generally, are considered below. We also advised on the Irish tax implications for securitisation transactions and on the listing of securitisation transactions throughout 2023 – although such matters are outside the scope of this article.

Credit Servicing Directive

On 28 December 2021, the EU Directive on Credit Servicers and Credit Purchasers (EU/2021/2167) (the "Credit Servicing Directive") entered into force. EU member states were required to transpose the Credit Servicing Directive into national law by 29 December 2023. At the time of writing, the Irish Department of Finance (the "Department") has not yet completed the transposition of the Credit Servicing Directive under Irish law but has confirmed that it intends to meet this deadline.

The Credit Servicing Directive applies to the sales and servicing of non-performing loans issued by a credit institution established in the EU. EU credit institutions must comply with new pre-sale and post-sale disclosure and reporting obligations. Credit servicers must obtain an authorisation in their home EU member state and will then have the right to provide those services in other EU member states. In-scope credit purchasers do not need to be authorised although they must comply with certain obligations, including an obligation to appoint an authorised credit servicer, an EU credit institution or an EU-supervised consumer credit or mortgage creditor to service their non-performing loans with certain specified types of borrowers.

There is an obligation on EU member states to transpose the minimum requirements of the Credit Servicing Directive but a limited number of discretionary options have been identified for consideration by EU member states on certain issues in relation to the Credit Servicing Directive. In January 2023, the Department launched a public consultation on the transposition of the Credit Servicing Directive in Ireland. The consultation paper sought feedback on the ten points in the Credit Servicing Directive where EU member states have an element of discretion. In June 2023, the Department published its decisions following this consultation. The published outcome of the consultation sets out the initial decisions taken by the Department as to which discretions will be exercised in the context of the transposition of the Credit Servicing Directive into Irish law.

There is an existing Irish credit servicing regulatory framework (which was introduced by the Irish Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 and has subsequently been further amended) under Part V of the Irish Central Bank Act 1997. Amongst other matters and although the Department decisions are subject to change, the published decisions document appears to clarify a couple of key items in terms of the likely impact of the Credit Servicing Directive on the existing credit servicing regulatory framework in Ireland.

Firstly, the Department has indicated that the existing Irish credit servicing regulatory framework will operate alongside this new EU regime (once introduced) – effectively creating two parallel regimes. The decisions document provides as follows: "It has been decided to maintain the existing domestic regulatory regime for credit servicers and credit purchasers (including the obligation on the holder of the legal title to the rights of the creditor to be authorised) for matters and agreements not expressly covered by the scope of the Directive".

Secondly, there will be an automatic recognition of existing Irish credit servicing firm authorisations under the Credit Servicing Directive. The decisions document provides that "entities carrying out credit servicing activities under the provisions of Part V of the Central Bank Act 1997 will be recognized as authorized credit servicers" under the Credit Servicing Directive.

Credit Securities Depository Regulation

Article 3 of the Central Securities Depository Regulation (CSDR) aims to centralise the ownership record and improve traceability in respect of transferable securities, by requiring them to be recorded in book-entry form. Since 1 January 2023, Irish issuers of certain transferable securities that are traded, or admitted to trading, on EEA trading venues have been required to represent new issuances in book-entry form. Issuers have until 1 January 2025 to convert legacy in-scope securities still existing in certificated form into book-entry form.

In 2023, compliance with Article 3 of the CSDR was a central focus for Irish issuers of listed securities which are not traded through the clearing systems, and will continue to be so in 2024, as these issuers must not only ensure compliance for new issuances, but also turn their attention to the significant task of making legacy securities Article 3-compliant in advance of the January 2025 deadline.

In 2024, we will also see the entry into force of an amendment (brought in under Commission Delegated Regulation (EU) 2023/1626) to Article 19 of the regulatory technical standards on settlement discipline under the CSDR which

will impose an obligation on central securities depositories (CSDs) to carry out the calculation, collection and distribution of cash penalties for settlement fails on cleared transactions. While this obligation currently lies with central counterparties (CCPs), following a European Securities and Markets Authority (ESMA) consultation process, it was decided that CSDs should take over this process, as they already have obligations in relation to the penalties process for settlement fails for uncleared transactions. This amendment also aims to reduce operational risk, technical complexities and costs. The change will not take effect until 2 September 2024, in order to give CCPs and CSDs time to implement any necessary changes to their internal systems and procedures.

Lastly, a provisional agreement was reached between the Council of the EU and the European Parliament on 27 June 2023 on a proposed CSDR "Refit" regulation. It was formally approved by the European Parliament on 9 November 2023 and by the Council of the EU on 27 November 2023. Publication of the CSDR "Refit" regulation in the Official Journal is still awaited at time of writing. The updated regime is intended to reduce the financial and regulatory burden on CSDs and improve their ability to operate across borders. The key areas it will focus on are:

- a simpler CSD passporting regime;
- improving co-operation between supervisory authorities;
- banking-type ancillary services for CSDs;
- an amended settlement discipline regime; and
- the oversight of third country CSDs.

Securitisation Regulation

There were a number of developments regarding Regulation (EU) 2017/2402 (the "Securitisation Regulation") throughout 2023 and which are of relevance to Irish issuers. Some of the most important are outlined below.

Risk retention RTS

On 18 October 2023, Commission Delegated Regulation (EU) 2023/2175 (the "Risk Retention RTS") was published in the Official Journal. It entered into force on 7 November 2023 and replaced the existing 2014 regulatory technical standards under the Capital Requirements Regulation.

The key issues dealt with under the Risk Retention RTS include the following:

- Hedging – the Risk Retention RTS provide that:
  (a) a retention holder is entitled to hedge against risks other than the credit risk of the retained securitisation positions;
  (b) hedging is permitted where it was undertaken prior to the securitisation as a legitimate means of credit granting or risk management subject to investors not being disadvantaged; and
  (c) where a retention holder retains more than 5% of the economic interest, hedging against any retained interest exceeding 5% is permissible.
- NPE securitisations – the Risk Retention RTS clarify that the requirement to retain a minimum material net economic interest of 5% can be calculated against the net value of the non-performing exposures (NPEs) rather than the nominal amount.
- Sole purpose test – in order for an entity not to be deemed as having the sole purpose of securitising assets:

(a) it must have the business strategy and capacity to meet its payment obligations from income that is not derived from the securitised exposures; and
(b) its management must have the relevant experience to pursue the established business strategy.

- Own-issued instruments – providing a securitisation is comprised of solely own-issued debt instruments, risk retention requirements will not apply.
- Change of retention holder – the Risk Retention RTS clarify that the entity retaining the risk can be changed in certain situations (eg, if the retention holder becomes insolvent, is no longer in a position to act as the retention holder for reasons beyond the control of the retainer or its shareholders, or if retention is on a consolidated basis).

EBA consultation on STS synthetic securitisations

The consultation relating to guidelines on the simple, transparent and standardised (STS) criteria for on-balance-sheet securitisations closed on 7 July 2023 with the European Banking Authority (EBA) committing to publish their final draft guidelines by Q1 2024.

These draft guidelines are expected to comprise of three separate guidelines on the following topics:

- amended guidelines for asset backed commercial paper ("ABCP");
- amended guidelines for non-ABCP; and
- guidelines relating to synthetic securitisations which became eligible for STS status following an amendment to the Securitisation Regulation in April 2021.

EU Capital Markets Union

The European Commission published a series of proposed measures in December 2022 to further develop the EU's Capital Markets Union, including measures:

- to make EU clearing services more attractive and resilient (the "Derivatives Proposal");
- to harmonise certain corporate insolvency rules across the EU (the "Insolvency Proposal"); and
- to alleviate, through a new Listing Act, the administrative burden for companies (particularly SMEs) on stock exchanges (the "Listing Act Proposal").

The Derivatives Proposal extends beyond a focus on central clearing and makes a number of other amendments to the European Market Infrastructure Regulation (EMIR) as part of a broader review colloquially known as "EMIR 3.0". For example, the Derivatives Proposal amends the EMIR to provide non-financial counterparties that become subject for the first time to the obligation to exchange collateral for OTC derivative contracts not cleared by a central counterparty, with an implementation period of four months in order to negotiate and test the arrangements to exchange collateral.

The Insolvency Proposal lays down harmonised rules for insolvency proceedings, including on the annulment of transactions entered into by a debtor prior to insolvency (avoidance actions).

Finally, the Listing Act Proposal extends beyond enabling SMEs to access the capital markets and includes proposed amendments to the Prospectus Regulation, the Market Abuse Regulation and the Markets in Financial Instruments Directive.

At the time of writing, the Derivatives Proposal remains under review by the European Parliament and the Council of the EU. The Insolvency Proposal is currently at first reading before the Council of the EU. Lastly, the Council of the EU is urging to finalise the Listing Act Proposal before the end of the current legislative cycle in June 2024 and this proposal continues to progress through the legislative process.

Whilst the proposals are subject to change, it is important that corporates and financial market participants continue to monitor developments in 2024. The proposals are arguably of particular relevance to Ireland given its central role in EU securitisation transactions.

EU Green Bond Standard

As one of the EU's green finance initiatives, the European Commission proposed a voluntary EU green bond standard (EuGBS) under a proposed regulation on European green bonds in July 2021.

Regulation (EU) 2023/2631 of the European Parliament and of the Council (the "EU Green Bond Standard Regulation") was published in the Official Journal of the European Union on 30 November 2023 and will apply from 21 December 2024. This is a significant development, including for Irish issuers of green bonds.

While the EuGBS provided for in the EU Green Bond Standard Regulation is a voluntary standard, it has the potential to become the leading standard in the international green bond market.

The key terms of the EU Green Bond Standard Regulation include the following:

- The funds raised by EuGBS bonds must be allocated to projects aligned with the taxonomy outlined in the EU Taxonomy Regulation (the "EU Taxonomy"). For those sectors not yet covered by the EU Taxonomy and for certain very specific activities there will be a "flexibility pocket" of 15%.
- Transparency requirements on how EuGBS bond proceeds are allocated through detailed reporting requirements.
- All EuGBS bonds must be checked by an external reviewer to ensure compliance with the EU Green Bond Standard Regulation and that funded projects are aligned with the EU Taxonomy.
- External reviewers providing services to issuers of EuGBS bonds will need to be registered with and supervised by the European Securities and Markets Authority.

As well as corporate bond issuers, the EU Green Bond Standard Regulation is also relevant to issuers, sponsors and originators of securitisations.

The EU Green Bond Standard Regulation includes a provision that certain of the EuGBS requirements apply to the originator, rather than the issuer. This ensures that rather than being limited to including green collateral at the issuer level, a securitisation may benefit from looking at the originator's role in sourcing green assets and still meet the EuGBS standard. However, the EU Green Bond Standard Regulation also provides that bonds issued for the purpose of synthetic securitisation are not currently eligible to meet the EuGBS standard.

The EU Green Bond Standard Regulation also contains some exclusions for securitised exposures and additional specific disclosure requirements for securitisations.

ESMA Statement about Sustainability Disclosure

On 11 July 2023, ESMA published its statement on sustainability disclosures in prospectuses seeking to align the approach of national competent authorities towards ESG-related disclosures included in certain prospectuses under the Prospectus Regulation. The statement sets out that the "use of proceeds" section of such prospectuses should contain disclosure about the use and management of the proceeds and information enabling investors to assess the sustainability credentials of issuers.

Citing Article 6(1) and Recital 54 of the Prospectus Regulation, ESMA reiterated that in determining whether information should be included or omitted from a prospectus, consideration must be given to its specificity and materiality to a potential investor. In making disclosures, ESMA recommended that any statements concerning the ESG profile of an issuer or its securities be substantiated and that any terms of art, such as mathematical terminology, be adequately defined and comprehensible to investors.

In the event that material ESG-related information is not disclosed in accordance with the Prospectus Regulation, an Irish issuer could find itself subject to both criminal charges and administrative fines under Ireland's European Union (Prospectus) Regulations 2019. Sanctions that may be imposed by the Central Bank of Ireland include a maximum fine of EUR20 million or 3% of the issuer's total annual turnover (or in the case of entities which prepare consolidated financial accounts, the annual turnover contained in such consolidated accounts). Where disclosures are known to be false or misleading, an issuer and its directors may be made subject to criminal prosecution, and if convicted, a fine of EUR5,000 or 12 months' imprisonment, or both.

Issuers and arrangers of securities with sustainability features should therefore review prospectus documentation to ensure ESMA's sustainability disclosure expectations are met.

European Commission Proposal on ESG Ratings

On 13 June 2023, the European Commission proposed a regulation on the transparency and integrity of ESG ratings activities (the "Proposed ESG Ratings Regulation"), with the aim of increasing transparency and confidence in sustainability-related information. On 14 July 2023, an amended version of the Proposed ESG Ratings Regulation was published. At the time of writing, the Council of the EU and the European Parliament are considering the Proposed ESG Ratings Regulation and finalising their negotiating positions ahead of trilogue negotiations.

If adopted in its current form, the potential application of the Proposed ESG Ratings Regulation would be relatively broad requiring any "legal person whose occupation includes the offering and distribution of ESG rating or scores on a professional basis" to be authorised by ESMA and to publish on its website prescribed information pertaining to the methodologies, models and key rating assumptions used. ESG ratings are defined widely as "an opinion, a score or a combination of both, regarding an entity, a financial instrument, a financial product, or an undertaking's ESG profile or characteristics or exposure to ESG risks… irrespective of whether such ESG rating is explicitly labelled as a "rating" or an "ESG score". Certain ESG ratings are explicitly out of scope, such as private ratings which are not publicly disclosed and ratings pro-

posed by the EU or its member states' public authorities.

ESMA would have significant powers to supervise ESG ratings providers' compliance with the Proposed ESG Ratings Regulation and may carry out on-site inspections of such providers, as well as rated entities or outsourced third parties, without prior announcement. ESMA could also delegate supervisory tasks to the Central Bank of Ireland as competent authority in Ireland.

Where an infringement occurs, ESMA could withdraw the relevant provider's authorisation, temporarily suspend or prohibit ESG rating activities, issue public notices or impose fines (up to 10% of the relevant provider's total annual net turnover or, where the provider benefited from the infringement, the amount of such benefit). It is therefore incumbent on in scope providers to assess the potential impact of the Proposed ESG Ratings Regulation on their ratings methodologies and ensure any potential conflicts of interest are appropriately addressed.

JAPAN

Law and Practice

Contributed by:
Hiroaki Takahashi, Kaoru Sato, Kenji Miyagawa and Koji Kawamura
Anderson Mori & Tomotsune

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Contributed by: Hiroaki Takahashi, Kaoru Sato, Kenji Miyagawa and Koji Kawamura,
Anderson Mori & Tomotsune

Anderson Mori & Tomotsune has a securitisation team of more than 20 partners and 40 other qualified lawyers, who provide comprehensive strategic advice on maximising returns in a variety of tax-effective and innovative structures. The firm is a leader in the Tokyo market in establishing and structuring securitisation and other structured finance transactions, representing the entire range of global market participants in securitisations across a wide variety of asset classes, including commercial real estate, loan receivables, equipment lease receivables, trade receivables, promissory notes and whole-business securitisation. The securitisation and structured finance attorneys have extensive experience in the most complex Japanese and cross-border securitisations, real estate financings, and other structured finance transactions. The team works with several investment banks and international investors in devising securitisation structures for single-property, multi-property and conduit-type transactions, offering the full range of expertise at every level, and advises on cutting-edge transactions that involve relatively new and evolving structured products in Japan, including covered bonds and security trusts, and self-trusts.

Authors

Hiroaki Takahashi is a partner at Anderson Mori & Tomotsune who advises on structured finance, including securitisation, real estate investment (J-REIT) and project finance. His experience in securitisation includes active involvement in various domestic and international securitisations of asset-backed commercial paper, lease and credit card receivables, bank loans (collateralised loan obligations), housing loans (mortgages), consumer loans, auto loans, apartment loans, real estate, entertainment businesses and cemetery leaseholds. He has been advising on securitisation matters for more than 20 years, ever since the emergence of the securitisation market in Japan in the mid-1990s.

Kaoru Sato is a partner at Anderson Mori & Tomotsune and advises on a wide spectrum of structured finance matters, such as securitisation of receivables and real property, and project finance and PFI/PPP. He also has extensive experience in finance transactions, including debt financing by REITs, non-recourse loans and corporate loans of various kinds. His experience prior to joining Anderson Mori & Tomotsune includes working at a Japanese securities company and at a government-affiliated financial institution.

Contributed by: Hiroaki Takahashi, Kaoru Sato, Kenji Miyagawa and Koji Kawamura,
Anderson Mori & Tomotsune

Kenji Miyagawa is a special counsel at Anderson Mori & Tomotsune, who specialises in the areas of securitisation, structured finance, real estate and renewable energy. He has acted on numerous cross-border securitisation and structured finance transactions over his 20 years of practice. Kenji has also contributed to many publications and seminars on the subjects of securitisation and real estate.

Koji Kawamura is a partner at Anderson Mori & Tomotsune, and specialises in the areas of securitisation, structured finance, and other types of finance transactions. He has substantial experience in the securitisation of consumer loans, lease receivables, residential mortgage-backed securities and commercial mortgage-backed securities. Koji's practice extends across inbound and outbound cross-border transactions.

Anderson Mori & Tomotsune

Otemachi Park Building
1-1-1 Otemachi
Chiyoda-ku
Tokyo 100-8136
Japan

Tel: +81 3 6775 1032
Fax: +81 3 6775 2032
Email: hiroaki.takahashi@amt-law.com
Web: www.amt-law.com

ANDERSON MŌRI & TOMOTSUNE

Contributed by: Hiroaki Takahashi, Kaoru Sato, Kenji Miyagawa and Koji Kawamura,
Anderson Mori & Tomotsune

1. Specific Financial Asset Types

1.1 Common Financial Assets

According to the report by the Japan Securities Dealers Association and the Japanese Bankers Association (Securitisation Market Trends Survey Report – Issuance Trends in Fiscal 2022), the total issuance amount of securitisation products in fiscal year 2022 was JPY4,819.9 billion, decreasing 13.0% from fiscal year 2021, while the number of issues was 190, 1.0% down year-on-year.

The report also shows that there was an increase in the securitisation product issuance amount for fiscal year 2022 by underlying assets, the amount of consumer loan, whereas RMBS, CDO, leases, shopping credits, sales receivables/commercial bills and "others" decreased. In addition, looking at the securitisation product issuance amount by product type, the amount of "trust beneficiary rights" was JPY2,679.7 billion (55.6% of the total), followed by bonds with JPY1,639.5 billion (34.0%).

1.2 Structures Relating to Financial Assets

From the viewpoint of the transaction structure, the following three types are to be considered in most transactions.

Godo Kaisha (GK) Structure

A GK used as an SPE for securitisation could finance its purchase of assets by way of debts (loans and bonds) and/or equities (shares). However, a GK is not eligible for the special tax treatment applicable to *tokutei-mokuteki-kaisha* (TMKs), and a GK's profits are subject to corporate tax in the same way as standard corporations conducting actual business. Therefore, *tokumei-kumiai* (TK) investments are more frequently used than shares, due to the impact on the GK's taxable income. The distribution of profits to TK investors may be regarded as "expenses" to be deducted from profits for corporate tax purposes. The structure in which TK investments are used to reduce a GK's taxable income is generally referred to as the "GK-TK structure", where the originator sells the assets to a GK for the purchase price, which is funded by way of bonds and/or loans and TK investments.

Theoretically, the GK-TK structure is available for any type of asset securitisation. However, in practice, the GK-TK structure is predominantly used for real estate securitisation or non-recourse financing for real estate, while monetary claims are securitised by the trust structure discussed under Trust Structure.

For the GK-TK structure for real estate securitisation, it is important to note that the Real Estate Specified Joint Enterprise Act (the "Joint Enterprise Act") will apply if the GK owns real estate itself. This will require the GK to obtain pre-approval (*kyoka*) from the government (the Ministry of Land, Infrastructure, Transport and Tourism, the Financial Services Agency, or the local municipality).

The Act was amended in 2013 to facilitate a GK being used as an SPC to implement the GK-TK structure. The rules for conducting business by a GK were relaxed and GKs could utilise the GK-TK structure through a filing, rather than seeking permission. However, new GK-TK structures have rarely taken advantage of this amendment because the new filing scheme requires the delegation of the business of real estate transactions to approved real estate operators (*3-go-jigyosha*) and of the solicitation for the purchase of TK investments to approved brokers and dealers (*4-go-jigyosha*) for TK investments. The

Act was further amended in 2017 to facilitate the GK-TK structure by requiring merely filing rather than permission and without the aforementioned delegation requirements, to the extent that the investors are limited to certain "qualified specifically exempted investors" (*tekikaku-tokurei-toshika*).

The most common GK-TK structure involves a GK owning the beneficial interests in real estate rather than the real estate directly, to avoid the application of the Joint Enterprise Act. However, since beneficial interests constitute "securities" under the Financial Instruments and Exchange Act (FIEA), a GK owning beneficial interests funded by TK investments is subject to the self-investment regulation under the FIEA (for further details, see **4.10 SPEs or Other Entities**).

Furthermore, since TK investments also constitute securities under the FIEA, solicitation for the purchase of TK investments is subject to the business regulations under the FIEA. Where the GK's principal assets comprise beneficial interests that also constitute "securities", the disclosure regulations under the FIEA will apply (for further details, see **4.1 Specific Disclosure Laws or Regulations**).

TMK Structure

The TMK is a type of entity introduced by the Act Concerning Asset Securitisation of 1998 specifically to facilitate asset securitisation. A TMK is required to file the commencement of business with government authorities, and is not authorised to conduct any acts outside those set out in the asset liquidation plan.

A TMK is subject to the supervision of the FSA by way of various supervising measures, and particular requirements apply to TMKs (see **6.2 SPEs** for details).

Trust Structure

Trusts are generally considered the most appropriate vehicle for securitisation because they are recognised as having legally assured bankruptcy remoteness under the Trust Act and are generally subject to "pass-through" taxation, whereby taxation at the trust level (double taxation) can be avoided. Furthermore, the trust structure and the terms of TBIs can be created flexibly under the trust agreement.

In the standard trust structure, the originator entrustor (*itakusha*) entrusts its assets with a trustee in exchange for TBIs in the entrusted assets and then obtains funding by selling TBIs to third persons.

However, if investors prefer loans rather than purchasing TBIs, the originator entrustor can obtain cash by seeking redemption of its TBIs through the trustee borrowing loans from investors. Depending on investors' demand, the trustee can seek funds by issuing trust bonds to investors instead of receiving loans.

Furthermore, if some investors prefer loans and others prefer TBIs, some TBIs can be redeemed by loan investors providing loans to the trustee, while other TBIs can be sold to investors.

1.3 Applicable Laws and Regulations

The relevant legislation includes the Companies Act, Commercial Code, Act on Special Measures Concerning Taxation, Act Concerning Liquidation of Assets, Trust Act, Trust Business Act, FIEA, and Act on General Incorporated Associations and General Incorporated Foundations.

1.4 Special-Purpose Entity (SPE) Jurisdiction

When the legal framework for securitisation was first developed in the late 1990s, exempted

companies in the Cayman Islands were predominantly used for standard securitisation transactions. However, with the enactment of new laws (such as the Act Concerning Liquidation of Assets and the Act on General Incorporated Associations and General Incorporated Foundations) and the inclusion of GKs as a new type of corporation under the Companies Act, it has become standard practice to set up SPEs in the form of TMKs or GKs in Japan.

1.5 Material Forms of Credit Enhancement

Subordination and cash reserves are often used as credit enhancement. In cases where an originator retains subordinated portions of securitisation products, or guarantees payments to owners thereof, a true sale issue will arise.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer's responsibilities are to originate and transfer their assets to SPEs. In most cases involving the securitisation of monetary claims, transferors and originators will continue to collect receivables and provide servicing of the securitised assets on behalf of the transferee SPEs. In real estate securitisation, they will also sometimes act as master lessees in respect of the assets that they have sold and leased back.

That being said, the roles and responsibilities of transferors and originators vary, depending on the type of asset securitised.

2.2 Sponsors

The term "sponsors" generally refers to "arrangers" who arrange securitisation transactions, or to the parents, affiliates or banks (including commercial banks, investment banks, trust banks and securities companies) that provide originators with financial support for the securitisation transaction.

2.3 Originators/Sellers

Originators are securitising their assets by transferring them to SPEs. With respect to securitisation of monetary claims, originators usually remain as servicers to collect funds on the securitised monetary claims. This is achieved through delegation by SPEs of collection functions to originators.

2.4 Underwriters and Placement Agents

Underwriters and placement agents are essentially the parties who market and sell securitised products to investors. For regulatory purposes, underwriters (*hikiuke-nin*) are defined as persons who acquire securities (*yuka-shoken*) for the purpose of reselling them, or commit to acquiring securities that are unsold. Placement agents, however, are defined as persons who engage in brokerage activities or in the sale and purchase of securities in connection with the private placements or public offerings of securities pursuant to the FIEA.

Underwriters are subject to greater regulatory oversight, regardless of the kind of securitised product they deal with, because they shoulder the risk of having to acquire unsold securities. On the other hand, there are two categories of placement agents:

- type I financial instruments business operators (*dai-isshu-kinyu-shohin-torihiki-gyosya*) that deal in type I financial instruments such as bonds (*shasai-ken*) issued by GKs or *kabushiki kaisha* (KKs) and preferred shares (*yusen-shosshi-shoken*) issued by TMKs; and

- type II financial instruments business operators (*dai-nishu-kinyu-shohin-torihiki-gyosya*) that deal in type II financial instruments, such as trust beneficiary interests, standard or preferred equities in GKs and TK equities in a TK under a GK-TK investment structure.

Underwriters are typically securities companies, whereas placement agents can be securities companies, banks, trust banks and asset sale or management companies registered as type II financial instruments business operators.

2.5 Servicers

In transactions involving the securitisation of monetary claims, the originator would usually act as the servicer after the assets have been transferred to the relevant SPE because the originator is expected to service the assets more efficiently based on its existing business relationship with the obligors. Additionally, since the transfer of monetary claims is frequently made without any notice to obligors, the originator would need to continue servicing the assets as if they were the asset-owner.

However, if there is any default in respect of the monetary claims, or if the monetary claims are not collectible through ordinary means (for instance, in situations of dispute or litigation with an obligor), the servicer's involvement in the servicing of the monetary claim will give rise to legal concerns as to whether such involvement is deemed an activity that falls within the "legal business" that can be undertaken only by qualified attorneys under the Attorney Act. In such events, a third-party claim-collection company licensed to conduct claim-collection business as a "special servicer" under the Act on Special Measures Concerning Claim Management and Collection Businesses would usually be engaged, or the transferee SPEs would be engaged in the servicing of such monetary claim by themselves.

Furthermore, if an originator servicer becomes insolvent or unable to continue to provide collection services, the servicing role will be transferred to another third-party servicer as a "back-up servicer". As part of the typical process of structuring a securitisation transaction, the questions of whether to appoint a back-up servicer from the outset and, if so, which party to be appointed as such will be discussed between the relevant sponsor arranger and a credit rating agency.

2.6 Investors

The role of an investor is to provide funds to the originator through SPEs. Investors are split into two categories for purposes of disclosure under the FIEA:

- qualified institutional investors; and
- non-qualified institutional investors.

Additionally, investors are split into two categories for purposes of the regulation of product sales activities of brokers/dealers or placement agents:

- "specified investors" (*tokutei-toshika*), which includes QIIs and quasi-institutional investors (as defined in the FIEA); and
- non-specified investors.

2.7 Bond/Note Trustees

There is no legal concept under Japanese law of bond or note trustees who act as trustees for bond or noteholders. With that said, the Companies Act requires bond issuers to appoint bond administrators, which will be entrusted with the performance of certain functions, such as receipt of payments and preservation of rights of claim, on behalf of bondholders unless (i) the

amount of each bond is 100 million yen or more or (ii) the number obtained by dividing the total amount of bonds of a certain class by the minimum amounts of the number of each bond of that class is less than 50 (Article 702).

However, given the cumbersome mandatory provisions under the Companies Act, most sophisticated securitisation transactions for institutional investors do not, in practice, involve the appointment of "bond administrators", in reliance on either of the exemptions described above. Instead, financial advisers or fiscal agents (FA) are appointed and their rights and obligations may be provided for in the bond documents.

2.8 Security Trustees/Agents

Security trusts became available in Japan pursuant to amendments to the Trust Law, which were proposed in 2006 and came into effect in 2007. Trust banks usually act as security trustees that owe fiduciary duties to multiple lenders, typically in the context of syndicated loans for project finance, such as renewable energy projects. However, secured "bonds" are rarely used because of the provisions of the Secured Bond Trust Act, which require trust agreements to be executed with trust banks, etc, having a special licence. Accordingly, the use of security trusts for securitisation purposes is extremely rare.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

To ensure the bankruptcy remoteness of a transfer (ie, a true sale), the asset transfer agreements or trust agreements should contain provisions covering the following:

- the parties' intent to effect a true sale; and
- representations and warranties on the parties' solvency, including the fact that no event has occurred that would result in the parties' bankruptcy or expose them to insolvency proceedings.

However, provisions covering the following should be avoided:

- grant of full recourse to the transferor or a covenant by the transferor to compensate for credit risks in transferred assets;
- grant of control over the transferred assets to the transferor; and
- commitment by the transferor to repurchase the transferred assets and the like.

3.2 Principal Warranties

In addition to the standard representations and warranties by the transferor (covering matters such as due incorporation, full authority to transfer, compliance with applicable laws and constitutional documents, legality, validity and enforceability of obligations under the transaction documents, absence of litigation and absence of violation of any court or governmental order), warranties relating to true sale, the absence of the possibility to exercise any right of avoidance, the parties' intention to effect a true sale, the absence of or reasons for the commencement of bankruptcy, civil rehabilitation, corporate reorganisation or other similar insolvency proceedings, the absence of fraudulent intent and the like are also used in securitisation documentation.

Compensation for damages incurred is the principal remedy for breaches of representations and warranties.

3.3 Principal Perfection Provisions

The appropriate method of perfection depends on the type of asset in question. Securitisation of real estate, movable assets and monetary claims is perfected by way of registration (*toki*), registration or transfer of possession, and registration of claim assignment or provision of notice to, or procurement of consent from, the obligor, respectively. The relevant transaction documents would typically stipulate the method of perfection required.

3.4 Principal Covenants

Securitisation documentation typically contains standard covenants to comply with the applicable laws and the terms of the applicable transaction documents, and to ensure that no adverse changes occur in respect of the securitised assets.

In transactions involving the securitisation of monetary claims, where the collection and servicing of the monetary claims will usually be delegated to the transferor servicer, a transferor will typically also covenant not to make material changes in its collection policy and to comply with its fiduciary duties (including segregating the management of its proprietary accounts from the management of accounts containing the securitised assets).

Damages are the principal remedy available for breach of covenants because specific performance and injunctive relief are, in principle, unavailable for such a breach.

3.5 Principal Servicing Provisions

In transactions involving the securitisation of monetary claims, collection and other services in respect of the monetary claims will usually be delegated to the originator under a servicing agreement between the originator and the transferee SPE. Such servicing agreements usually contain provisions requiring the servicer to service the monetary claims in the same way as before, based on fiduciary duties that the servicer owes to the transferee SPE and, ultimately, investors in the transferee SPE.

Delegation to a third person, including the originator, to collect receivables, raises issues under the Attorney Act, which prohibits any person other than a qualified attorney from engaging in the business of providing legal advice or representation, handling arbitration matters, aiding in conciliation, or providing other legal services in connection with any lawsuit, non-contentious case (or a case similar thereto), or other general legal services, for the purpose of obtaining compensation. Violation of this prohibition is punishable by criminal sanction. An exception to this prohibition is where the service provider is licensed under the Act on Special Measures Concerning Claim Management and Collection Businesses (the Servicing Act) to perform the relevant services.

3.6 Principal Defaults

Principal defaults typically used in securitisation documentation include:

- the repurchase of all the securitised assets upon the occurrence of certain tax events;
- the exercise of a clean-up call option if the exposure underlying the securitised assets has decreased to 10-15% of the initial exposure; and
- early amortisation in the event of the servicer's default or deterioration in the performance of the securitised assets.

Damages are the principal remedy available for such a default, because specific performance

and injunctive relief are, in principle, unavailable for such a default.

3.7 Principal Indemnities

Damages constitute the principal indemnity in securitisation transactions, because specific performance and injunctive relief are, in principle, unavailable in such transactions.

3.8 Bonds/Notes/Securities

The standard set of documents involved in an issuance of bonds include (i) a bond purchase agreement containing the terms and conditions of the bonds and (ii) a fiscal agency agreement.

3.9 Derivatives

Interest swap derivatives are typically used to hedge risks associated with interest rate fluctuations in situations where the instruments invested in adopt fixed rates while the underlying assets are based on floating rates. On the other hand, currency swap derivatives are typically to hedge foreign exchange risks where there is mismatch in the currency between underlying assets and the instruments invested in.

3.10 Offering Memoranda

Certain forms of offering memoranda are required be delivered to investors under the FIEA for public offerings of bonds. Private offerings – ie, solicitation for purchase of bonds vis-à-vis 49 or less investors or qualified institutional investors, are exempted from the requirement to deliver offering memoranda under the FIEA. Nevertheless, it is a customary practice for certain disclosure documents similar to the statutory offering memoranda to be delivered to investors in private placements, too. Furthermore, the Japan Securities Dealers Association has promulgated certain voluntary “Rules Concerning Marketing Securitization Products”. Under these rules, delivery of documents of certain formats setting out specific disclosure items (depending on the type of assets be delivered to investors) is recommended even in private placements.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

The Financial Instruments Exchange Act of Japan (FIEA) provides disclosure requirements and procedures. Article 5.1 of the FIEA provides disclosure rules applicable to “regulated securities”, including securitisation products.

Examples of regulated securities in respect of securitisation products include the following.

- TMK bonds and preferred shares issued by TMKs under a TMK structure are considered “type I financial instruments”, and solicitation, sale and purchase and brokerage activities in respect of TMK bonds and preferred shares accordingly have to be handled by type I financial instrument exchange business operators licensed under the FIEA.
- TBIs issued under a trust structure and TK interest issued under a GK-TK structure are considered “type II financial instruments”, and solicitation, sale and purchase and brokerage activities in respect of TBIs and TK interest accordingly have to be handled by type II financial instrument exchange business operators licensed under the FIEA.

For a public offering, forms are provided in the Appendices to the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc, which is an ordinance related to the FIEA.

The basic form for disclosure for public offerings is the filing of a security registration statement (*yuka shoken todokede sho*) by the issuer pursuant to Article 5.1 of the FIEA. The security registration statement will describe matters pertaining to the public offering, the trade name of the issuer, the financial condition of the issuer and the corporate group to which the issuer belongs.

There is no filing requirement for private placements, but a financial instruments business operator who solicits the purchase of a financial instrument has to notify a prospective purchaser of certain matters provided in the FIEA and deliver a document to the prospective purchaser explaining the details of the financial instrument being offered, among other requirements.

For sales of financial products by way of a private placement (eg, those sold to sophisticated investors that satisfy the requirements for a private placement), filing by the issuer and, in some cases, explanation by a financial instruments business operator are not required, but the notification requirement applies.

The principal penalty for violation of the filing requirement or obligation to deliver a document explaining details of the financial instrument is criminal imprisonment and/or a fine. For a violation of the notification requirement, a minor administrative penalty will apply. If a financial instruments business operator violates any requirement under the FIEA, an administrative sanction will apply.

4.2 General Disclosure Laws or Regulations

See **4.1 Specific Disclosure Laws or Regulations**.

4.3 Credit Risk Retention

The FSA has published guidelines recommending that an originator retains a part of the risks associated with the securitisation products. The guidelines also recommend checking whether the originator continues to retain a part of the risks and, if not, to review and analyse the involvement by the originator in the securitised assets and the quality of the securitised assets.

Furthermore, an amendment to the FSA's capital adequacy regulations became effective in March 2019, under which banks are required to use three times (up to 1,250%) the risk-weight on their securitisation exposure unless the banks can confirm that the originators fulfil certain risk-retention criteria, such as the retention of 5% or more of the junior exposure, etc, or the origination of underlying assets being not improperly conducted.

4.4 Periodic Reporting

As far as laws and regulations relating specifically to securitisation are concerned, there is no requirement for periodic reporting. However, requirements for periodic reporting may apply to the vehicle used for a securitisation transaction.

As an example, in a case where a stock corporation, *kabushiki kaisha* or TMK – which is designed to be used as a special-purpose vehicle for a securitisation transaction under the Act on Securitisation of Assets – is used as a securitisation vehicle, a periodic disclosure of its financial statements may be required under the Companies Act and the SPC Act, respectively. For a TMK, there is a further requirement to submit business reports every business year. Separately from the vehicle used for a securitisation, when the special provisions under the FIEA are applicable concerning specially permitted business of a qualified institutional investor, etc,

tekikaku kikan toshika tou tokutei gyomu, which exempts the registration requirement for certain private placements and/or certain acts of investing money, the submission of business reports for every business year is required.

The Ministry of Justice is the regulator for the disclosure of financial statements under the Companies Act, while requirements under the SPC Act and the FIEA are governed by the FSA.

The penalties for non-compliance vary depending on the requirement. For example, a failure to disclose financial statements under the Companies Act or SPC Act will be subject to a minor administrative fine, but a failure to submit business reports under the SPC Act or the FIEA is subject to a criminal sanction. In connection with a breach of the FIEA or SPC Act, an administrative sanction is also applicable.

4.5 Activities of Rating Agencies

There is no regulation prohibiting securitisation activity by a rating agency (RA). However, the FIEA has provided for:

- the registration of an RA;
- certain requirements for registered RAs to comply with, including a fiduciary duty, no conflict-of-interest rule and reporting requirements;
- monitoring registered RAs by requesting reports, on-site inspection and ordering business improvements; and
- certain disclosure requirements if credit ratings of unregistered RAs are used.

4.6 Treatment of Securitisation in Financial Entities

Under the Banking Act and other acts regulating financial institutions, the Japanese government may set the criteria to be used by banks and other financial institutions to determine the soundness in their management. In this connection, the FSA has issued official announcements regarding the criteria for maintaining certain capital adequacy ratios and liquidity coverage ratios. The official announcements implemented from 31 March 2019 correspond to the revisions to the securitisation framework published by the Basel Committee for Banking Supervision in December 2014.

4.7 Use of Derivatives

Certain types of derivatives are defined in the FIEA, and dealing, brokering or other certain types of businesses on those derivatives cannot be done unless duly registered under the FIEA. However, there are no specific laws or regulations on the use of derivatives in the context of securitisation or SPEs.

4.8 Investor Protection

The FIEA provides various obligations of a financial instruments business operator for the purpose of investor protection. Such rules are not securitisation-specific.

The basic obligations of a financial instruments business operator under the FIEA include a prohibition against conflicts of interest, a duty of due care of prudent management (*zenkan chui gimu*), a duty of loyalty (c *hujitsu gimu*), a duty of self-execution and a duty of separate management of assets.

The FSA regulates these matters. Criminal and administrative sanctions will apply to any breach of obligations under the FIEA.

4.9 Banks Securitising Financial Assets

As part of the obligations under the Basel III regime, banks are obliged to disclose their

"securitisation gain on sale" in conformity with the form for a capital position disclosure.

4.10 SPEs or Other Entities

Depending on the securitisation scheme, a trust (TMK) or a company similar to the US limited liability company (*godo kaisha*) is used to accomplish securitisations.

Which entity is used varies in each transaction, taking into consideration bankruptcy remoteness, tax benefit, licences and other legal requirements, flexibility in terms of management of the entity, costs associated with the entity, etc.

A trust enables the separation of legal and beneficial ownership. Specifically, the trustee in a trust structure is the legal owner of the underlying assets, while the economic interests in the trust assets belong to the holders of trust beneficial interests issued by the trustee. It is also easier to generate cash flow from the underlying trust assets by issuing multiple or different classes of TBIs in a trust.

Assets held in trust will also be remote from risks of bankruptcy of both the originator and the trustee if the asset transfer from the originator to the trustee is deemed to be a true trust (*shinsei shintaku*). The factors to be considered in determining whether a true trust exists are similar to the factors involved in determining whether a true sale (*shinsei baibai*) has occurred.

Trustees are subject to various requirements, including licensing requirements under the Trust Business Act and fiduciary duty requirements. Due to these requirements, the trust structure is generally regarded as being stable and credible.

The transactional parties in a trust structure are eligible for certain tax benefits. For example, the transfer tax rate applicable to the sale and purchase of trust beneficial interests is much lower than the rate applicable to transfers of fee simple real estate.

Due to the advantages set out above, trust structures are used at various levels in securitisation transactions in Japan, including:

- the underlying asset level, where underlying assets are converted to TBIs;
- the securitisation vehicle level, where the underlying assets are transferred to the trustee who issues TBIs and/or to whom asset-backed loans are made; and
- the lending level, where the trustee advances loans to the securitisation vehicle through the issuance of TBIs and/or procuring asset-backed loans from end-investors.

Practical points to note include the following.

- TBIs are considered type II financial instruments under the FIEA, so the procurement and provision of brokerage activities in respect of TBIs have to be handled by a type II financial instrument exchange business operator licensed under the FIEA.
- The concept of self-declaration of trust or declaration of trust was introduced in Japan pursuant to amendments to the Trust Act that came into effect in 2006 (the "2006 Trust Act Amendments"), following which it is now possible for an operating company to securitise its assets through self-declarations of trust or declarations of trust, provided the operating company – if required to do so by the characteristics of the securitisation structure involved (such as the number of TBI hold-

ers) – holds a trust business licence under the Trust Business Act.
- The concept of a security trustee was also introduced by the 2006 Trust Act Amendments. Before these amendments, security trustee structures were not allowed in Japan (as was the case in other continental law jurisdictions such as France and Germany) because it was not possible to separate the holders of security interests from the holders of secured claims. The security trust structure is now permitted as a result of the 2006 Trust Act Amendments, but a security trustee is required to hold a trust business licence under the Trust Business Act.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

There are many activities that a securitisation vehicle should avoid, including money-lending business, financial instruments business, joint real estate venture business, trust business and real estate brokerage.

How legal practitioners avoid engaging in such activities depends on the transactions (for example, see **4.1 Specific Disclosure Laws or Regulations**).

The regulator will vary, depending on the law involved for each transaction, with the possibility of criminal sanctions being imposed for any breach.

4.12 Participation of Government-Sponsored Entities

Government-sponsored entities (GSEs) may participate in the securitisation market. Regulations applicable to each entity will vary, depending on the particular law applicable to that entity – eg, the Act on Development Bank of Japan, Inc, the Japan Finance Corporation Act, the Japan Bank for International Co-operation Act and the Shoko Chukin Bank Limited Act. The Japan Housing Finance Agency has been playing an active role, similar to GSEs such as Fannie Mae and Freddie Mac in the USA, in providing low-cost finance for the public to purchase houses or for financial institutions extending housing loans by way of securitisation businesses.

4.13 Entities Investing in Securitisation

There are various laws and regulations generally regulating investments of financial products depending on the types of entities. However, there is no law specifically prohibiting or limiting investment in securitisation products by an entity.

4.14 Other Principal Laws and Regulations

The principal laws and regulations which are not already mentioned include the following.

- The Companies Act regulates the incorporation, membership, management, financing, and other such matters in respect of GKs.
- The Commercial Code also contains important provisions applicable to TKs in respect of the “GK-TK structure”.
- The Act Concerning Liquidation of Assets is the primary legislation regulating TMKs.
- The Act on Special Measures Concerning Taxation contains provisions on the special treatment of the taxable income of TMKs and deductible expenses in a GK-TK Structure.
- The Trust Act regulates the creation of trusts, trust beneficial interests and management of trusts.
- The Trust Business Act regulates applications for licences, and obligations of and requirements applicable to trust banks as professional trustees.

- The FIEA stipulates the requirements on disclosure of financial interests and other business-related matters applicable to the relevant parties under the various securitisation structures.
- The Act on General Incorporated Associations and General Incorporated Foundations regulates general incorporated associations (*ippan-shadan-houjin*) in their capacities as SPEs that hold equity interests in TMKs or GKs.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

There are no laws or regulations that specifically prohibit synthetic securitisation in Japan.

Issuers/originators engage in synthetic securitisation for the principal purpose of transferring the credit and other default risks in the assets held on their balance sheets, improving their capital ratios and thereby – especially for banks or other regulated financial institutions – freeing up capital for making additional loans.

More generally, investors engage in synthetic securitisation because of stronger appetites for investment products that offer potentially better yields, given the current extremely low interest rate environment in the domestic market.

The FSA amendment to the banks' capital adequacy regulations became effective in March 2019 and has had a material impact on structuring synthetic securitisation products, including the originators' risk retention policies, etc (see **4.3 Credit Risk Retention**).

As credit derivative transactions fall within the definition of "market derivative transaction", those dealing in the brokerage, sale, purchase or arrangement of credit derivatives are required to register with the FSA and to comply with the relevant regulatory requirements under the FIEA. Synthetic securitisation transactions are not specifically regulated. However, since credit derivatives are subject to the FIEA regulations, synthetic securitisation transactions involving credit derivatives would similarly be subject to the provisions of the FIEA.

The principal difference between synthetic and regular securitisation transactions is that synthetic securitisation transactions involve the transfer of credit risks to SPEs, not through the physical transfer of assets, but by utilising credit derivatives or other types of derivatives or guarantees.

Synthetic securitisation transactions typically take the form of a synthetic CDO, the structure of which is as follows:

- an existing or newly established SPE will be used to acquire Japanese Government Bonds (JGBs) or other highly liquid financial products such as bank deposits (the collateral) through proceeds from the SPE's issuance of notes to investors;
- the originator then enters into a credit default swap (CDS) with the SPE and, as part of the CDS, the originator will designate certain assets that it owns (such as loan receivables and bonds) as the reference obligations, and transfer the credit risks of the reference obligations to the SPE;
- the SPE will pay its investors interest on the notes, based on the CDS premiums it receives from the originator and the interests it receives on the collateral; and

- normally, the collateral will be invested during the term of the CDO transaction and applied toward redemption of the notes; where any credit event occurs with respect to the reference obligations, however, proceeds from the disposition of the collateral will be applied towards payments to the originator under the CDS.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Insolvency laws in Japan affect securitisation indirectly by causing the securitisation structure to be formed in a way that provides bankruptcy remoteness. A "true sale" of financial assets is a major requirement to ensure segregation from the financial risk of the originator and its affiliates.

In the case of a true sale, ownership of the assets is transferred to the transferee (special-purpose entity/vehicle – SPE/SPV).

In the case of a secured loan, ownership of the assets remains with the originator.

In a true sale, the asset is no longer related to the originator and is fully insulated from any originator risks. The transferee effectively becomes the owner of the asset and holds all rights and obligations for the assets.

In a secured loan, the transferee has a secured right only, and the underlying asset remains subject to the financial risk of the originator (although the transferee has a secured right over the asset, there could be cases where the security right does not prevail).

True Sales and Secured Loans

In a true sale, the transferee is the owner of the asset; if the asset has been taken by the trustee (*kanzainin*) or is mingled with the other assets of the debtor, the transferee has a right of recovery (*torimodoshi-ken*) in an insolvency proceeding.

In a secured loan, the transferee has a right to set aside (*betsujo-ken*) and receive payments outside the insolvency proceeding. However, the trustee can petition the court to extinguish the security right (subject to some provision for value to the security-holder) in reorganisation proceedings under the Corporate Reorganisation Act, in rehabilitation proceedings under the Civil Rehabilitation Act and in the case of straight bankruptcy under the Bankruptcy Act. In addition, where a reorganisation proceeding under the Corporate Reorganisation Act is made, no exercise of any security interest based on a reorganisation claim is allowed.

The Issue of True Sale

A true sale, in respect of an asset, is generally understood under Japanese law to mean that (i) the asset sold or entrusted by an originator is not regarded as collateral and (ii) the asset, upon being sold, ceases to be part of the originator's bankruptcy or insolvency estate. As the true-sale concept is not expressly codified under Japanese law, interpretation of the Civil Code and/or insolvency laws of Japan is necessary to determine whether an asset sale constitutes a true sale. For purposes of the interpretation, the overall structure of the transaction for the relevant asset sale will be examined, in addition to the relevant sale itself. Where necessary, legal opinions on whether an asset sale constitutes a true sale will also be obtained from external legal counsel of the transacting parties.

Opinion of Counsel

An opinion of counsel to support the true sale has normally been obtained because the concept and elements of a "true sale" have not yet been clearly stipulated in Japanese law, nor has there been any definitive judicial precedent with regard to it.

The material conclusions of such an opinion are that the asset sold or entrusted by the originator is not regarded as collateral, and that, upon being sold, the asset ceased to be part of the bankruptcy or insolvency estate of the originator.

Factors to be considered include the following:

- the intention of each of the transacting parties;
- whether the economic risks and interests in respect of the asset have been transferred;
- whether the right of control over the relevant asset has been transferred;
- whether the asset transfer has been perfected;
- whether the purchase price of the relevant asset is reasonable;
- whether the originator has the right or obligation to repurchase the asset and, if so, the terms of the right or obligation;
- whether the originator achieves credit enhancement and, if so, the details of the credit enhancement; and
- the accounting treatment of the asset transfer by the originator.

The typical qualifications of such an opinion are that a Japanese court may have a different opinion because there is no judicial precedent with regard to a true sale.

Bankruptcy-Remoteness

Bankruptcy-remoteness can refer to two issues under Japanese law, each of which is discussed in turn below:

- the bankruptcy-remoteness of a special-purpose company (SPC); and
- the isolation of an asset from the originator's bankruptcy or insolvency estate.

Bankruptcy-remoteness of an SPC

Two types of measures are typically used in Japan to make an SPC bankruptcy-remote. First, SPCs are structured in a way that minimises the risk of their insolvency, which is primarily achieved through the following:

- restricting the objects and powers of the SPC;
- limiting the amount of debt the SPC may incur;
- appointing independent directors to the SPC;
- restricting the SPC's capacity to undergo a merger or reorganisation;
- limiting the SPC's capacity to amend its organisational documents (*teikan*);
- including limited recourse provisions in the agreements to be entered into by the SPC; and
- having equity interest with voting rights held by an independent party, such as a general incorporated association (*ippan-shadan-hojin*) established specifically for that purpose.

Secondly, "non-petition" provisions are used to prohibit the creditors and directors of an SPC from filing for the commencement of bankruptcy proceedings in respect of the SPC. There is, however, uncertainty as to whether Japanese courts will uphold the validity of such provisions.

Asset isolation

Certain requirements have to be fulfilled to isolate an asset from an originator's bankruptcy or insolvency estate. First, there must be a mutual agreement between the transacting parties for the legal and valid "transfer" of the asset, as opposed to a pledge of the asset.

Secondly, the asset transfer must be perfected against third persons (ie, certain procedural steps have to be taken to make the acquisition of the asset effective against third persons). For this purpose, it should be noted that the originator's receiver is regarded as a "third person" under Section 177 of the Civil Code. An SPC that fails to perfect promptly faces certain risks, such as being unable to effect perfection if the SPC subsequently goes bankrupt, or having that perfection voided by a receiver in bankruptcy proceedings if the date of perfection falls too close to the date of the bankruptcy of the SPC.

Thirdly, the asset transfer must fulfil true-sale requirements and must not be voided in bankruptcy proceedings in respect of the relevant originator.

Other Insolvency Issues

The following issues in respect of an originator's insolvency should also be considered.

Defence against right of avoidance

The right of avoidance (*hinin-ken*) under insolvency proceedings is a right of the trustee/supervisor in an insolvency proceeding, which is similar to the right to demand rescission of a fraudulent act (*sagai-koi-torikeshi-ken*) of a creditor under the Civil Code. If the requirements under the insolvency law are satisfied, the acts of the bankrupt may be avoided in the interest of the insolvency estate in an insolvency proceeding. As such claims are difficult to defend against, it is important in practice to ensure that the originator is in good financial health at the time of completion of the transfer, in order to avoid any such claims of fraudulence.

"Piercing the corporate veil" doctrine (hojinkaku hinin no hori)

Japanese courts have affirmed the doctrine of piercing the corporate veil; specifically, they have disregarded corporate entities in certain situations where it is unfair to deem a corporate entity independent from its members. In determining whether an asset has been properly transferred to an SPC from the originator, it is necessary to examine whether the doctrine of piercing the corporate veil will apply.

Termination of the service agreement and replacement of service providers

An originator usually acts as a debt collection service provider through a service agreement with the SPC. The SPC should ensure that the service agreement is terminated on a timely basis and that an alternative service provider can begin debt collection services in respect of the underlying assets, in order to enable the SPC to avoid any interruption in the collection of debts (and in turn enable the SPC to pay the investors in a timely manner) should the originator become bankrupt or insolvent. Service agreements generally contain cancellation or termination provisions. It should be noted, however, that the validity of such provisions can be challenged by a receiver under Japanese bankruptcy laws, on the basis that Japanese laws allow a receiver to choose between terminating an agreement and demanding its specific performance, if the agreement is a bilateral contract and neither party has fulfilled its contractual obligations thereunder.

Commingling risks

Where an SPC holds a claim for collected cash against an originator (who is also a collection service provider) and the originator subsequently becomes bankrupt, the claim will be considered a bankruptcy claim and, as such, may not be satisfied in large part. To mitigate any such loss, a service agreement generally contains provisions that enable the SPC to terminate the agreement in situations where the originator is likely to become bankrupt or insolvent. In practice, however, it is sometimes difficult to know when the originator's bankruptcy or insolvency is imminent, such that the SPC may not be able to terminate the agreement in time. Accordingly, the cash reserve is structured to cover the loss and enable an SPC to pay its investors as contracted.

6.2 SPEs

The essence of securitisation is finance, based not on an entity owning assets but on cash flow from specific assets themselves. Therefore, the financial assets must be transferred to an SPE, or they will be treated as assets of the originator and be included in the insolvency estate and exposed to the financial risk of the originator. Therefore, it is usual to utilise an SPE structure.

See **6.1 Insolvency Laws** (Bankruptcy Remoteness) regarding the required or desirable aspects of an SPE.

Available legal formalities or entities for SPEs under Japanese law are corporations (ie, KK, GK, and TMK) and trusts.

Under Japanese law, the most common type of entity for conducting business is a KK. However, generally speaking, a KK is not deemed to be an appropriate form of entity for securitisation because:

- KKs are subject to the Corporate Reorganisation Act where secured creditors must exercise their rights in accordance with the corporate reorganisation procedures; and
- a KK's compliance costs are higher in terms of its:
  (a) obligation to publish financial statements;
  (b) limitation on the term of directors; and
  (c) requirement to appoint accounting auditors, statutory auditors, etc, and establish a specified internal control system, if the KK's total debts are JPY20 billion or more.

A GK is a relatively new form of corporation introduced by the Companies Act of 2005 and is generally deemed a more appropriate form of entity for securitisation than a KK, since it is not subject to the Corporate Reorganisation Act nor to the onerous limitations or requirements in relation to management and financial compliance applicable to a KK, as previously described. Since GKs are subject to corporate tax, equity investments in the form of a TK, similar to a limited partnership, are frequently used for profit distribution to TK investors to be deducted as expenses for GKs' corporate tax purposes (see **7.2 Taxes on Profit** and **1.2 Structures Relating to Financial Assets**).

A TMK is an entity introduced by the Act Concerning Asset Securitisation of 1998 (the SPC Act) specifically to facilitate asset securitisation.

A TMK is required to file (*todokede*) the commencement of business with government authorities, and is not authorised to conduct any acts outside those set out in the asset liquidation plan (ALP).

A TMK is subject to the supervision of the Financial Services Agency of Japan (FSA) by way of various measures such as an on-site investi-

gation, an order to correct illegal acts and an order to cease business. Compliance by a TMK with the SPC Act and other applicable laws is expected to be monitored by the government. Particular requirements apply to TMKs in specified circumstances, such as:

- a prohibition on the acquisition of certain assets by the TMK;
- an amendment to the ALP is subject to certain limitations and procedures under the SPC Act, and in many cases the unanimous approval of interested parties is required;
- lenders for "securitisation of assets" must be qualified institutional investors (QIIs);
- securitised assets must, in principle, be specified at the outset, and the acquisition of additional assets is subject to strict limitations except for certain cases;
- actual money transfer is required for the issuance of preferred shares and a certificate of preferred shares is required for their transfer; and
- the management and disposition of the assets must be delegated to certain qualified persons.

Accordingly, where a TMK is used as an SPC for securitisation, the above requirements and restrictions should be taken into account in the structuring of the transaction and the management of the TMK.

Comparison between GKs, KKs (so-called "closed KK share transfers", which are subject to the approval of the board of directors or shareholders' meeting) and TMKs may be summarised as follows.

- Application of Corporate Reorganisation Act:
  (a) GK: no;
  (b) KK: yes; and
  (c) TMK: no.
- Bond issue:
  (a) GK, KK, TMK: applicable.
- Required approval and other internal process for bond issue:
  (a) GK: representative members' approval;
  (b) KK: directors' (directors' meeting) approval; and
  (c) TMK: directors' approval and preparation and filing of an ALP.
- Taxation:
  (a) GK, KK: corporate taxation but profit distribution for TK investments to be deductible for corporate tax purposes; and
  (b) TMK: corporate taxation but pay-through treatment where profit distribution could be deducted as an expense for corporate tax purposes.
- Mitigation on real estate taxation:
  (a) GK, KK: not available; and
  (b) TMK: available (see **7.1 Transfer Taxes**).
- Registration tax on incorporation:
  (a) GK: JPY60,000;
  (b) KK: 0.7% of capital amount (JPY150,000 minimum); and
  (c) TMK: JPY30,000.
- Public notice obligation on financial information:
  (a) GK: no;
  (b) KK: yes; and
  (c) TMK: yes.
- Large company regulations:
  (a) GK: no;
  (b) KK: yes (where a KK's capital is JPY500 million or more, or a KK's total debt is JPY20 billion or more, the KK must appoint an accounting auditor and a statutory auditor, and set up an internal control system); and
  (c) TMK: no.
- Accounting auditor:
  (a) GK: not required;

  (b) KK: required if it is a large company; and
  (c) TMK: required if the total debt is JPY20 billion or more.
- Statutory auditor:
  (a) GK: not required;
  (b) KK: required for a large company unless it is a corporation with committees; and
  (c) TMK: required.
- Internal control system:
  (a) GK: not required;
  (b) KK: required for a large company; and
  (c) TMK: not required.
- Transferability of shares:
  (a) GK: approval of other members is required, unless provided otherwise in the Articles of Incorporation;
  (b) KK: approval of the company is required; and
  (c) TMK: approval is required for the transfer of specified shares to non-members, whereas restrictions on the transfer of preferred shares are prohibited.

Apart from corporate vehicles (ie, TMKs, GKs or KKs), trusts are also commonly used as an SPE for securitisation because they are legally assured bankruptcy remoteness under the Trust Act. Therefore, a trustee's bankruptcy will not statutorily affect its trust assets. Also, trustees are subject to various requirements, including licensing requirements and fiduciary duties, and other regulatory requirements on their businesses under the Trust Business Act and related regulations. Due to such requirements and regulatory supervision by the FSA, the trust structure is generally regarded as stable and credible from the investors' viewpoint.

In addition, trusts are generally subject to "pass-through" taxation, whereby taxation at the trust level ("double taxation") can be avoided. The trust is merely a "conduit" and is not a taxable entity, and trust beneficiaries are deemed to hold the underlying trust assets for tax purposes.

Furthermore, the trust structure and the terms of trust beneficial interests (TBIs) can be created flexibly under the trust agreement, as described in **1.2 Structures Relating to Financial Assets**.

6.3 Transfer of Financial Assets

A property title is in principle transferable and assignable under the laws of Japan, whether it is tangible or intangible and movable or immovable.

A transferee of a true sale that complies with the perfection requirements is completely protected and entitled to keep the property, and to enforce the claim against the obligor and any third persons.

Perfection procedures vary, depending on the type of asset to be transferred.

With regard to claims and/or receivables, for perfection against an obligor, a notice to or consent from the obligor is required. For perfection against third persons, including a trustee (*kanzainin*), such a notice or consent must have a certified date stamp affixed at a notary public office, or be delivered by content-certified mail certifying the date of delivery of the notice or consent.

Registration under the Act on Special Measures Concerning Claim Management and Collection Businesses would work as an alternative method of perfection against third persons.

A loan secured by way of an assignment of a claim and/or receivable will require the same perfection requirements.

A transferee of a true sale that has not been perfected is not entitled to claim that it is the holder of the claim or receivable against the obligor if the perfection requirements against the obligor are not met and/or against third persons if the perfection requirements against third persons are not met. In other words, the obligor may refuse to make payment of the claim on the ground that the transferee has not perfected against the obligor; if the same claim or receivable is purchased from the transferor by a third person, that person could be found to be the true holder of the claim or receivable.

6.4 Construction of Bankruptcy-Remote Transactions

The most standard means of constructing a bankruptcy-remote transaction is to use SPCs or trusts, as stated previously; practically, there are no other means for a bankruptcy-remote transaction in a material sense.

6.5 Bankruptcy-Remote SPE

See **6.1 Insolvency Laws** (Bankruptcy-remoteness of an SPC).

7. Tax Laws and Issues

7.1 Transfer Taxes

In securitisation transactions involving real estate, transfers from originators to SPEs are subject to real estate acquisition tax (which is levied on the transferee) and real estate registration tax (which is levied on the applicants of the registration upon registration of title transfers).

Where a TMK is the transferee, and if certain conditions are met, the rate of real estate registration tax for the transfer of ownership will be discounted to 1.3% (from 2%) and the tax base of the real estate acquisition tax will be reduced to 40% of the purchase price of the relevant real estate.

In view of such tax benefits, SPEs are frequently established in the form of TMKs in real estate securitisation transactions.

7.2 Taxes on Profit

The net profits of SPEs are generally subject to corporate tax. Accordingly, the net profits of GKs and KKs that are used as SPEs will be subject to corporate tax unless they are extracted by TK investors through the so-called GK-TK structure, under which profits distributed to TK investors are deemed expenses that are deductible from a GK's taxable income.

Similarly, "pay-through" TMKs are also entitled to certain tax exemptions. Specifically, TMK profits and the like that are distributed to preferred shareholders will be deemed expenses for tax purposes and are deductible from a TMK's taxable income if certain requirements under the Act on Special Measures Concerning Taxation (ASMCA) are met.

Under a trust structure, the trust itself is merely a "conduit" and is therefore not subject to corporate tax. Beneficiaries of the trust, however, would be deemed to hold the underlying trust assets for tax purposes, except where the trust does not constitute an exceptional trust under any of the following categories:

- a group investment trust;
- a retirement pension trust;
- a specified charitable trust; or
- a corporation taxable trust.

7.3 Withholding Taxes

If the transferor is a domestic corporation, capital gain on the transfer of loan receivables is subject

to corporate tax of that transferor corporation. However, if the transferor is a foreign corporation with a permanent establishment in Japan, a capital gain on the transfer of loan receivables is subject to corporate tax; no corporate tax will be levied on a foreign corporation that has no permanent establishment in Japan.

No corporate tax will be levied on capital gain on the transfer of securities by a foreign corporation that has no permanent establishment in Japan. However, capital gain is taxed on the transfer of stocks in certain exceptional cases, such as:

- sales of stocks of the identical issuer that the transferor has bought up;
- the sale of stocks in a domestic corporation by a foreign corporation that falls into the "special relationship shareholders" with that domestic corporation;
- the sale of a certain type of stock of a company that has real estate of 50% or more; and
- the sale of membership of a golf club in stock means.

If a foreign corporation transfers real estate in Japan to a domestic corporation, the payment of the purchase price is subject to withholding tax, which must be paid by the domestic corporation.

In addition, capital gain on the transfer of real estate in Japan by a foreign corporation that has no permanent establishment is subject to corporate tax.

7.4 Other Taxes

The taxes on the payment of dividends, interest, etc, to investors of SPEs are as follows:

- dividends of specified or preference shares of TMK/GK to residents or domestic corporations – 20% withholding tax is levied;
- interest on bonds of TMK/GK to residents or domestic corporations – 20% withholding tax is levied (15% if an investor is a corporation);
- dividends of specified or preference shares of TMK/GK to non-residents or foreign corporations – 20% withholding tax is levied, subject to the relevant tax treaties;
- interest on bonds of TMK/GK to non-residents or foreign corporations – 15% withholding tax is levied, provided that this tax will be exempted subject to certain conditions with respect to book-entry bonds; and
- income of TK to residents or non-residents or domestic or foreign corporations – 20% withholding tax is levied.

7.5 Obtaining Legal Opinions

Tax opinions are obtained in most of the aforementioned transactions. In Japan, such tax opinions are usually issued by an accounting or tax firm, rather than a law firm.

Tax opinions typically cover the following, based on assumptions of certain facts, but without specific qualifications:

- the withholding tax implications in respect of interest income from notes, loans, beneficial interests and the like;
- the same issue as above, but as applied to foreign investors;
- the corporate tax implications for SPEs;
- the consumption tax implications in respect of asset transfers, collections and payments in respect of assets (if those assets consist of monetary claims) and the various fees involved;
- the tax implications in consideration of Japanese anti-tax haven legislation and the

Japanese thin-capitalisation legislation in connection with SPEs;
- where the SPE is a TMK, whether that TMK is a tax-qualifying TMK; and
- where TK investments are involved, the validity of the TK arrangement from the Japanese tax perspective.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Accounting opinions on the off-balance sheet treatment of securitisation transactions are usually based on the true sale legal opinions on such transactions. However, in securitisation transactions, factors such as the originator's accounting treatment of the transaction and whether the transacting parties intend for the transaction to constitute a true sale are critical factors for the purposes of issuing a true sale legal opinion. Accordingly, if a transaction is treated as on-balance sheet by the originator, an issue could arise as to whether a true sale opinion could be rendered, notwithstanding any such on-balance sheet accounting treatment.

8.2 Dealing with Legal Issues

In most cases, true sale legal opinions are rendered either without reference to the originator's accounting treatment of the relevant transaction, or on the assumption that the originator's accounting treatment is consistent with a legal true sale. However, where legal practitioners are specifically requested to opine on how the originator's accounting treatment affects the legal nature of a transfer, the legal opinion will be rendered on the basis of certain assumptions and qualifications, based on the general understanding that legal analyses of true sale should be considered separately from the question of accounting treatment.

Trends and Developments

Contributed by:
Taku Sonoura, Hayato Kimura, Kenichi Tanizaki, Ciaran Rose
and Hirofumi Kaji
Atsumi and Sakai

Atsumi and Sakai is a full-service, Tokyo-based law firm that operates as a foreign law joint venture, enabling it to admit foreign lawyers as partners and offer clients the quality of service that the modern international business community expects and demands. The firm serves and supports its clients around the clock through its offices in Tokyo, New York, London and Frankfurt. Atsumi and Sakai has extensive and in-depth expertise in advising on traditional asset-backed securities and cutting-edge securitisations in fields such as covered bonds and IP rights. The firm has a proven track record in cross-border deals, acting for originators, arrangers, trustees and institutional investors on several innovative and award-winning transactions. Securitisation deals for which the firm has acted and advised on include the following: monetary receivables; electronically recorded monetary claims; real estate (apartment/office buildings); whole business securitisation (WBS); intellectual property rights; covered bonds; self-declared trusts; catastrophe bonds (CAT); and perpetual care.

Authors

Taku Sonoura has more than 20 years of experience in finance transactions, focusing on banking and structured finance. With a capability for devising innovative and creative schemes, clients value his extensive knowledge and in-depth experience in securitisation, factoring, supply chain finance and fintech. Clients also appreciate his ability to review critical issues from multiple perspectives to provide practical solutions to meet their complex legal needs and challenges in doing business.

Hayato Kimura is a partner with Atsumi and Sakai. He has more than ten years of experience advising on financial transactions, securitisations, real estate, tech, corporate insolvency, reorganisations and liquidation matters. Prior to joining the firm, he worked at a real estate investment advisory company and a real estate investment department of a Japanese securities company. Hayato is a key member of the firm's innovation practice group and co-authored a book (Japanese) entitled "6000 Legal Countermeasures for Financial Institutions Volume 4: Money Lending & Collection", published by Kinzai Institute for Financial Affairs in 2022.

Kenichi Tanizaki is a partner of Atsumi and Sakai, and has advised major banks and financial institutions, securities firms, insurance companies, fintech companies and venture capitalists on a wide range of banking and finance matters, including API developed by a bank, cashless settlement, money transfer services and other innovative services, in addition to regulatory, compliance and AML/CFT issues. Prior to joining the firm, Kenichi worked at one of Japan's major banks, handling a wide range of banking transactions and services. He presented seminars on fintech, regulatory issues and cashless settlement for domestic and international financial institutions.

Ciaran Rose is a corporate and finance lawyer with dual admission in Ireland and California. As Of-Counsel with Atsumi and Sakai, he assists clients on complex and high-value transactions involving M&A, restructuring and finance. Prior to joining the firm, he worked for leading law firms in Vietnam and Japan, and a world-leading aircraft lessor in Ireland, gaining exposure to capital markets, structured finance, derivatives, financial regulation, aircraft leasing, project finance and intellectual property. Ciaran has contributed to multiple publications and seminars on contract drafting, IP prosecution, data protection, financial regulation and Japanese business law and practice.

Hirofumi Kaji is of-counsel with Atsumi and Sakai. He specialises in conducting business development for Japanese securities firms and assisting foreign companies with market entry and business entity set up in Japan. Previously, he worked in the securitisations division of a large Japanese bank in London and Tokyo, where he assisted in developing and selling securitised products and structured notes. He also worked for a major US insurance company, conducting due diligence for large acquisitions of insurance companies and analysis of securitised products of target insurance companies. Hirofumi has also managed ALM and credit portfolios for a major institutional investor.

Contributed by: Taku Sonoura, Hayato Kimura, Kenichi Tanizaki, Ciaran Rose and Hirofumi Kaji, **Atsumi and Sakai**

Atsumi and Sakai

Fukoku Seimei Building
2-2-2 Uchisaiwaicho
Chiyoda-ku
Tokyo
Japan, 100-0011

Tel: +81 3 5501 2111
Fax: +81 3 5501 2211
Email: info@aplaw.jp
Web: www.aplawjapan.com/en

Introduction

Securitisation in Japan

Generally, securitised products are treated as debt financing instruments. The term "asset securitisation products" is also generally understood to refer to debt instruments, specifically bonds, beneficial interests and commercial paper (Article 295, paragraph 3 of the Cabinet Office Order on Financial Instruments Business, etc (Order No 52 of 2007)), as well as preferred equity securities and preferred equity subscription warrants, as stipulated in the Act under the Securitisation of Assets (Act No 105 of 1998).

Securitised products are characterised by an underlying asset such as a monetary receivable transferred from the owner or the execution of an agreement allocating risk of fluctuation in value of assets held by a third party, in whole or in part, from such third party to the issuer. In addition, the issuer of a securitised product would be a bankruptcy remote legal entity, such as a special purpose company or trustee. The definition of "asset securitisation product" per the abovementioned Cabinet Order, is consistent with this concept of securitised products.

Instruments that are not beneficial interests, such as equity interests, are generally not considered to be securitised products. Therefore, as an example, capital acquired by silent partners under a silent partnership (*tokumei kumiai*) agreement would be excluded from such scope, per Article 535 of the Commercial Code (Act No 48 of 1899). With the exception of the section on real estate securitisation, the below discussion is based on the premise that securitised assets are debt financing instruments.

Prevalence in Japan

Securitisation is most commonly used in real estate investment, offering high returns with low acquisition costs due to low interest rates. However, the financial environment appears to be changing. Specifically, over the last decade, the yield on the ten-year JGB (10Y), a leading indicator of long-term interest rates, has remained low in the 0–0.7% range, or even negative in certain periods. In October 2023, the 10Y interest rate approached 1%. Although the rate has since fallen back to 0.6%, it is expected that interest rates will broadly trend upward from 2024 onward.

Structured bonds

A structured bond is a financial instrument that incorporates derivatives as a condition for the payment of interest or redemption of straight bonds, where rights in connection with the incorporated derivative transaction function as the underlying asset. In Japan, structured bonds have been viewed as products that are similar or approximate to securitised products. For instance, a synthetic CDO is considered to be both a structured bond and a securitised product.

However, having regard to the characterisation of securitised products outlined in the discussion in Section 1 above, a structured bond would not be classified as a securitised product in instances where there is no underlying asset such as a monetary receivable transferred from the owner, or no agreement for the apportioning of risk of losses in respect to assets held by third parties (see Section 1 above) has been executed.

Structured bonds that are not classified as securitised products can offer high returns. However, they are somewhat complicated by varied conditions for redemption linked to fluctuations in share prices or exchange rates. For example, in the case of Nikkei Stock Average-linked bonds, the full amount of principal can be redeemed if certain predetermined events do not occur by the time of redemption (eg, the Nikkei average falls below a certain percentage of its initial value, also referred to as a knock-in). If a knock-in occurs even once, then an amount linked to the value of the Nikkei average (less than the amount of principal) will be redeemed, instead of the full principal amount.

As structured products are high-risk instruments for which an accurate assessment of risk is difficult without sufficient investment experience, it is considered that selling such products to retail investors is not appropriate. In 2023, the Financial Services Agency (FSA) issued administrative dispositions (business improvement orders) to several banks and securities companies in connection with the marketing of structured bonds.

Moreover, the 2023 amendment of the Financial Instruments and Exchange Act (FIEA) has imposed stricter obligations on financial institutions to provide verbal (as well as written) explanations of risks of structured products, per its newly amended Article 37-2, paragraph (2). As a result, several financial institutions have ceased the sale of structured bonds to retail investors.

Overall, while sales of structured bonds to individual investors and retail investors are expected to decline, due in part to the changing regulatory environment, low-risk securitised products will remain a promising prospect for institutional investors.

New Centralised and Decentralised Platforms

For originators, securitisation represents an exit strategy that is somewhat similar to loan syndication and private placement. Therefore, ensuring that securitisation opportunities are available and accessible to a broad base of investors will be crucial.

Decentralised platforms for the sale of securitised products that do not involve a centralised recording institution are emerging, whereby smaller tranches of securitised products are sold to retail investors using security tokens. Further, a trend towards making private placements smaller to reach a wider range of investors seems to be taking hold. However, on the other hand, centralised exchanges bringing OTC trading closer to market trading (loan receivables

transactions conducted through an exchange) are also emerging.

Security tokens (decentralised platform)

Regulations related to security tokens

Security tokens have not yet been defined under Japanese law. However, security tokens that are classified as "paragraph (1) securities" under the FIEA are referred to as "electronically recorded transferable rights" under the Act. "Electronically recorded transferable rights" means those rights in respect of securities that are indicated as a financial value, which can be transferred by using an electronic data processing system. The transfer of financial values using an electronic data processing system is generally thought to refer to distributed ledger technologies such as blockchain.

Purpose of security tokens

Security tokens are expected to enable retail investors to trade in real time, lower administrative costs, improve operational efficiency and improve the convenience of transactions. Additionally, lower transaction costs will allow for smaller investment units, thus contributing to an increase in the number of retail investors.

Security token projects – bonds and real estate

Use of security tokens is booming in Japan, especially in real estate and bonds. In July 2021, the Kenedix Realty Token Shibuya Jinnan, a real estate-backed security token, was issued. The token represents investment in a single apartment building in Shibuya, an area with many high-end luxury residences. The project uses "Progmat", an original blockchain-based security token platform operated by Mitsubishi UFJ Trust and Banking Corporation. Progmat allows retail investors to conduct transactions. Rights transfer data can also be stored on the platform. Since the minimum investment amount is at least two million yen, the investment size is small by comparison to other real estate investment projects, making it relatively accessible for retail investors.

Additionally, the Real Estate Digital Security, Kobe Rokko Island DC, was launched in November 2021. The token is based on a single logistics centre located near Kobe harbour, one of the main logistics centres in Japan. The minimum investment amount for retail investors is approximately 500,000 yen, again significantly lower than other comparable real estate investment projects.

Other recently launched real estate-backed security tokens have sought to appeal to retail investors by offering, instead of cash dividends, coupons for restaurants and hotels located in the project property, as part of the security token offering. Furthermore, on 25 December 2023, a secondary market for security tokens called "START" was launched in Japan.

In recent years, security tokens have also been launched in the bond sector. In May 2021, SBI Securities launched a security token offering for its own corporate bonds, using the "ibet for Fin" platform developed and operated by BOOSTRY Co., Ltd., a venture between Nomura Holdings, Inc., Nomura Research Institute, Ltd., and SBI Securities. Co., Ltd. As the project is aimed at retail investors, the minimum investment amount is 100,000 yen.

Securitisation and security tokens (exit strategy for retail investors)

Previously, exchange-listed securitised products were not sold to retail investors, other than J-REITs. This is because small tranches were unsuitable for institutional investors, while high costs made it difficult to sell such tranches to

retail investors. However, the emergence of security tokens have made it possible to reduce costs and expand the investor base to include individual investors.

Exchange trading of loans receivables (centralised platform)

Tokyo Financial Exchange

The Tokyo Financial Exchange (TFX) plans to commence loans receivable transactions in 2025. Although the transactions will be conducted over the counter, the centralisation of information could stimulate the buying and selling of loans receivables. TFX has confirmed that its subsidiary will create a new platform for loans receivable transactions for financial institutions of various sizes in Japan and overseas.

A bulletin board will be set up for financial institutions to exchange information regarding their plans to purchase or sell loans, or for conducting other transactions. The platform will allow sharing of other information with pre-selected counterparties from the loan negotiation stage. Users can also negotiate loan sales and purchases among themselves. The transactions will be conducted as electronic agreements, thereby speeding up the documentation phase.

Loans receivable transactions and syndicated loans

A typical scheme for banks to originate loans that they cannot provide on their own has been the syndicated loan, whereby a number of banks form a syndicate to spread the risk. Exchange trading of loans as a platform for spreading the risk across a larger base has now been positioned as an alternative to syndicated loans.

Relationship with securitisation

The sale of loans receivables is basically a discount sale of individual loans. Securitisation can be described as the process of selling loans receivables on a larger scale by being pooled and then divided into tranches. Exchange trading of loans receivables is a step towards securitisation, and could facilitate the emergence of large-scale securitisation. If exchange trading functions as a platform for institutional investors to actively originate large loans, this will enable institutional investors to solicit banks to participate in syndicated loans through the exchange, instead of approaching and negotiating with banks on an individual basis.

Accompanying Support and Expansion of Underlying Assets

Accompanying support

Accompanying support refers to an arrangement whereby a financial institution provides financial support to a company, while making a commitment in connection with the company's business. The objective of the financial institution is to secure loan guarantees other than in respect of fixed assets. There are similarities between the concepts of accompanying support and rehabilitation finance. The scope of underlying assets eligible for securitisation is expected to expand through the emergence of accompanying support in Japan.

By contrast to accompanying support, financing that focuses on the value of an individual tangible asset is limited to the asset's liquidation value, without reference to the company's activities, and in such circumstances there is little incentive for the financial institution to pay significant attention to the debtor's business. Therefore, the rationale for accompanying support is to provide loans that are not secured by the value of fixed assets, thereby opening financing avenues to startups and small businesses that do not possess tangible fixed assets. In this regard it has been noted that more than 30% of the market

capitalisation of first section TSE-listed companies is based on intangible assets, which are not used as collateral.

ABL

Another notable area is asset-based lending (ABL), whereby current assets such as inventory and accounts receivable are used as collateral. However, under Japanese law, there are no explicit provisions regarding security interests by way of assignment, a commonly utilised method for collateralising current assets. The lack of clarity as to the legal effect of such assignments has posed an obstacle to the use of ABL. A review of collateral regulations is being considered by the Collateral Law Subcommittee of the Ministry of Justice's Legislative Council. The "Interim Proposal for Review of Collateral Law", published on 20 January 2023, recommends codifying security interests by way of assignment for movable assets and receivables, allowing multiple security interests (security interests of second or lower priority) to be created over the same movable asset or receivable, enabling financing from multiple financial institutions, and allowing security interests by way of assignment of revolving security interests (security interests for unspecified receivables).

Business growth security interest

The government is working to improve the environment for growth financing by, among other measures, creating a mechanism to enable financing that does not rely on guarantees, real estate collateral or growth financing secured by the business as a whole. In response, the FSA established a "Working Group on Systems to Support Business-Focused Lending Practices" within its Financial System Council, and the results of its deliberations were released in the form of a report on 10 February 2023.

The report proposes the devising of a business growth security interest in which the total assets of the company (the value of the business including intangible assets) are the subject of the security interest. The report further proposes, in the event that the security interest is exercised, that: (i) a court-appointed trustee continues the business, (ii) a sponsor subsequently succeeds to the business, and (iii) the financing institution continuously follows up on the company's business performance, even after providing financing (accompanying support financing).

A business growth security interest captures the fluctuating value of the business itself. For credit management purposes, there is, inevitably, a strong incentive to monitor and support the debtor's business. Business growth security interests are envisioned to be used in connection with financing of start-ups, project finance, LBOs, business restructuring and business succession. In the context of securitised products, business growth security interests may be used for business securitisation or securitisation through CLOs with a portfolio of small and medium-sized loans secured by business growth security interests.

Intellectual property finance

The Japan Patent Office is promoting IP finance by providing regional financial institutions (regional banks) with an "IP Business Assessment" template that can be used to evaluate the overall utilisation by small and medium-sized enterprises (SMEs) of their own IP, as well as an "IP Business Proposal" that summarises solutions to management issues based on the IP of SMEs. The National Center for Industrial Property Information and Training (INPIT) has set up "Intellectual Property Comprehensive Support Offices" in each of the 47 prefectures in Japan. Through these offices, the INPIT provides sup-

port for various IP related management issues and challenges faced by SMEs, such as ideas, technologies and brands.

Once the business growth security interest has been established through legislation, loans to SMEs are expected to grow through utilisation of the know-how accumulated through IP finance.

Revitalisation business

In response to the COVID-19 pandemic, bail-out finance with no interest and no contractual repayment was provided. Referred to as zero-zero loans, the total amount is said to have exceeded 40 trillion yen, and some analysts now conclude that over 2 trillion yen of zero-zero loans have already become non-performing loans. However, zero-zero loans have not snowballed, due to the continued negative interest rate policy. However, as mentioned previously, an interest rate hike is now viewed by many as inevitable in the near future.

The handling of non-performing loans (NPLs) to SMEs is expected to become a topical theme, as opinions are varied regarding what are the most appropriate financial schemes that can be used to dispose of NPLs. It should be noted that the collapse of the bubble economy resulted in Japanese financial institutions holding a large amount of NPLs. These NPLs were sold at significant discounts to their book value in the late 1990s and early 2000s, through bulk sale. Initially the purchasers were special purpose companies (*tokubetsu mokuteki kaisha*) established by foreign funds.

However, the situation normalised following the sudden emergence of several debt collection companies as purchaser candidates, resulting from: (i) the enactment of the Act on the Securitisation of Assets, which made it possible to use a specific purpose company (*tokutei mokuteki kaisha*) and enjoy tax advantages; (ii) the enactment of the Act on Special Provisions of the Civil Code Concerning the Perfection Requirements for Claims (currently the Act on Special Provisions, etc, of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims (Act No 104 of 1998)), which made it possible to perfect an assignment of claims by way of registration of assignment of claims; and (iii) the enactment of the Act on Special Measures Concerning Claim Management and Collection Business (Act No 126 of 1998). The systems under (i) through (iii) above remain available for monetary claim transactions including NPLs.

In addition to bulk sale, securitisation techniques that incorporate credit enhancement mechanisms, such as preferred-subordinated structures, could be used to de-recognise NPLs from balance sheets by selling the preferred portion to investors. A market for high-yield bonds or leveraged loans consisting of those with relatively high credit risk that are not classified as NPLs could also be created.

In an environment where know-how of credit management expertise has not yet been accumulated, it has proven difficult to provide middle-risk borrowers with loans that bring adequate returns to lenders. However, there is room for such market expansion in the future. Credit portfolio management (CPM) using securitisation techniques could be considered in this context.

Conclusion

Securitisation activity stagnated in Japan following the 2008 financial crisis. This was due in part to excessively low interest rates, making debt investments (including securitised securities) less attractive, and partly because the

transaction costs of securitisation could not be absorbed. However, even in such an environment, there has been a steady supply of assets to be securitised, and formation of new markets for securitisation is expected in the near future.

LUXEMBOURG

Law and Practice

Contributed by:
Vassiliyan Zanev and Natalja Taillefer
Loyens & Loeff

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Loyens & Loeff has a securitisation practice in Luxembourg that handles the structuring, regulatory and tax aspects of structured finance and securitisation transactions, including true sale and synthetic securitisation deals, collateralised loan obligations (CLOs), commercial mortgage-backed securities (CMBS), inventory securitisations, securitisation platforms and issuances of asset-backed securities. It has an outstanding record of representing issuers, originators and investors (including financial institutions, investment funds and large corporates) and working on both traditional and innovative securitisations involving various asset classes (for example, the first Islamic finance sukuk securitisation of IP rights). The team is part of a fully integrated firm with home markets in the Benelux and Switzerland, and offices in all major financial centres, such as London, New York, Paris, Zurich and Tokyo.

Authors

Vassiliyan Zanev co-chairs the investment management group of Loyens & Loeff and he leads the fund finance and securitisation practice of Loyens & Loeff in Luxembourg. He represents a variety of financial institutions, investment funds and corporations across a range of structured finance and lending transactions, with particular emphasis on securitisation, fund finance and real estate finance. Vassiliyan is a member of the EMEA Advisory Council of the Fund Finance Association.

Natalja Taillefer is a counsel in the finance practice of the Luxembourg investment management team. She is a member of the Luxembourg Bar (List IV) and Estonian Bar and advises her clients in various banking and finance matters with an emphasis on securitisation and structured finance transactions. She has extensive experience in representing originators, issuers and investors (including financial institutions, investment funds and large corporates) in cross-border securitisations covering various classes of assets. Natalja offers regulatory expertise with regard to both domestic and European law securitisation issues. In particular, she is a member of the working group of the Luxembourg Capital Markets Association preparing the position paper in relation to the application of the EU Securitisation Regulation.

Loyens & Loeff

18-20, Rue Edward Steichen
L-2540
Luxembourg

Tel: +352 466 230
Fax: +352 466 234
Email: info@loyensloeff.lu
Web: www.loyensloeff.lu

1. Specific Financial Asset Types

1.1 Common Financial Assets

Two Levels of Regulation

The type of assets that can be securitised in Luxembourg varies based the applicable legislation. Securitisation transactions in Luxembourg are governed by two layers of regulation. On the national level, the Luxembourg Law of 22 March 2004 on securitisation, as amended (the "Securitisation Law") is applicable on an opt-in basis (see **4.10 SPEs or Other Entities** for a definition of securitisation under the Securitisation Law). On a pan-European level, the EU Regulation (EU) 2017/2402 of 12 December 2017 (the "Securitisation Regulation") (see **4.1 Specific Disclosure Laws or Regulations** with regard to the definition of securitisation under the Securitisation Regulation), aims to mandatorily capture the transactions satisfying certain conditions with the purpose of reducing macroeconomic risks relating to the securitisation.

While there may be an overlap between the Securitisation Law and the Securitisation Regulation, the definition of "securitisation" under the Securitisation Law is broader than the definition of "securitisation" used in the Securitisation Regulation and, hence, a vast number of transactions carried out by Luxembourg securitisation undertakings (the "SPEs") fall within the scope of the Securitisation Law, but not of the Securitisation Regulation.

Securitised Assets Under the Securitisation Law

The Securitisation Law does not, per se, limit the types of assets to be securitised, and the most commonly securitised assets are securities, loans, mortgages, NPLs, trade and lease receivables, interests in investment funds and structured products. Nevertheless, the passive management requirement under the Securitisation Law (please see **4.11 Activities Avoided by SPEs or Other Securitisation Entities**) may in practice have some practical implications for the types of securitised assets. Although most common assets to be securitised are intangible, securitisation of tangible assets (notably movable assets, inventory and commodities) is also acceptable, provided that the purpose of the transaction is to refinance those assets and to render them liquid.

Securitised Assets Under the Securitisation Regulation

The Securitisation Regulation is more restrictive with regard to the types of securitised assets and limits the securitisation transactions falling within its scope to credit risk only.

1.2 Structures Relating to Financial Assets

Luxembourg SPEs are generally adapted to securitisation of any type of financial assets and the structure of the transaction is mostly driven by investor preferences and not by the type of the securitised assets.

1.3 Applicable Laws and Regulations

The principal applicable laws and regulations that have a material effect on the structures referred to in **1.2 Structures Relating to Financial Assets** are the following:

- the Securitisation Law;
- the Securitisation Regulation;
- the Luxembourg Law of 5 August 2005 on financial collateral arrangements, as amended (the "Collateral Law");
- the Luxembourg Law of 10 August 1915 on commercial companies, as amended (the "Companies Law");
- the Law of 5 April 1993 relating to the financial sector, as amended (the "1993 Law");
- the Luxembourg Commercial Code;
- the Luxembourg Law of 7 August 2023 on business preservation and modernisation of bankruptcy law (the "Reorganisation Law");
- the Prospectus Regulation (EU) 2017/1129 (the "Prospectus Regulation") and the Luxembourg Law of 16 July 2019 on prospectuses for securities, as amended (the "Prospectus Law");
- the Luxembourg Law of 16 July 2019 implementing, among others, the Securitisation Regulation (the "SR Law");
- the Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (the "MiFID II");
- the Regulation (EU) No 648/2012 on over-the-counter derivatives, central counterparties and trade repositories, as amended ("EMIR");
- the Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers (AIFMD) and the Luxembourg Law of 12 July 2013 on alternative investment fund managers transposing the AIFMD, as amended (the "AIFM Law");
- the Luxembourg Law of 27 July 2003 on trust and fiduciary contracts (the "Fiduciary Law");
- the EU Regulation (EC) 593/2008 on the law applicable to contractual obligations (the "Rome I Regulation");
- the EU Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms, as amended by Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 (CRR II) and Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, as amended by Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 (CRD V); and
- the Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast).

1.4 Special-Purpose Entity (SPE) Jurisdiction

Luxembourg remains one of the most popular jurisdictions of incorporation for SPEs (by the number of SPEs) in the world. The main factors contributing to its success are its detailed yet flexible legal framework that accounts for the practical needs of the investors and SPEs and provides a wide array of efficient structuring tools and eligible assets, but also its stable political and economic environment, high degree of legal certainty, as well as access to savvy services providers.

1.5 Material Forms of Credit Enhancement

Third-party guarantees, letters of credit, reserve funds and over-collateralisation are standard credit enhancement tools. Often, the financial instruments issued by the securitisation undertaking are split into several tranches carrying different risk and return profiles.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer is a bankruptcy-remote SPE under the Securitisation Law acquiring the securitised risk and transferring it to the investors, mainly through the issuance of debt financial instruments. Most SPEs in Luxembourg are unregulated.

2.2 Sponsors

The sponsor is the originator or other entity initiating and co-ordinating the securitisation process. For any securitisations falling within the scope of the Securitisation Regulation, a sponsor needs to be a credit institution or an investment firm.

2.3 Originators/Sellers

The originator/seller is an entity that has originated or was otherwise involved in the original agreement giving rise to the exposures being securitised or, alternatively, buys the relevant exposures on the secondary market with the intention to subsequently securitise them. Depending on the type of the securitised assets, the originator can be a credit institution, a trading undertaking, a manufacturer, an insurance company, etc. The originator/seller then transfers the assets or the economic interest pertaining to the assets to the SPE.

With regard to the securitisations falling within the scope of the Securitisation Regulation, an originator, the sponsor or the original lender of a securitisation (each as defined in the Securitisation Regulation) must comply with the risk retention requirements as described in Article 6 of the Securitisation Regulation.

2.4 Underwriters and Placement Agents

The underwriter (often an investment bank) serves as an intermediary between the issuer and the investors in an offering. The underwriter analyses investor demand, provides guidance on structuring the transaction and underwrites the notes.

2.5 Servicers

The servicer is in charge of collecting and enforcing the securitised receivables. This role is often performed by the originator, but other specialised service providers may also be appointed.

Currently, the securitisation undertaking may, according to the Securitisation Law, entrust the assignor or a third party with the collection of claims it holds as well as with any other tasks relating to the management thereof, without

such persons having to apply for an authorisation under the legislation on the financial sector.

Once Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers (the “NPL Directive”) is implemented, Luxembourg credit servicers of non-performing loans that fall within the scope of the NPL Directive will need to obtain a licence from the Luxembourg Supervisory Commission of the Financial Sector (CSSF).

2.6 Investors

Investors acquire the financial instruments issued by the SPE. The largest investors are usually foreign pension funds, insurance companies, investment funds and commercial banks.

2.7 Bond/Note Trustees

The trustees usually act on behalf of the investors under the securitisation documentation and are responsible for monitoring cashflows, the compliance by the SPE and the other obligors with the contractual obligations and facilitate the communication between the parties. The form of the trustee appointment (trust or agency) and the scope of its rights and obligations are determined in the securitisation documentation, commonly subject to foreign law.

The Securitisation Law also allows the appointment of a Luxembourg fiduciary representative entrusted with the management of the SPE’s investors’ interests. The fiduciary representative may also be granted a power to act in the investors’ interest in a fiduciary capacity, in which case the assets it acquires for the benefit of investors form a fiduciary estate separate from its own assets and liabilities.

2.8 Security Trustees/Agents

A security trustee/agent holds the collateral securing the SPE’s obligations on behalf of the investors and, in the default scenario, is responsible for its enforcement.

The form of the security trustee appointment (trust or agency) and the scope of its rights and obligations are determined in the securitisation documentation, commonly subject to foreign law.

The Collateral Law allows the collateral to be provided in favour of a person acting for the account of the beneficiaries of the collateral, a fiduciary or a trustee, without a need for a parallel debt or similar structures.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The form of documentation, as well as its principle subject matters are generally determined in accordance with the law applicable to the transfer instrument. This law would normally be chosen depending on the jurisdiction where the securitised assets and, where applicable, the underlying debtors are located. Most securitisations in Luxembourg involve assets located abroad, and hence their content would be determined by the chosen law and the market practice of the relevant jurisdiction.

Where Luxembourg assets are involved, Luxembourg law requirements with regard to the transfer of the title and the perfection of such transfer (depending on the types of the assets) would normally be included, as well as the customary representations and covenants with regard to

the status of the securitised assets, the underlying debtors, etc.

3.2 Principal Warranties

In practice, securitisation documents are rarely governed by Luxembourg law and the scope of the principal warranties would thus be determined by the applicable foreign law and market practice. Standard warranties generally cover the status of the parties, the validity and enforceability of the documents, as well as warranties with regard to the securitised assets.

From the Luxembourg perspective, the following matters are usually subject to specific warranties:

- the securitisation undertaking being an unregulated securitisation undertaking within the meaning of the Securitisation Law (see **4.4. Periodic Reporting**);
- management of assets in compliance with the Securitisation Law;
- separate treatment of assets allocated to different compartments, if applicable;
- the securitisation undertaking not being subject to the AIFMD and the AIFM Law; and
- the central administration and the centre of main interests (COMI) of an SPE being in Luxembourg.

Additional representations may be required in a securitisation transaction subject to the Securitisation Regulation.

3.3 Principal Perfection Provisions

Luxembourg law will be applicable with regard to the perfection of the transfer of, or a security interest over, Luxembourg assets (see **6.3 Transfer of Financial Assets**).

3.4 Principal Covenants

In practice, securitisation documents are rarely governed by Luxembourg law and the scope of the principal covenants would thus be determined by the applicable foreign law and market practice. From the Luxembourg perspective, the matters referred to in **3.2 Principal Warranties** would normally also be subject to the relevant covenants.

3.5 Principal Servicing Provisions

In practice, servicing documents are rarely governed by Luxembourg law and the scope of the relevant servicing provisions would thus be determined by the applicable foreign law. Usually, the standard provisions relating to the collection, enforcement and administration of the securitised assets, information obligations, and servicing fees are expected.

It is notable that the Securitisation Law expressly provides that, in the case of any insolvency proceedings opened with regard to the servicer, the SPE may claim any sums collected by the servicer on its behalf prior to the opening of the bankruptcy proceedings without other creditors having any rights to such amounts. It is currently unclear how this provision would be treated in insolvency proceedings opened outside Luxembourg.

3.6 Principal Defaults

In practice, securitisation documents are rarely governed by Luxembourg law and the scope of the relevant default provisions would thus be determined by the applicable foreign law and market practice. Non-payment, insolvency, a misrepresentation and a breach of other undertakings are the standard principal defaults.

3.7 Principal Indemnities

In practice, securitisation documents are rarely governed by Luxembourg law and the scope of the relevant indemnities provisions would thus be determined by the applicable foreign law and market practice.

3.8 Bonds/Notes/Securities

The acquisition of the securitised risks by a securitisation undertaking must generally be financed through the issuance of financial instruments (instruments financiers) or by contracting for the whole or part of any kind of loan, the value or yield of which is linked to such risks. Both debt and equity financial instruments can be issued for this purpose.

The financial instruments are as defined in the Collateral Law, which definition covers a broad range of instruments, whether they are in physical form, dematerialised, transferable by book-entry or delivery, bearer or registered, endorseable or not and regardless of their governing law.

Based on the above, the financing arrangements of an SPE may be documented either as securities (bond, notes) or as loans.

If governed by Luxembourg law, the terms and conditions of the financial instruments issued by an SPE would normally include the disbursement and repayment modalities, interest accrual provisions, representations and covenants, as well as standard limited recourse, non-petition and subordination provisions.

3.9 Derivatives

Investors may be using derivatives either to hedge risks (eg, interest rate or currency risks) or for investment purposes (eg, credit default swaps, total return swaps or credit linked notes).

3.10 Offering Memoranda

In Luxembourg, the securitisation undertaking offering its securities – or, where applicable, the entities distributing or placing such securities with investors – must ensure compliance with the restrictions deriving from the Prospectus Regulation and the Prospectus Law.

Pursuant to the Prospectus Regulation (and subject to the exemptions described below), no offer of debt securities may be made to the public in Luxembourg without the prior publication of a Prospectus Regulation-compliant prospectus. Such prospectus needs to comply with the information requirements set out in the Prospectus Regulation and in the Commission Delegated Regulation (EU) 2019/980 of 14 March 2019, including the relevant annexes.

The Prospectus Regulation provides that an offer of debt securities to the public is exempted from the obligation to publish a prospectus if:

- the offer is addressed solely to qualified investors, as defined in the Prospectus Regulation;
- the offer is addressed to fewer than 150 natural or legal persons per member state, other than qualified investors;
- the offer is addressed to investors who acquire debt securities for a total consideration of at least EUR100,000 per investor, for each separate offer; and
- the offered securities have a denomination per unit of at least EUR100,000.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Regarding transactions falling within the scope of the Securitisation Regulation, the latter imposes extensive transparency obligations on the originator, the sponsor and the securitisation special purpose entities (SSPEs, as defined in the Securitisation Regulation).

The Securitisation Regulation defines "securitisation" as a transaction or scheme whereby the credit risk associated with an exposure or a pool of exposures is tranched, having all of the following characteristics:

- payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures;
- the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme; and
- the transaction or scheme does not create exposures that possess all the characteristics listed in Article 147(8) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

The Securitisation Regulation requires that the holders of a securitisation position, the competent authorities and the potential investors (upon request) are provided with, inter alia:

- regular information on underlying exposures;
- prior to pricing, all underlying documentation that is essential for the understanding of the transaction, with an indicative list of the documents included in the Securitisation Regulation;
- prior to pricing, in the absence of a prospectus, a transaction summary or overview of the main features of the securitisation;
- regular investor reports; and
- any inside information and the significant events.

The originator, sponsor and SSPE must designate among themselves a reporting entity.

The Commission Delegated Regulation (EU) 2020/1224 of 16 October 2019 and the Commission Implementing Regulation (EU) 2020/1225 of 29 October 2019 are applicable with regard to the detailed disclosure requirements under the Securitisation Regulation, including various templates for the provision of information.

The Commission Delegated Regulation (EU) 2020/1226 of 12 November 2019 and the Commission Implementing Regulation (EU) 2020/1227 of 12 November 2019 are similarly applicable for the provision of information in accordance with the STS notification requirements.

4.2 General Disclosure Laws or Regulations

See **3.10 Offering Memoranda**.

4.3 Credit Risk Retention

Risk Retention

The Securitisation Regulation has replaced and consolidated risk-retention requirements formerly spread across various sectoral laws. Generally, the originator, sponsor or original lender in respect of a securitisation must retain, on an ongoing basis, a material net economic interest in the securitisation of not less than 5% of the

nominal value of the concerned exposures or, in the case of non-performing exposures (NPEs), where a non-refundable purchase price discount has been agreed, of the sum of the net value of the securitised exposures that qualify as NPEs and, if applicable, the nominal value of any performing securitised exposures. In addition, in an NPE securitisation, the servicer is allowed to take on the risk-retention slice. The Securitisation Regulation also includes an exhaustive list of acceptable risk-retention techniques.

Where the originator, sponsor or original lender has not agreed who will retain the material net economic interest, the latter must be retained by the originator. For the purposes of the risk-retention provisions set out in the Securitisation Regulation, an entity shall not be considered to be an originator where it has been established or operates for the sole purpose of securitising exposures.

The regulatory technical standards specifying in greater detail the risk-retention requirements for originators, sponsors, original lenders, and servicers are included in the Commission Delegated Regulation (EU) 2023/2175 of 7 July 2023.

Institutional investors investing in securitisation positions are required in the course of their mandatory due diligence to verify whether these risk-retention formalities have been complied with.

Enforcement of the Securitisation Regulation

The CSSF and the Luxembourg Authority for the Insurance Sector (CAA) (the latter only with regard to the entities generally submitted to its supervision) are the competent authorities in Luxembourg to ensure compliance by the originators, original lenders and SSPEs established in Luxembourg with Articles 6 to 9 of the Securitisation Regulation (ie, risk retention, transparency requirements, ban on re-securitisation and criteria for credit-granting), as well as with the simple, transparent and standardised (STS) securitisations framework.

The penalties for non-compliance with the above risk-retention requirements are set out in the SR Law. Pursuant to the SR Law, the CSSF and the CAA may, within their respective competences, impose administrative sanctions in the event of an infringement (ranging from a public statement regarding the identity of the infringing person and the nature of the infringement to a monetary fine).

The CSSF and the CAA also enjoy certain investigative powers and may refer information to the State Prosecutor for criminal prosecution.

4.4 Periodic Reporting

Statistical Reporting for All Securitisation Undertakings

All Luxembourg securitisation undertakings are subject to reporting obligations pursuant to Circular 2014/236 of the Luxembourg Central Bank (LCB) and Regulation (EU) No 1075/2013 of the European Central Bank (ECB) of 18 October 2013 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions, consisting of an initial registration obligation with the LCB, as well as ongoing reporting obligations (eg, liquidation or major changes in the information provided at the registration). Securitisation undertakings whose balance sheet exceeds certain thresholds will also need to comply with the periodic reporting obligations towards the LCB, including quarterly reports and monthly reports.

Pecuniary sanctions may be imposed on a defaulting SPE.

Reporting and Regulatory Requirements for Authorised Securitisation Undertakings

Securitisation undertakings subject to authorisation

Luxembourg SPEs issuing financial instruments to the public on a continuous basis must be authorised and supervised by the CSSF and must, among others, comply with certain reporting and regulatory requirements.

Financial instruments are deemed to be issued on a continuous basis if there are more than three issuances of financial instruments offered to the public during a financial year. For multi-compartments securitisation undertakings (see **6.2 SPEs**), this threshold is determined at the level of the securitisation undertaking on a consolidated basis, and not at the level of each compartment.

Public issuances are issuances of financial instruments:

- which are not intended for professional clients within the meaning of the 1993 Law (which corresponds to the definition of professional clients for MiFID II purposes);
- whose denominations are less than EUR100,000; and
- which are not distributed on a private placement basis.

Criminal sanctions and fines may apply in case an SPE issues financial instruments to the public on a continuous basis without having obtained a prior authorisation from the CSSF.

Reporting

Authorised securitisation undertakings are required, among others, to present to the CSSF a copy of the issue documents, a copy of the financial and auditor reports, as well as any information on the change of a service provider, or the amendment of any substantial provisions of a contract (including the terms of the issued financial instruments).

Additionally, authorised securitisation undertakings must provide to the CSSF, on a semi-annual basis, a report summarising new securities issuances, other upcoming issuances and the issuances matured during the relevant reporting period.

Finally, a draft balance sheet and profit and loss account of the securitisation undertaking (where applicable, by compartment) is to be provided within 30 days of the financial year close.

In case of a breach, the CSSF may impose upon the directors, managers, officers and liquidators of authorised securitisation undertakings a monetary fine.

4.5 Activities of Rating Agencies

Rating agencies are regulated by Regulation (EC) No 1060/2009 of 16 September 2009 on credit rating agencies, as amended (the "CRA Regulation"). The CRA Regulation aims to address, among others, the over-reliance on credit ratings by financial institutions, which are now required to make their own credit risk assessment and may not mechanistically rely on credit ratings, potential conflicts of interest involving the credit agency or its relating persons, as well as various disclosure obligations of the rating agencies.

It is noteworthy that with regard to securitisation instruments (ie, financial instruments or other assets resulting from a securitisation transaction or scheme, as defined in the Securitisation Regulation), the CRA Regulation establishes a requirement of a double credit rating. It also provides that the issuer of the securitisation instru-

ment must consider appointing at least one credit rating agency with no more than 10% of the total market share.

The CRA Regulation also sets out a number of requirements with regard to ratings on re-securitisations, notably a mandatory rotation of credit rating agencies issuing ratings on re-securitisations with underlying assets from the same issuer every four years.

ESMA is in charge of the supervision of credit rating agencies and may impose pecuniary penalties on infringing credit rating agencies. The CSSF and the CAA are the competent authorities in Luxembourg for the purposes of implementing the CRA Regulation and verifying compliance with the obligations arising from this regulation by the entities subject to their respective supervision.

4.6 Treatment of Securitisation in Financial Entities

The CRR II and CRD V set out a legal framework with regard to the prudential regulation of credit institutions and investment firms in the EU and provide, inter alia, for capital requirements (including capital adequacy calculation methodology), disclosure obligations and operational requirements for entities holding securitisation exposures.

CRD V has been transposed and CRR II has been implemented in Luxembourg by the Law of 20 May 2021.

Solvency II is applicable with regard to solvency capital requirements pertaining to securitisation positions held by insurance and re-insurance undertakings.

As most securitisation transactions in Luxembourg involve originators and investors located outside Luxembourg, local capital adequacy laws applicable to such originators and investors need to be considered.

4.7 Use of Derivatives

EMIR is directly applicable in Luxembourg. EMIR also applies to non-financial counterparties, which are very broadly defined. The CSSF confirmed in its press release 13/26 dated 24 June 2013 that securitisation undertakings are also covered, and may therefore be subject to EMIR obligations (notably clearing and reporting obligations).

EMIR has been implemented in Luxembourg by the Law of 15 March 2016 on OTC derivatives, central counterparties and trade repositories, in respect of the sanctioning powers granted to the CSSF to guarantee the correct application of rules and requirements deriving from EMIR.

4.8 Investor Protection

The Securitisation Regulation and the Securitisation Law ensure a high degree of investor protection.

Aside from the stringent disclosure and reporting requirements (see **4.1 Specific Disclosure Laws or Regulations**), the Securitisation Regulation imposes a wide array of other requirements aiming to ensure adequate investor protection.

- The risk-retention rules (see **4.3 Credit Risk Retention**) aim to eliminate a potential conflict of interest by aligning the incentives of the originator with the incentives of an SSPE (and, ultimately, the investors).
- The credit-granting requirements imposed on the originators, sponsors and original lenders

aim to ensure the quality of the securitised assets.
- Institutional investors are subject to rigorous due diligence requirements. In particular, the investors must, among others:
  (a) verify the credit-granting criteria of the originator or original lender and their internal processes and systems, where such originator or lender is not a credit institution or an investment firm established in the European Union;
  (b) verify that the originator, sponsor or original lender complies with the risk-retention and transparency requirements;
  (c) carry out a due diligence assessment of the risk characteristics of the individual securitisation position and of the underlying exposures, etc; and
  (d) have written procedures in place in order to monitor compliance with the above obligations and the performance of the investment and underlying exposures, and perform regular stress tests, etc.

In Luxembourg, the Securitisation Law ensures the bankruptcy remoteness of a securitisation undertaking and legal certainty with regard to the standard contractual tools used in securitisation deals, such as non-petition, limited recourse and subordination provisions (see **6.2 SPEs** and **6.5 Bankruptcy-Remote SPE**).

Please see **4.4 Periodic Reporting** and **4.2 General Disclosure Laws or Regulations** in relation to additional reporting and disclosure rules in Luxembourg.

The Securitisation Regulation aims to protect retail investors by including certain restrictions with regard to the sale of securitised positions to retail clients, including a requirement to perform a suitability test in accordance with Article 25(2) of MiFID II. Additionally, in the case of offerings made to retail investors, a key information document may need to be prepared, in accordance with Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products. Finally, MiFID II contains a number of requirements aiming to protect investors, including product governance, information and record-keeping.

4.9 Banks Securitising Financial Assets

See **4.6 Treatment of Securitisation in Financial Entities**.

Additionally, the Luxembourg Law of 8 December 2021 implementing the EU's Covered Bonds Directive (EU) 2019/2162 (the "Covered Bonds Law") regulates the issue of covered bonds (*lettres de gage*). Although the existing framework under the 1993 Law already provides for a special covered bonds regime for Luxembourg mortgage banks (*banques d'emission de lettres de gage*), the Covered Bonds Law also allows the issuance of covered bonds by the standard banks without requiring a specialised licence for this purpose.

Luxembourg banks (including mortgage banks) are supervised by the CSSF and are subject to certain activity restrictions and other requirements under the 1993 Law and the Covered Bonds Law, including a mandatory over-collateralisation ratio.

4.10 SPEs or Other Entities

Securitisation Criteria

In order to benefit from the regime under the Securitisation Law, it is necessary that:

- the Luxembourg securitisation undertaking (also referred to here as an SPE) submits itself to the provisions of the Securitisation Law

in its articles of incorporation, management regulations or issue documents; and
- the transaction satisfies the substantive criteria of the securitisation set out in the Securitisation Law.

Regarding the second condition, the Securitisation Law defines a securitisation as a transaction by which a securitisation undertaking (i) acquires or assumes, directly or indirectly through another undertaking, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties, and (ii) issues financial instruments or contracts for the whole or part of any kind of loan, the value or yield of which depends on such risks.

Despite this very broad definition, the CSSF clarifies in its guidelines on securitisation dated 23 October 2013 (the "Securitisation FAQ") that the main purpose of a securitisation transaction under the Securitisation Law must be an economic "transformation" of certain risks into securities and that the parties should comply with the legal definition of securitisation and the spirit of the law.

Legal Form

In Luxembourg, a securitisation undertaking governed by the Securitisation Law can be set up as a company or fund.

A securitisation company is subject to the general corporate framework under the Companies Law and can take the form of:

- a public limited company (*société anonyme*, or SA);
- a private limited company (*société à responsabilité limitée*, or Sàrl);
- a partnership limited by shares (*société en commandite par actions*, or SCA);
- a co-operative organised as a public limited company (*société cooperative organisée sous forme de société anonyme*);
- a general corporate partnership/unlimited company (*société en nom collectif*);
- a common limited partnership (*société en commandite simple* or SCS);
- a special limited partnership (*société en commandite spéciale* or SCSp); or
- a simplified company limited by shares (*société par action simplifiée*).

The possibility to establish a securitisation undertaking as an SCS or an SCSp provides for structuring opportunities for securitisation transactions, given the (in principle) tax-transparent nature of such partnerships.

A securitisation undertaking can also be set up as a fund (*fonds de titrisation*), managed by a Luxembourg-based management company (*société de gestion*) in accordance with its management regulations. A securitisation fund does not have legal personality and can be structured as (i) a co-ownership of assets or (ii) as a fiduciary arrangement where the assets are held by the management company acting as fiduciary for the account of the investors.

Securitisation funds and securitisation companies are required to be registered with the Luxembourg Register of Commerce and Companies (RCS).

Please also see **6.2 SPEs** for the compartmentalisation option of Luxembourg securitisation undertakings.

AIFMD

AIFMD and AIFM Law address the question of whether an SPE can be considered as an alternative investment fund (AIF).

Pursuant to the AIFMD and the AIFM Law, an SSPE does not constitute an AIF. However, the definition of an SSPE under the AIFMD is different from the definition of an SSPE under the Securitisation Regulation. SSPEs are defined in the AIFMD as entities whose sole purpose is to carry on a securitisation or securitisations within the meaning of Regulation ECB/2008/30 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions and other activities that are appropriate to accomplish that purpose. Regulation ECB/2008/30 has been repealed by Regulation ECB/2013/40.

According to the Securitisation FAQ (with reference to the guidance note on the definitions of "financial vehicle corporation" and "securitisation" under Regulation ECB/2008/30 issued by the ECB), securitisation undertakings issuing collateralised loan obligations are considered as being engaged in securitisation transactions and, as a result, are not subject to the AIFM Law. In contrast, entities that primarily act as "first" lenders (ie, originating new loans) are not considered as being engaged in securitisation transactions and will thus fall within the scope of the AIFM Law. The same applies to securitisation undertakings issuing structured products that primarily offer a synthetic exposure to assets other than loans (non-credit-related assets) and where the credit risk transfer is only ancillary.

Independently from their potential qualification as SSPEs (for the purpose of the AIFMD), securitisation undertakings that only issue debt instruments should not, according to the Securitisation FAQ, constitute AIFs for the purpose of the AIFM Law. Similarly, irrespective of whether securitisation undertakings qualify as SSPEs for the purpose of the AIFMD, it is the view of the CSSF that securitisation undertakings that are not managed in accordance with a "defined investment policy" (within the meaning of the AIFM Law) do not constitute AIFs.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Public Issuance of Financial Instruments

A securitisation undertaking issuing securities to the public on a continuous basis within the meaning of the Securitisation Law (see **4.4 Periodic Reporting**) will be subject to authorisation and prudential supervision by the CSSF.

Please see **4.10 SPEs or Other Entities** with regard to the application of the AIFMD and the AIFM Law to the securitisation undertakings.

Passive Management

While the Securitisation Law permits any kind of assets to be securitised, the nature of securitisation transactions requires that the securitised risks stem exclusively from the assets acquired or assumed by a securitisation undertaking in the course of the securitisation and not from any entrepreneurial or commercial activity of the securitisation undertaking. Thus, Luxembourg securitisation undertakings must generally have a passive attitude when managing their assets. This rule is not applicable to undertakings securitising debt securities, debt financial instruments and receivables, provided that the securitisation undertakings do not issue financial instruments to the public. The role of the securitisation undertakings investing in non-debt assets should be limited to the administration of financial flows linked to a securitisation transaction

itself and to the "prudent-man" management of the securitised risks, and exclude all activities likely to qualify the securitisation undertaking as entrepreneur. Any management of such assets by the securitisation undertaking that creates increased risk in addition to the risk inherent thereto or which aims to create additional wealth or promote the commercial development of the securitisation undertaking's activities would be incompatible with the Securitisation Law, even if the actual management had been delegated to an external service provider.

Loan Origination

Loan origination by a Luxembourg SPE is also restricted. Structures originating loans instead of acquiring them on the secondary market may fall under the definition of securitisation, provided that the securitisation undertaking does not finance its loan origination activity from the funds raised from the public and that the issuance documentation either clearly defines the assets servicing the repayment of the loans originated by the SPE or clearly describes the borrowers and/or the borrower selection criteria, as well as information on characteristics of the loans granted.

Assignment of Assets and Granting of Security Interests

A securitisation undertaking cannot assign its assets, except in accordance with the provisions set forth in its constitutional or issuance documents. It may only grant security interests over its assets in order to secure the obligations that are related to the securitisation transaction.

4.12 Participation of Government-Sponsored Entities

Luxembourg is not known to participate in the securitisation market through government-sponsored entities.

4.13 Entities Investing in Securitisation

The vast majority of securitisation undertakings in Luxembourg are not regulated and, as a result, they usually target investors that are "professional clients" for the purposes of MiFID II, including credit institutions and investment funds.

In most cases, the investors in Luxembourg securitisation transactions are located abroad. Luxembourg does not impose any additional obligations in terms of such investors, but they must comply with their local rules and regulations (eg, diversification and capital adequacy rules).

Please see **4.8 Investor Protection** concerning the restrictions on the sale of securitisation positions to retail clients under the Securitisation Regulation.

Institutional investors investing in securitisation positions under the Securitisation Regulation are subject to the mandatory due diligence requirements. Please see **4.8 Investor Protection** for more details.

4.14 Other Principal Laws and Regulations

There are no further details to add on any principal laws and regulations mentioned in **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisation (where only the risk but not the title to the assets is transferred) is permitted in Luxembourg and is governed by the same legal framework as traditional securitisation; that

is, mainly the Securitisation Law and the Securitisation Regulation. The Securitisation Regulation generally recognises synthetic securitisations, and such securitisations can, in principle, benefit from the STS label, provided they meet certain criteria (including relating to simplicity, transparency, standardisation etc).

Synthetic securitisations involving the use of derivatives may be subject to EMIR (see **4.7 Use of Derivatives**).

The Securitisation Law provides expressly that securitisation transactions falling within its scope do not constitute activities subject to the Luxembourg Law of 7 December 2015 on the insurance sector. For this reason, there is no risk in Luxembourg that certain synthetic securitisation structures would trigger the licensing requirements under the insurance legislation.

Synthetic securitisation structures in Luxembourg are usually set up with the involvement of an SPE, which would enter into a derivative contract or a guarantee with the counterparty. Similarly to a traditional securitisation, the securitisation undertaking would then issue financial instruments to the investors and use the proceeds of the issuance to fund its obligations under such derivative contract or a guarantee and to collateralise such obligations.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Luxembourg SPEs are subject to the general insolvency regime set out in the Luxembourg Commercial Code. The main risk associated with insolvency proceedings initiated in Luxembourg is the claw-back of the assets transferred to the SPE in the course of the securitisation.

Regarding the qualification (and, consequently, potential recharacterisation) of the legal nature of the transfer of the securitised assets as a "true sale" or a secured loan, this is, in principle, determined in accordance with the laws applicable to the transfer instrument and the underlying assets. As, in practice, transfer documents and underlying assets are typically not governed by Luxembourg law, the qualification of the transfer as a true sale or a secured loan is most often a matter of foreign law.

Irrespective of the law applicable to the transfer, the Securitisation Law provides expressly that an SPE's obligation to reassign the securitised claims back to the transferor included in the securitisation documents may not give basis for the requalification of the assignment and the risk that the assignment would be considered as a secured loan is thus limited as a matter of Luxembourg law.

Similarly, foreign law would usually also apply with regard to the grounds for the claw-back of the assets transferred to the SPE, as the originators and sellers in a securitisation transaction are normally located outside Luxembourg. Where Luxembourg law does apply, certain transactions entered into, or payments made, during the pre-bankruptcy hardening period (which is of a maximum of six months and ten days preceding the bankruptcy judgment, except in the case of fraud, where no time limit is applied) could be clawed back. For example:

- any transfer of assets made without consideration or for an inadequate consideration;
- any payment of debt that has not fallen due, as well as any payment of due debt if made

by any means other than in cash or by bill of exchange; and

- any other payment of due debt or any other act made by the insolvent company after it has ceased payments to its creditors (such cessation of payments being one of the bankruptcy criteria in Luxembourg), if the counterparty was aware of such cessation of payment.

The Securitisation Law excludes the claw-back risk in relation to security interests granted by the SPE no later than the time of issuance of the financial instruments or the conclusion of the agreements secured by such security interests, notwithstanding the security interests being extended to new assets or claims.

The Securitisation Law seeks to mitigate the risk of bankruptcy by recognising standard non-petition, limited recourse and subordination provisions included in the documentation governing the securitisation transaction (please see **6.5 Bankruptcy-Remote SPE**) that are meant to exclude the occurrence of the bankruptcy proceedings in the first place.

On 1 November 2023, the new Reorganisation Law entered into force. It provides for a new legal framework allowing a Luxembourg debtor claiming that the continuity of its business is threatened (whether in the short or long run) to benefit from a set of tools and procedures that would enable it to preserve its business and avoid bankruptcy, including in-court and out-of-court reorganisation, and court-sanctioned stay of enforcement proceedings. The Reorganisation Law is applicable to securitisation companies and partnerships but not to the securitisation undertakings governed by the Securitisation Law that issue financial instruments to the public on a continuous basis. The Reorganisation Law is not applicable to the financial collateral arrangements under the Collateral Law and such arrangements shall remain enforceable in accordance with their terms.

6.2 SPEs

Securitisation transactions in Luxembourg are usually structured to avoid a potential bankruptcy of the SPE. For this purpose, securitisation undertakings are normally set up under – and need to comply with – the Securitisation Law to be able to benefit from its protection.

Structurally, securitisation undertakings are normally set up to eliminate any corporate connection with the originator in order to avoid a potential consolidation for the purpose of any bankruptcy, accounting or tax laws. For this reason, shares in an SPE would generally be held by an orphan; for example, a Dutch foundation (*stichting*) or an Anglo-American charitable trust.

In Luxembourg, it is also possible to set up a compartmentalised SPE, as a result of which the estate of the SPE would effectively be segregated into different compartments, each representing a distinct part of the assets and liabilities of the securitisation undertaking, ring-fenced by law, including in the event of its bankruptcy.

Certain investors also require the appointment of an independent director on the board of the SPE.

The recourse rights of the creditors are, as a rule, limited to the assets of the SPE. Where such rights relate to a specific compartment, the recourse of the relevant creditors is then limited to the assets of that compartment.

6.3 Transfer of Financial Assets

The validity, enforceability and perfection of the transfer of financial assets are a matter of the applicable law determined pursuant to the Luxembourg conflict of law rules, which, in turn, depend on the types of assets being transferred.

Conflict of Law Rules

In regard to the assignment of, or security over, receivables, Article 14 of the Rome I Regulation provides that:

- the relationship between the assignor/security provider and the assignee/security taker is governed by the law applicable to the agreement between such parties; and
- the law governing the underlying claims determines (i) the question of whether that claim can be assigned or made subject to a security interest, (ii) the relationship between the assignee/security taker and the debtor, (iii) the conditions under which the granting of an assignment of, or a security interest over, that claim can be enforced against the debtor, and (iv) the question of whether the debtor's obligations under that claim have been paid and discharged in full.

The Securitisation Law also contains certain conflict-of-law rules applicable in securitisations. In particular, and in line with Article 14 of the Rome I Regulation, the following matters are subject to the law governing the receivable:

- the transferrable nature of the receivable;
- the relationship between the transferee and debtor;
- the conditions of effectiveness of the transfer against the debtor; and
- the satisfactory nature of the payment made by the debtor.

While Article 14 of the Rome I Regulation does not provide for any conflict-of-law rules in relation to the enforceability of an assignment of receivables vis-à-vis third parties, the Securitisation Law states explicitly that it is the law of the location of the transferor that governs the effectiveness of the assignment towards third parties. This solution offered by the Securitisation Law is consistent with the approach adopted in the EU Commission proposal of 12 March 2018 for a regulation on the law applicable to the third-party effects of assignments of claims (the "Proposal"). According to the Proposal, the third-party effects of an assignment of receivables would be subject to the law of the country in which the assignor has its habitual residence.

Regarding assets other than receivables, the creation, perfection and enforcement of a security interest over, or transfer of, assets is governed by the law where such asset is located, notwithstanding the contractual choice of the parties.

In practice, the originators, sellers and securitised assets are prevailingly located abroad and thus the perfection of the transfer of (or the security interest over, as the case may be) such assets would not be governed by Luxembourg law.

Luxembourg Perfection Requirements

Where Luxembourg law applies, perfection requirements depend on the type of the relevant financial asset. Regarding the receivables, the assignment of an existing claim to or by an SPE becomes effective both between the parties and against third parties as from the moment the assignment is agreed on (unless agreed otherwise). While the assignment of a future claim is conditional on it coming into existence, as soon as the claim does come into existence, the assignment becomes effective between the par-

ties and against third parties as from the moment the assignment is agreed on (unless agreed otherwise) despite the opening of bankruptcy proceedings or any other collective proceedings against the assignor, even if such proceedings are opened before the date on which the claim comes into existence.

The Securitisation Law does not require notification of the assigned debtor for the purpose of the perfection of the assignment. Nevertheless, the debtor can validly discharge its obligations to the transferor if it has not become aware of the transfer. A transfer of receivables entails a transfer of any related guarantees and/or security interests and its enforceability by operation of law against third parties, without any further formalities.

In the case of other assets, it is recommended to assess the relevant perfection requirements on a case-by-case basis, depending on the type of the asset.

As described in **6.1 Insolvency Laws**, the qualification of a transaction as a true sale or a secured loan would normally be subject to the laws governing the sale agreement (which is, in turn, generally chosen based on the location of the assets to be transferred). As the securitised assets are rarely located in Luxembourg, foreign law would usually be applicable to such determination.

Where Luxembourg law does apply, the court would normally look at the economic substance of the transaction and the intention of the parties, as determined based on the available evidence. Unfortunately, there is little to no case law in Luxembourg, which would set the precise criteria. The Securitisation Law provides expressly that an SPE's obligation to reassign the securitised claims back to the transferor included in the securitisation documents may not give basis for the requalification of the assignment and the risk that the assignment would be regarded as a secured loan is thus limited.

As the qualification of the sale agreement is rarely a matter of Luxembourg law, true sale opinions are uncommon in Luxembourg and the practitioners would instead normally opine on the enforceability of the foreign-law judgments made with regard to such agreements.

6.4 Construction of Bankruptcy-Remote Transactions

A Luxembourg SPE governed by the Securitisation Law can also hold the securitised assets as a fiduciary for the investors, under the Fiduciary Law. A Luxembourg fiduciary arrangement (*fiducie*) results in a separate fiduciary estate distinct from the personal estate of the fiduciary (or other fiduciary estates held by such fiduciary) and the assets forming part of the fiduciary estate can be seized only by the creditors whose rights relate to such estate, including in the case of bankruptcy or liquidation of the fiduciary.

Given that bankruptcy remoteness is mostly a factual matter, Luxembourg opinions would normally be issued only with regard to the validity of the non-petition, limited recourse and subordination provisions.

6.5 Bankruptcy-Remote SPE

As mentioned in **6.2 SPEs**, securitisation undertakings need to be set up under – and need to comply with – the Securitisation Law to be able to benefit from its protection.

As bankruptcy remoteness is mostly a factual matter, the following criteria generally need to be satisfied (and the relevant provisions are included as standard in the issuance and corporate

documentation of an SPE) for an SPE to be sufficiently protected against the risk of bankruptcy:

- restrictions on corporate object and activities in the articles of association of the SPE and in the issuance documents are meant to ensure that the SPE will not engage in any transactions other than the relevant securitisation transaction;
- debt limitation provisions in the issuance documents are meant to limit the number of creditors that may potentially file for insolvency of the SPE;
- independent directors and separateness covenants in the securitisation documents are meant to mitigate the risk of potential consolidation of the SPE with any other entity (including the originator); and
- security interests over the securitised assets of the SPE are meant to give the investors a priority over such assets vis-à-vis other creditors.

The securitisation documentation and/or the constitutional documents of an SPE would usually also include standard non-petition, limited recourse and subordination provisions, which are expressly recognised by the Securitisation Law. Any proceedings initiated in front of a Luxembourg court in breach of non-petition provisions will be declared inadmissible.

The Securitisation Law includes statutory subordination rules that determine the rank of various instruments that can be issued by an SPE. This order of priority may be overridden by the constitutional documents of, or any agreement entered into by, the SPE and any proceedings initiated in breach of either such default waterfall, or the overriding provisions, will be declared inadmissible.

7. Tax Laws and Issues

7.1 Transfer Taxes

There is in principle no Luxembourg stamp duty or registration tax on the transfer of financial assets, unless such transfer would be made by means of notary deed or the transfer agreement would be voluntarily registered in Luxembourg (or annexed to a document that is subject to mandatory registration).

7.2 Taxes on Profit

A securitisation company is a regular taxable entity liable for corporate income tax and municipal business tax on its income. However, commitments to investors are deductible from its tax base, resulting in the company being virtually tax neutral.

An attention point, though, arises where the securitisation company earns taxable income other than interest income (eg, gains on discounted/distressed debt): in such case, the deductibility of interest might be capped under the interest deduction limitation rule, which may cause tax leakage.

While the anti-hybrid rules are generally not expected to affect securitisation companies, their impact should still be monitored on a case-by-case basis.

A securitisation undertaking in the form of a tax transparent entity is not liable for corporate income tax and, provided it does not conduct a business (which it should normally not), also not liable for municipal business tax.

7.3 Withholding Taxes

Income received by a securitisation undertaking may be subject to withholding tax in the source country.

A Luxembourg securitisation company (contrary to a tax transparent entity) qualifies as resident for tax treaty purposes. Whether it is effectively eligible to treaty benefits will depend on the perspective of the source jurisdiction.

There is, in principle, no Luxembourg withholding tax on interest payments made by an SPE.

7.4 Other Taxes

Management services provided to a securitisation undertaking benefit from a VAT exemption and VAT leakage is therefore reduced to a minimum. If they are specific and essential to the management of the securitisation undertaking, collateral management fees and investment advisory fees may be considered to be covered by this exemption. Subscription, underwriting and placement fees may also be VAT exempt, based on the general exemption of fees on the negotiation of securities.

A securitisation company qualifies, per se, as a VAT-taxable person in Luxembourg. As a result, the securitisation company must register for VAT if it receives services from non-Luxembourg service suppliers in order for it to self-assess the Luxembourg VAT (in the absence of a general exemption for such services).

A securitisation company is liable for minimum net wealth tax, which in the majority of cases amounts to EUR4,815.

7.5 Obtaining Legal Opinions

Tax opinions are rarely requested in the context of a securitisation transaction. Topics covered would relate to the income tax and net wealth tax position of the SPE, and possibly the VAT position. Assumptions and qualifications would then notably cover (i) the nature of income of the SPE, (ii) the ongoing compliance of the SPE with all of its obligations under the securitisation law and (iii) an exclusion of abuse of law and EU state aid law considerations.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

All SPEs have to prepare and publish annual accounts.

The annual accounts and financial statements of both regulated and unregulated SPEs have to be audited by one or more approved Luxembourg independent auditors (*réviseurs d'entreprises agréés*). In case of a multi-compartment SPE, each compartment will have to be separately detailed in the financial statements of the SPE.

The Securitisation Law allows multi-compartment SPEs that are financed by equity, to approve the balance sheet and the profit and loss statement of each compartment by virtue of the votes of such compartment's shareholders only, provided that such option is included in their articles of association. Similarly, the articles of association of an SPE may provide that profits, distributable reserves and mandatory legal reserves of a compartment, are determined on a separate basis and without reference to the financial situation of the SPE as a whole.

Also, to provide investors with an adequate overview, the CSSF recommends that the valuation of the underlying assets is to be carried out at fair value.

In practice, the originators are generally located outside Luxembourg and, for this reason, the balance sheet treatment of the transfer of securitised assets and the questions of consolidation

would normally be dealt with by the accountants in the jurisdiction of the originator.

8.2 Dealing with Legal Issues

In Luxembourg, legal opinions do not generally cover accounting issues.

Trends and Developments

Contributed by:
Andreas Heinzmann, Manuel Fernandez, Valerio Scollo and Katharina Schramm
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Authors

Andreas Heinzmann is a partner in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in securities law, capital markets regulation and international banking work. He advises banks, financial institutions and corporates on the issue of debt and equity securities, including stock exchange listings, securitisations, repackagings, high-yield bonds, structured products and derivatives, and publishes regularly in this field of expertise. He is a member of working groups on securitisation organised by bodies of the financial industry in Luxembourg.

Manuel Fernandez is a partner in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in securities law and capital markets regulation. He advises banks, financial institutions and corporates on the issue of debt and equity securities, including stock exchange listings, securitisations, repackagings, high-yield bonds, structured products and derivatives, related regulatory matters and related litigations.

Contributed by: Andreas Heinzmann, Manuel Fernandez, Valerio Scollo and Katharina Schramm, **GSK Stockmann SA**

Valerio Scollo is a partner in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in securities law, capital markets regulation and international banking work. He advises banks, financial institutions, corporates and insurance companies on the issue of debt and equity securities, securitisations, repackagings, high-yield bonds, structured products and derivatives, and related regulatory matters.

Katharina Schramm is a senior associate in the banking and capital markets group of GSK Stockmann in Luxembourg and specialises in banking law, securities law, capital markets regulation and corporate laws. She advises banks, financial institutions and corporates on the issue of debt and equity securities, including stock exchange listings, securitisations, repackagings, high-yield bonds, structured products and derivatives, and related regulatory matters.

GSK Stockmann

44, Avenue John F. Kennedy
L-1855
Luxembourg

Tel: +352 271802 00
Fax: +352 271802 11
Email: luxembourg@gsk-lux.com
Web: www.gsk-lux.com

Contributed by: Andreas Heinzmann, Manuel Fernandez, Valerio Scollo and Katharina Schramm,
GSK Stockmann SA

Introduction

The EU Commission has recognised that securitisations are an important component of well-functioning financial markets, since they contribute to diversifying financial institutions' funding sources and releasing regulatory capital that can be reallocated to support further lending. Furthermore, securitisations provide financial institutions and other market participants with additional investment opportunities, thus allowing portfolio diversification and facilitating the flow of funding to businesses and individuals, both within member states and on a cross-border basis throughout the EU.

Important institutions in the ESG sector, such as the European Investment Fund in Luxembourg, are making good use of securitisation techniques to fulfil their mandate and to balance the allocation of risk assumed by them and the provision of direct or indirect funding to banks, corporates or investment funds within the EU.

Since the adoption of the Luxembourg Law of 22 March 2004 on securitisation undertakings in 2004, as amended from time to time (the "Former Securitisation Law") which was last amended by the new law dated 25 February 2022, applicable as of 8 March 2022 (the "New Securitisation Law", together with the Former Securitisation Law referred to as the "Securitisation Law"), Luxembourg has been a very active market for the setting up of securitisation vehicles and the structuring of securitisation transactions, and has become one of the major hubs for securitisation transactions in Europe. The Securitisation Law is very flexible and allows any type of securitisation transaction, with private placement or offer to the public, true sale or synthetic, tranched or untranched. Securitisation vehicles may be regulated or unregulated and can create compartments to ring-fence the assets and liabilities of a securitisation transaction from those of other transactions of the same securitisation vehicle. Of more than circa 1,500 securitisation vehicles (more than 6,000 compartments) active in Luxembourg as of today, only 28 are regulated.

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 (the "EU Securitisation Regulation") is further mitigating the negative perception caused by the 2008 financial crisis. In accordance with the EU Securitisation Regulation, a securitisation vehicle can issue senior and junior tranches of notes, each having a different risk profile triggering risk-retention requirements and reporting obligations towards the regulator in Luxembourg.

Synthetic Securitisation of Loan Portfolios

In a synthetic securitisation transaction, the originator is seeking credit protection via the use of credit derivatives in respect of the assets to be transferred but without selling that asset to the securitisation vehicle. A true sale of the assets is, in general, not possible due to the regulatory framework applicable to the originators, which are often regulated financial institutions, such as banks.

Generally, the originator, as protection buyer, transfers the credit risk in respect of a portfolio of loans to the securitisation vehicle as protection seller. While the credit risk in respect of the portfolio's assets is transferred, the legal ownership of that portfolio remains with the originator. Credit risk can be transferred via a multitude of derivative instruments embedded, for instance, in credit-linked notes, whereby the originator issues credit-linked notes to the securitisation

vehicle, which assumes the risk of a default in respect of the underlying risk. Further, the risk can also be transferred by way of a credit default swap or other complex credit derivative transactions.

In addition, the securitisation vehicle can enter into a collateral agreement with the originator and guarantee any failure to pay of the originator in connection with a portfolio of reference obligations. The originator will pay a fee to the securitisation vehicle for entering into the collateral agreement and to provide credit protection. Typically, the securitisation vehicle will provide a cash deposit to the originator, funded by the issue proceeds derived from the issue of securities by the securitisation vehicle to investors, which ultimately will bear the risk of the underlying loan portfolio. The main purpose of the collateral agreement is to achieve a better regulatory capital treatment for the originator.

Even though the Securitisation Law clarifies that transactions qualifying as securitisations under the Securitisation Law do not qualify as activities that are subject to the legal framework applying to the insurance sector, there have been discussions in the Luxembourg legal literature (as well as Belgian and French legal literature, to which Luxembourg courts tend to turn) as to whether the provision of credit protection by the use of credit derivatives or a guarantee could be recharacterised as an insurance contract. Without going into the details of the main difference between an insurance contract and a credit derivative or a guarantee, there are strong arguments in support of the proposition that these instruments would not be considered as insurance contracts under Luxembourg law.

This position was further strengthened by the adoption of the Luxembourg Law on professional payment guarantees dated 10 July 2020 (the "Professional Guarantee Law"), which introduced a special regime for personal securities (*sûretés personnelles*) providing for a payment obligation and granted in a professional context.

The professional guarantee (the "Professional Guarantee") is defined as an arrangement by which the guarantor undertakes towards a beneficiary to pay, at the request of the beneficiary or of an agreed third party, a sum determined in accordance with the specific terms in relation to one or more claims or the risks associated with them. The Professional Guarantee may be granted by any person, including an individual, in a professional context.

As stated above, there were discussions as to whether the granting of a guarantee in the context of a synthetic securitisation, in which credit risk of loss is transferred by using such an instrument, could constitute an insurance contract and hence a regulated insurance activity carried out by a securitisation vehicle. With the adoption of the Professional Guarantee Law, there are now further arguments, strengthening the view that such a guarantee will not qualify as an insurance contract under Luxembourg law.

Provision of Loans

The granting of loans as a business is heavily regulated in Luxembourg in accordance with the Law of 5 April 1993 on the financial sector, as amended (the "Financial Sector Law"). Professional lenders must either hold a banking licence or hold a licence as a professional of the financial sector carrying out lending operations. The main difference between a licensed bank and a licensed professional carrying out lending operations is that the latter is not allowed to take deposits or other repayable funds from the pub-

lic; ie, its lending activity is financed by its own funds and borrowing from affiliates and banks.

The capital requirements imposed on banks following the financial crisis in 2008 have been, in part, considered as having contributed to the reduction of the lending activities of certain EU banks. The reduction of bank lending has led to a gap in available bank funding for the EU economy. Therefore, the EU has aimed at fostering lending solutions to spur growth within the EU. One of the tools to pursue this goal was the promotion of a label of "high-quality securitisation" under the EU Securitisation Regulation, also for the purpose of achieving a Capital Markets Union (CMU) so that securitisation is recognised again as a tool to diversify the sources of financing for the real economy.

Undertakings qualifying under the Securitisation Law are expressly excluded from the scope of the Financial Sector Law, similar to alternative investment funds qualifying under Directive 2011/61/EU of the European Parliament and the Council of 8 June 2011 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 (AIFMD).

Securitisation vehicles can therefore, in principle, act as first lenders but are not permitted to arrange loans. This means that securitisation undertakings may, in principle, act as lenders and provide loans to corporate borrowers provided they do not carry out a credit activity on their own account and do not raise funds from the public. Further, the loan agreement must not have been negotiated by, or on behalf of, the securitisation vehicle. The latter is in line with the general idea of passive management, save for the active management of securitised assets in certain types of transactions as now allowed under the New Securitisation Law, of the assets allocated to a securitisation vehicle and that a securitisation vehicle should not itself create the risk pertaining to a loan origination, such as the identification and screening of the borrowers, the credit risk assessment and the negotiation of the loan agreement.

The documentation relating to a securitisation vehicle acting as first lender must therefore either clearly define the assets on which the service and the repayment of the loans granted by the securitisation vehicle will depend, or clearly describe the borrower(s) and/or the criteria according to which the borrowers will be selected, so that the investors are adequately informed of the risks, including the credit risks and the profitability of their investment at the time securities are issued by the securitisation vehicle.

According to a guidance note of the European Central Bank, which is relevant to assess the qualification of a securitisation under the Alternative Investment Fund Managers Directive (AIFMD), securitisation transactions may consist of the "adhesion by the purchaser to a set of predetermined terms that are identical or essentially similar to those on offer to other investors", such as participation in a loan syndication, unless the vehicle has underwriting responsibilities.

Tokenisation of Securities

Luxembourg has taken important steps to promote the digitalisation of the capital markets and introduced a "digital" security alongside the existing framework applicable to bearer, registered and dematerialised securities. The Luxembourg Law of 1 March 2019 (the "Blockchain Law I") established that a security token held via digital ledger technology such as blockchain

qualifies as a security and satisfies the criteria of being a transferable and negotiable instrument. Similarly to securities cleared via clearing systems, the Blockchain Law I recognises that transfers of securities are perfected by registration in the relevant account held on a blockchain.

The Luxembourg Law of 22 January 2021 (the "Blockchain Law II") brings additional improvements to the fintech legal framework in Luxembourg and bridges a gap regarding the regulation of dematerialised securities in Luxembourg. The Blockchain Law II allows investment firms and credit institutions to hold and manage securities issuance accounts via secured electronic registration systems – eg, DLT and databases.

In addition, with Regulation (EU) 2022/858 (the "EU DLT Pilot Regime"), a new pilot regime has been created on a European level to allow the development of DLT market infrastructures, applicable from 23 March 2023. The Luxembourg law of 15 March 2023 (the "Blockchain III Law") supplements the EU DLT Pilot Regime in Luxembourg and, amongst others, explicitly recognises the possibility of using DLT instruments for financial collateral arrangements.

With these legislative initiatives, Luxembourg contributes to enabling financial market participants to take full advantage of the opportunities offered by new technologies and at the same time provides for legal certainty in this evolving sector.

The New Securitisation Law

The New Securitisation Law broadens the means of financing securitisation transactions, including now also the possibility to finance through loans on an exclusive basis or to issue financial instruments (covering, unlike the previously used term "securities", amongst others, a broader field of instruments).

Further, the New Securitisation Law now explicitly allows active management of the securitised assets in certain types of transactions, as long as the transactions are not financed by way of offering financial instruments to the public. Luxembourg securitisation vehicles may now securitise a pool of risks consisting of debt securities, financial debt instruments or receivables which are actively managed, either by the undertaking itself, or by a third party. In practice, the new legal framework allows for securitisation of actively managed CDOs (Collateralised Debt Obligations) and CLOs (Collateralised Loan Obligations) in private placements.

Previously, the possibility of a securitisation vehicle to provide collateral to other parties was limited to securing the claims of direct creditors and investors. The New Securitisation Law has now also widened the scope of possible collateral arrangements by allowing a securitisation vehicle to grant collateral in favour of all parties involved in a securitisation transaction.

In addition to broadening the means by which a securitisation transaction may be financed, the New Securitisation Law also provides for rules governing the legal ranking of different instruments. By way of example, shares/fund units rank junior to beneficiary shares, which in turn rank junior to debt securities issued by the securitisation vehicle. Such new subordination rules are aligned with general rules applicable to commercial companies and mutual funds and incorporate the subordination principles in accordance with current market practice.

The Securitisation Law distinguishes between securitisation companies and securitisation

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funds, which qualify as securitisation vehicles and are eligible to carry out securitisation transactions within the meaning of the Securitisation Law.

Under the Former Securitisation Law, it was only possible to set up securitisation companies as a public limited company (*société anonyme*), a corporate partnership limited by shares (*société en commandite par actions*), a private limited liability company (*société à responsabilité limitée*) or a co-operative company organised as a public limited company (*société cooperative organisée comme une société anonyme*). The New Securitisation Law has added the possibility to use partnership structures for securitisation structures. Currently, an unlimited company (*société en nom collectif*), a common limited partnership (*société en commandite simple*), a special limited partnership (*société en commandite spéciale*), and a simplified joint stock company (*société par actions simplifiée*) can also be used as a securitisation vehicle.

Securitisation funds are not within the scope of the AIFMD and consist of one or several co-ownerships, or one or several fiduciary estates. Securitisation funds do not have legal personality and are managed by a management company. In accordance with the New Securitisation Law, while previously only the management companies of securitisation funds needed to be registered with the Luxembourg Trade and Companies Register, securitisation funds will also need to be registered.

Conclusion

The Securitisation Law, together with the EU Securitisation Regulation, provides a comprehensive toolkit for the European securitisation market and ensures that the regulatory framework enables securitisation to play its part in the European Capital Markets Union. Securitisation vehicles can effectively assume the risks pertaining to synthetic securitisation transactions and help to free up regulatory capital of institutional lenders, resulting in additional lending capacities of these entities to the real economy. The Professional Guarantee is perfectly fit to support sophisticated structuring of these transactions and to allocate the senior and/or junior risk pertaining to the underlying loan portfolios. Under certain circumstances, securitisation vehicles may, via the private placement of securities to institutional investors, be used as funding vehicles for small and medium-sized enterprises in distress. The possibility to digitalise securities under Luxembourg law may be useful for the diversification of the investor base using securitisation structures and the broadening of funding capacities. In particular, with the New Securitisation Law, Luxembourg has increased the flexibility and legal certainty of the securitisation framework by updating the national legal regime to match the needs of the securitisation market, while at the same time focusing on investor protection.

MALAYSIA

Law and Practice

Contributed by:
Dilys Tan
Adnan Sundra & Low

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Adnan Sundra & Low is one of the largest firms in Malaysia. The firm's ability to deliver practical legal advice and customised solutions have earned it many local and international awards, as well as top-tier ranking in various publications. Structured finance is one of the firm's key strengths, and it advises on all aspects thereof, including securitisation and quasi-securitisations. The firm is among the few firms in Malaysia to have advised on asset-backed securitisations (ABS), and was involved in one of the earliest ABS transactions in the country – namely, the collateralised bond obligations securitisation by CBO One Berhad. With the growth of the securitisation market in Malaysia, leading to securitisations being undertaken in relation to various asset classes, the firm has advised on several market-firsts, such as the securitisation of charge card receivables for Diners Club (M) Sdn Bhd, the securitisation of non-performing loans issued by ABS Enterprise One Berhad and the synthetic securitisation by Cagamas SME Berhad.

Author

Dilys Tan is a partner in Adnan Sundra & Low's capital markets and banking and finance practice group. She is primarily involved in corporate banking and finance, and in debt capital markets work, where she advises local and foreign financial institutions in bilateral and syndicated banking transactions (both conventional and Islamic), project financing transactions, debt capital market issuances (both conventional and Islamic), government-guaranteed debt issuances by government-linked companies, perpetual securities issuances and asset-backed securitisation transactions (involving various assets such as hire purchase receivables, real property and debt receivables). Dilys was admitted to the Bar of England and Wales (Lincoln's Inn) in 2005 and to the Malaysian Bar in 2006.

Adnan Sundra & Low

Level 25, Menara Etiqa
No 3, Jalan Bangsar Utama 1
59000 Kuala Lumpur
Malaysia

Tel: +603 2279 3288
Fax: +603 2279 3228
Email: enquiry@adnansundralow.com
Web: www.asl.com.my

1. Specific Financial Asset Types

1.1 Common Financial Assets

The financial assets most commonly securitised in Malaysia are as follows:

- commercial real estate;
- hire-purchase loans;
- housing loans;
- loan receivables;
- credit and debit card receivables;
- automotive loans; and
- debt-settlement receivables.

1.2 Structures Relating to Financial Assets

Transaction Structure

The usual transaction structure would be as follows.

Identification of assets

The identification of the assets to be the subject matter of the securitisation transaction. Such assets must fulfil the criteria set out in Chapter 2 (Structure) of Part 4 (Asset-Backed Securities) Section B (Specific Requirements) of the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework (the "LOLA Guidelines") issued by the Securities Commission Malaysia (SC), which includes the following:

- the assets must generate cash flow;
- the originator must have a valid and enforceable interest in the assets and in the cash flows of the assets prior to the securitisation transaction;
- there must be no impediments (whether contractual or otherwise) that would prevent the effective transfer of the assets or the rights in relation to such assets from the originator to the special purpose entity (SPE) – to this end, all the necessary regulatory and/or contractual approvals must be obtained and the originator must not have done or omitted to do any act which would enable the debtor of the originator to exercise a right of set-off in relation to such assets; and
- the assets must be transferred at a fair value.

Additionally, for an issuance of asset-backed sukuk, the assets that are the subject matter of the securitisation transaction must also be Shariah-compliant.

Identification of originator

The identification of the originator, who must be an entity incorporated in Malaysia and must be a going concern at the date of transfer of any assets to the SPE. Additionally, the originator is restricted from purchasing or subscribing up to 10% of the original amount of the asset-backed securities (ABS) issued by the SPE at market value unless with the prior approval of the SC, but there is no restriction on the holding of subordinated ABS by the originator.

Incorporation of SPE

The incorporation of the SPE, who must be a resident in Malaysia for tax purposes and must not have the same name as the originator or be similarly identified with the originator. The SPE must have independent and professional directors, and must be bankruptcy-remote. Please refer to **4.10 SPEs or Other Entities** for more information on the bankruptcy remoteness test.

The more common structure of the SPE would be that of a standalone special purpose vehicle incorporated for the sole purpose of the securitisation transaction, with its shares held on trust by a share trustee in favour of charitable organisations to be identified by the share trustee.

Sale of assets to SPE by originator

The sale of the assets to the SPE by the originator. Such a sale must fulfil the true sale criteria set out in the LOLA Guidelines. Please see **6.3 Transfer of Financial Assets** for more information on the true sale criteria.

Issuance of ABS by SPE

The issuance of the ABS by the SPE, whether conventional or Islamic in nature.

Corporate administrator appointment

The appointment of a corporate administrator of the SPE and a servicer for the assets.

1.3 Applicable Laws and Regulations

The principal applicable laws and regulations in Malaysia having a material effect on the structures referred to in **1.2 Structures Relating to Financial Assets** are:

- the Capital Markets and Services Act 2007 (CMSA);
- the Companies Act 2016;
- the LOLA Guidelines; and
- the Guidelines on Islamic Capital Markets Products and Services.

Depending on the type of asset being securitised, the relevant laws and regulations in Malaysia that would apply to such asset would also need to be taken into account when structuring a securitisation transaction.

1.4 Special-Purpose Entity (SPE) Jurisdiction

As mentioned in **1.2 Structures Relating to Financial Assets**, the SPE must be incorporated in Malaysia for tax purposes.

1.5 Material Forms of Credit Enhancement

Typically, the material forms of credit enhancement used in the securitisation marketplace would be:

- subordination, where the senior class ABS are assigned a higher rating, while the subordinated class ABS would be lower-rated or unrated;
- over-collateralisation;
- cash reserves or deposits; and/or
- financial guarantee.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer is typically a bankruptcy-remote special purpose vehicle incorporated solely for the purpose of the securitisation transaction, and must comply with the requirements of paragraphs 2.15 to 2.22 of Chapter 2 (Structure) of Part 4 (Asset-Backed Securities) Section B (Specific Requirements) of the LOLA Guidelines. Please refer to **1.2 Structures Relating to Financial Assets** for more information on the requirements for an issuer.

2.2 Sponsors

In Malaysia, there is no specific concept of a sponsor in a securitisation transaction.

2.3 Originators/Sellers

The originator/seller is the owner of the assets. The type of businesses the originators/sellers of the financial assets referred to in **1.1 Common Financial Assets** are include the following:

- commercial real estate – owners and operators of shopping malls;

- hire-purchase loans – providers of hire-purchase automobile loans who are not financial institutions;
- housing loans – providers of housing loans who are not financial institutions;
- loan receivables – providers of loans who are not financial institutions;
- credit and debit card receivables – providers of credit and/or debit cards; and
- debt-settlement receivables – water concessionaires.

The originator/seller is responsible for ensuring that its internal systems are in place such that funds due to the SPE are separated and ring-fenced from other funds due to the originator. For more information on the originator, please refer to **1.2 Structures Relating to Financial Assets**.

2.4 Underwriters and Placement Agents

The concept of “underwriter” or “placement agents” is not used in securitisation transactions in Malaysia. There are, however, principal advisers, lead arrangers and lead managers.

Principal advisers are generally investment banks who would typically structure the securitisation transaction and advise the originator on this.

Lead arrangers, on the other hand, typically submit the necessary applications to the SC (where necessary) or lodge the relevant documents (such as the lodgement kit, the information memorandum and the trust deed relating to the issuance of the ABS) with the SC. The lead arrangers are also investment banks.

Lead managers who are investment banks would function as the intermediary between the issuer and the investors, and would help to market and sell the ABS.

2.5 Servicers

A servicer is appointed by the SPE pursuant to a servicer agreement to administer the assets of the SPE and/or to perform on behalf of the SPE such services as may be required under the securitisation transaction.

Typically, the role of a servicer is undertaken by the originator of the assets as they would be the best person to administer the assets, and would have the proper systems in place. However, the servicer role may be undertaken by a third-party service provider instead. If the originator is also the servicer, it is necessary to ensure that the services provided by the originator are provided on an arm’s length basis on market terms and conditions.

Pursuant to the LOLA Guidelines for asset-backed transactions, the duties of a servicer must include the following:

- the servicer must keep proper accounts;
- the servicer must have adequate operational systems and resources in place to administer the assets – such internal systems should ensure that the cash flow belonging to the SPE are “ring-fenced” and segregated in relation to the securitisation transaction;
- any change of the servicer must be informed to the trustee; and
- where there is any change of servicer, the legal documents must provide for the periodic transfer of the necessary information from the originator to the new servicer to enable the monitoring of the assets, its performance analysis and collections from debtors of the originator.

In relation to servicers of real estate assets which entail the management of property, the servicer would need to:

- have a property manager licence under the Valuers, Appraisers, Estate Agents and Property Managers Act 1981 of Malaysia; or
- appoint the relevant service provider who is a licensed property manager under such Act to perform and carry out such managerial functions accordingly.

2.6 Investors
Investors of securitisation transactions include financial institutions and investment funds. Investors are primarily involved in the provision of funds to the originator vide the SPE in a securitisation transaction.

2.7 Bond/Note Trustees
A bond/sukuk trustee is required for a securitisation transaction, and the role is typically undertaken by trust companies registered with the SC. The bond/sukuk trustee's role is primarily to hold the benefit of the covenants, rights in and to the assets on behalf of the investors, and to enforce the rights of the investors in and to the ABS.

2.8 Security Trustees/Agents
A security trustee/agent holds the benefit and rights of the investors in and to the security on trust for the secured investors, and will generally enforce such rights upon the instructions of such investors following the declaration of an event of default/dissolution event.

A security trustee/agent role can be undertaken by a trust company registered with the SC (as a security trustee) or an investment bank (as a security agent).

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets
The documentation used to effect bankruptcy-remote transfers of assets to the SPE is typically the sale and purchase agreement, which would, at the very least, contain the following provisions.

- Description of the parties to the agreement.
- Description of the assets to be transferred.
- The intention by the parties to effect a true sale of the assets.
- The transfer of the seller's rights in and to the assets to the SPE.
- The purchase consideration payable by the SPE to the seller in consideration of the sale of the rights in and to the assets.
- The conditions precedent to be fulfilled prior to completion of the sale.
- The representations, warranties and covenants by the seller in respect of itself and the assets.
- The undertaking by the seller to repurchase the assets in the following circumstances:
  (a) where the assets have declined to a level that renders the asset securitisation transaction uneconomical to carry on, under which the seller may retain a first right of refusal to repurchase such assets at a fair value; or
  (b) where the seller is under an obligation to do so when it has breached any condition, representation or warranty in respect of the securitisation transaction.
- The declaration of trust by the seller in favour of the SPE of any receivables received by the seller on or after the completion date of the transfer.

3.2 Principal Warranties

The principal warranties to be provided by the seller/originator in the sale agreement would include the following:

- representations as to its capacity and corporate authority to enter into the agreement, its compliance with the relevant laws and regulations, and its solvency status; and
- representations as to its title to the assets, and whether such assets are free and clear from encumbrances.

A breach of such representations and warranties by the seller/originator, which, if capable of being remedied is not remedied within the period specified in the agreement, may result in the rescission of the sale agreement and the refund of the purchase consideration by the seller/originator to the SPE. This would in turn result in the mandatory early redemption of the ABS to which such assets relate.

The principal warranties to be provided by the SPE would be similar to that of an issuer of bonds/sukuk, and a misrepresentation thereby would be an event of default/dissolution event, which may result in the acceleration of the ABS.

3.3 Principal Perfection Provisions

The perfection provisions would vary depending on the type of assets.

Real estate assets would require registration of the transfer from the seller/originator to the SPE at the relevant land authority to be completed within a specified period of time following the date of completion; while the perfection provisions for receivables would entail the delivery of a written notice of assignment to the obligor of such receivables, such that the assignment of such receivable has been made known to the obligor, and the SPE may, via the servicer, take action against such obligor in the event of a default.

3.4 Principal Covenants

The principal covenants to be provided by the seller/originator vary depending on the type of asset being securitised. Such covenants by the seller/originator would be set out in the sale agreement and given in favour of the SPE, and would typically include the following:

- restriction from disposing, assigning or transferring to parties other than the SPE or from essentially doing such things as may jeopardise the SPE's ownership of the assets;
- restriction from creating any security interest over the assets; and
- restriction from claiming any ownership interest over the assets.

The principal covenants applicable to the SPE and that would be set out in the trust deed for the ABS include the following:

- restriction from amending/revising its constitution;
- restriction from having any employees or incurring any fiduciary responsibilities to third parties other than to parties involved in the securitisation transaction;
- restriction from having any subsidiaries;
- restriction from incurring further indebtedness or creating any security interest, other than those contemplated under the securitisation transaction; and
- an undertaking to subcontract to third parties all services that may be required by the SPE to maintain the SPE and its assets.

Failure to comply with the covenants will typically result in an event of default/dissolution event

under the ABS, and all amounts outstanding thereunder shall immediately become due and payable.

The principal covenants applicable to the servicer and set out in the servicer agreement would include the following:

- maintenance of all licences, approvals, authorisations and consents that may be necessary in connection with the assets and/or the provision of its services;
- undertaking to exercise due care and skill expected of a prudent owner of the assets in the administration and management of the assets;
- undertaking to have adequate operational systems and resources to administer the assets; and
- restriction from amending, modifying, waiving or varying any provision in the underlying agreements relating to the assets.

Failure by the servicer to comply with the above covenants would result in a servicer event of default, which may result in the termination of the servicer and appointment of a new servicer.

3.5 Principal Servicing Provisions

As mentioned in **2.5 Servicers**, a servicer is appointed by the SPE, pursuant to a servicer agreement, to administer the assets of the SPE and/or to perform on behalf of the SPE such services as may be required under the securitisation transaction. The servicer agreement would principally contain the following provisions.

- The period of appointment of the servicer.
- The payment of fees to the servicer for the provision of its services.
- The list of services to be provided by the servicer, including but not limited to:
  - (a) the administration and management of the assets of the SPE;
  - (b) the appointment of third-party service providers for the management of the assets;
  - (c) the collection of all payments due to the SPE;
  - (d) the enforcement of obligations due to the SPE;
  - (e) the preparation of the relevant reports relating to the assets and/or the SPE; and
  - (f) the preparation and maintenance of accounting records, and all such other accounts, books, documentation and records, in respect of the assets.
- The conditions for termination of the appointment of the servicer.

Failure by the servicer to comply with its obligations in the servicer agreement may result in the termination of its appointment and the appointment of a new servicer to replace it.

3.6 Principal Defaults

The events of default/dissolution events relating to the ABS are set out in the trust deed, and would typically include the following:

- default in payment of any principal, premium, interest or profit under the ABS;
- a breach by the SPE of any term or condition of the ABS or the provisions of the securitisation documentation;
- any misrepresentation by the SPE;
- the occurrence of an insolvency event relating to the SPE; and
- the appropriation or nationalisation of the assets of the SPE.

Upon the occurrence of such events of default/dissolution events, the holders of the ABS may declare that an event of default/dissolution event

has occurred – such ABS shall become immediately due and payable, and the security granted thereunder shall become immediately enforceable.

3.7 Principal Indemnities

The seller/originator would indemnify the SPE against all claims, losses, damages, costs, expenses and deficiencies suffered, incurred or sustained by the SPE as a result of any breach by the seller/originator or its representatives.

The servicer would indemnify the SPE from any loss, damage, liability and expenses incurred or sustained by the issuer as a result of a default by the servicer in the performance or observance of its obligations under the servicer agreement, and from any misrepresentation by the servicer.

The SPE, on the other hand, would provide the trustee for the benefit of the holders of the ABS the indemnities as usually provided in a normal bond/sukuk transaction.

3.8 Bonds/Notes/Securities

The terms and conditions of the ABS are set out in the trust deed, and would generally comprise the typical terms and conditions of ABS, including but not limited to the following:

- redemption of the ABS, whether early or mandatory redemption;
- trigger events;
- covenants/undertakings by the SPE;
- events of default/dissolution events;
- limited recourse to the SPE; and
- meeting provisions for ABS holders' meetings.

Additionally, pursuant to the LOLA Guidelines, the trust deed must also provide for:

- covenants on the SPE to give effect to the bankruptcy-remoteness of the SPE; and
- a provision that would entitle the trustee to appoint a receiver in respect of the assets of the SPE in the event of default/dissolution.

3.9 Derivatives

No derivatives are used in a securitisation transaction.

3.10 Offering Memoranda

In Malaysia, the Offering Memoranda typically take the form of an information memorandum, which is a marketing and disclosure document describing the securitisation transaction and the terms of the ABS, the SPE, the originator, the assets and the risks in investing in the ABS.

The LOLA Guidelines set out the minimum contents to be included in the information memorandum for ABS, such as the following.

- Risk factors in investing in the ABS.
- A detailed description of the structure of the securitisation transaction and all significant agreements relevant to the structure.
- A corporate profile of all parties involved.
- A detailed description of the securitised assets, including:
  (a) cash flow profile;
  (b) ageing of cash flows; and
  (c) if available, historic levels of arrears or rates of default for the assets and stress levels of cash flows.
- An explanation on the fund flow, particularly on:
  (a) how the cash flow from the assets is expected to meet the SPE's obligation to the holders of the ABS;
  (b) how payments are collected in respect of the assets;
  (c) the priority of payments to the holders of

the ABS of different classes;
(d) details of any other arrangements upon which payments to holders of the ABS are dependent;
(e) information regarding the accumulation of surpluses in the SPE; and
(f) details of any subordinated securities.

- Information on credit enhancement, including an indication of where material potential shortfalls are expected to occur.
- Credit rating for the ABS and the definition of such credit rating.
- Disclosure of the fees payable by the SPE, including management fees and expenses charged by the servicer.

In addition to the above, additional disclosures are required to be made by the principal adviser and originating bank in primary collateralised loan obligation (CLO) transactions, for the purpose of enhancing transparency and clarity of information to investors and parties involved in a primary CLO transaction, such as:

- the lending policies involved and the extent of terms and conditions which are set on borrowers, which can be made on an anonymous and aggregated basis;
- the utilisation of proceeds by the borrowers, in amount on a projected or actual basis, where applicable;
- the sources of repayment by the borrowers, in percentage;
- whether any early repayment or prepayment by the borrowers is permissible, and the terms and conditions for such early repayment or prepayment;
- the date of repayment by borrowers to the SPV and maturity date of CLOs; and
- the responsibilities of all transaction parties, including the principal adviser, originating bank, solicitor, portfolio manager, trustee and technical adviser (if any).

Additionally, the information memorandum must clearly provide that an originator does not in any way stand behind the ABS issued by the SPE, except to the extent specified in the transaction documents and such credit enhancement provided by the originator (if any). If an originator is intending to subscribe for the ABS, the information memorandum must also clearly disclose this.

In addition to the information memorandum, a product highlights sheet is required to be issued by the SPE to investors. Paragraph 1.06 of Part 1 of the Guidelines on Sales Practices of Unlisted Capital Market Products issued by the SC (the "Sales Practices Guidelines") sets out the types of investors for which a product highlights sheet is applicable. In the case of ABS, a product highlights sheet is required for investors who are:

- high net worth entities (unless they have opted out of this);
- high net worth individuals;
- retail investors; and
- a person who acquires the ABS where the consideration is not less than RM250,000 or its equivalent in foreign currencies for each transaction.

The product highlights sheet must contain clear and concise information, which must not be false or misleading or contain any material omission. The information required to be included in the product highlights sheet includes the following.

- Date of issuance of the product highlights sheet on the first page thereof.
- Information on the preparer of the product highlights sheet.

- A brief description of the ABS.
- Key features of the ABS, particularly:
  - (a) any significant unusual feature;
  - (b) the applicable Shariah principle;
  - (c) issue size;
  - (d) rating;
  - (e) mode of issue;
  - (f) events of default/dissolution; and
  - (g) an illustration of the best-case scenario and worst-case scenario (where permitted and applicable).
- Key risks of investing in the ABS, particularly risks that commonly occur or may cause significant losses.
- All relevant fees, charges and commissions – including any management fees, distribution fees, redemption fees, switching fees and any other substantial fees payable by the investors – and an indication as to when such fees are payable, whether one-off or on a recurring basis.
- Valuations and relevant matters relating to exit from the investment, such as:
  - (a) the frequency of publication of valuations;
  - (b) duration of the cancellation period;
  - (c) how the investors may exit during the cancellation period; and
  - (d) any costs, charges or penalties for early exit or early redemption, and the basis for such costs, charges or penalties.
- Contact information to facilitate enquiry or complaints.

Other requirements of a product highlights sheet are set out in Part 3 of the Sales Practices Guidelines.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Please refer to **3.10 Offering Memoranda**.

4.2 General Disclosure Laws or Regulations

Please refer to **3.10 Offering Memoranda**.

4.3 Credit Risk Retention

There are no laws or regulations on credit-risk retention for securitisation transactions in Malaysia.

4.4 Periodic Reporting

There are no specific laws or regulations in Malaysia that require periodic reporting for securitisation transactions in Malaysia, save for in primary CLO transactions, where under the LOLA Guidelines the principal adviser and originating bank must ensure that there are adequate provisions in the loan agreements or facility agreements to require borrowers to provide the following reporting criteria, and to ensure that these are enforceable (together with the imposition of various forms of penalties):

- submission of financial statements, including semi-annual accounts and audited annual accounts, to the trustee, portfolio manager and rating agency (RA) on a timely basis; and
- immediate notice to the trustee and RA of any material changes to the nature of the business and shareholding structure.

4.5 Activities of Rating Agencies

There are no laws or regulations in Malaysia that regulate the securitisation activities of RAs. In Malaysia, RAs are regulated by the SC pursu-

ant to the CMSA and the Guidelines on Credit Rating Agencies issued by the SC. Presently, in Malaysia there are only two RAs registered with the SC:

- RAM Ratings Services Berhad; and
- Malaysian Rating Corporation Berhad.

4.6 Treatment of Securitisation in Financial Entities

Bank Negara Malaysia (BNM) regulates the banking and financial sector in Malaysia, and Part F of the Capital Adequacy Framework (Basel II – Risk-Weighted Assets) and the Capital Adequacy Framework for Islamic Banks (Basel II – Risk-Weighted Assets) issued by the BNM set out the securitisation framework.

This framework outlines the approaches in determining regulatory capital requirements on exposures arising from securitisation transactions, and the operational requirements for allowing regulatory capital relief for originating banking institutions.

Under the securitisation framework, all financial institutions, whether acting as originators or as third-party investors, must hold regulatory capital against all securitisation exposures in the banking book. Regulatory capital relief is granted based on the assessment of whether risks under a securitisation transaction have been effectively and significantly transferred. An originating banking institution may, upon receiving the written approval of the BNM for capital relief, exclude the underlying securitised assets from the calculation of risk-weighted assets or reduce the capital requirement using credit-risk mitigation techniques.

4.7 Use of Derivatives

In Malaysia, there are no specific laws or regulations that apply to the use of derivatives in a securitisation transaction.

4.8 Investor Protection

In general, the regulatory framework in Malaysia relating to securitisation transactions and bonds/sukuk transactions aims to protect the rights of investors. The CMSA require that any documents submitted to or lodged with the SC do not contain any statements or information that are false or misleading, and that there is no material omission from such documents.

Additionally, the LOLA Guidelines and the Sales Practices Guidelines prescribed minimum contents to be disclosed in disclosure documents. All these are intended to ensure that investors can make an informed assessment of the ABS into which they are investing.

The SC is the regulator for capital market instruments, and civil and criminal liabilities are imposed on the responsible party (as identified in the LOLA Guidelines).

4.9 Banks Securitising Financial Assets

In general, financial institutions in Malaysia are required to comply with the requirements of the Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA). Pursuant to Section 100(1) of the FSA and Section 112(1) of the IFSA, the BNM's approval must be obtained for a financial institution to enter into an agreement or arrangement for a scheme to transfer the whole or any part of the business of such financial institution. However, for the purposes of securitisation transactions where the underlying financial assets are not serviced by a licensed person – ie, the SPE – such trans-

fers are exempted from obtaining the BNM's approval.

Additionally, financial institutions are also expected to comply with the expectations set out in the Prudential Standards on Securitisation Transactions and the Prudential Standards on Securitisation Transactions for Islamic Banks issued by the BNM, and with other applicable regulatory requirements and guidelines.

4.10 SPEs or Other Entities

Please refer to **2.1 Issuers**.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

As mentioned in **2.1 Issuers**, the SPE is incorporated solely for the purpose of the securitisation transaction, and therefore must not undertake any other activities unrelated to the securitisation transaction.

The limitations on the SPE's activities are set out in the constitution of the SPE, as well as a restrictive covenant in the trust deed for the ABS. A breach by the SPE of such covenant would result in an event of default under the ABS.

4.12 Participation of Government-Sponsored Entities

Government-sponsored entities in Malaysia do participate in the securitisation market, albeit not frequently.

4.13 Entities Investing in Securitisation

Entities that invest in securitisation transactions include financial institutions and investment funds. There are no specific rules restricting investments in securitisation transactions by such entities, save for the requirements described in **4.6 Treatment of Securitisation in Financial Entities**.

4.14 Other Principal Laws and Regulations

Please refer to **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are permitted in Malaysia. They generally comprise a structure with at least two different stratified risk positions or tranches that reflect different degrees of credit risk, which involves the transfer of credit risk of an underlying pool of exposures by the originator, in whole or in part, by way of credit-linked notes, credit default swaps or guarantees to hedge the credit risk of the underlying exposures.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Securitisation transactions in Malaysia would require that the sale of assets by the originator to the SPE be a "true sale", such that the assets are beyond the reach of the originator and its creditors in the event of a winding-up of the originator. Please refer to **6.3 Transfer of Financial Assets** for further elaboration on the true sale criteria in Malaysia.

6.2 SPEs

In Malaysia, the SPE in a securitisation transaction would need to have at least the following characteristics.

- It must be resident in Malaysia for tax purposes.

- It must have independent and professional directors or trustees, as the case may be.
- It must be bankruptcy-remote. For more information on this, please refer to **6.4 Construction of Bankruptcy-Remote Transactions.**
- It must be dissolved in the following circumstances:
  - (a) when the SPE refuses to accept transfers of the assets or to issue ABS within 90 business days from the date on which the securitisation transaction has been lodged with the SC or such other period as may be specified by the SC;
  - (b) when more than 75% of the holders of the ABS have resolved, in accordance with the terms and conditions of the securitisation transaction, that the SPE be dissolved, and the SC has been notified of this resolution – if there are classes of ABS, more than 50% of the senior classes of the holders of ABS must have agreed to the dissolution of the SPE; or
  - (c) upon the full repayment of the ABS in accordance with the terms and conditions of the securitisation transaction.

Please also refer to **1.2 Structures Relating to Financial Assets** and **2.1 Issuers**.

6.3 Transfer of Financial Assets

Asset Transfer and "True Sale" Criteria

The transfer of the assets from the originator to the SPE must be a "true sale", in that the risk of the transfer of assets from the originator to the SPE being recharacterised as a financing transaction instead of a "true sale" should be minimised as far as possible. To that end, the true sale criteria set out in paragraphs 2.09 to 2.14 of Part 4, Section B of the LOLA Guidelines must be complied with. Such criteria include that:

- the underlying asset must have been isolated from the originator to the extent that it is put beyond the reach of the originator and its creditors, even in a receivership or bankruptcy, as far as possible;
- all rights and obligations of the originator in the underlying asset must be effectively transferred to the SPE;
- the originator must not hold any equity stake, whether directly or indirectly, in the SPE, and the originator must not be in a position to exercise effective control over the decisions of the SPE in relation to the securitisation transaction;
- the SPE must have no recourse to the originator for any losses arising from the assets save for any credit enhancement provided by the originator at the outset of the securitisation transaction; and
- if the originator is also the servicer, the services provided by the servicer must be on an arm's length basis and on market terms and conditions – also, there must be no obligation imposed on the originator to remit funds to the SPE, unless and until such funds have been received by the originator from the debtor of the underlying assets.

Typically, a true sale opinion is also obtained from the transaction solicitors to confirm that the true sale criteria above have been fulfilled.

In Malaysia, the following are ways in which an effective transfer of the assets from the originator to the SPE can occur.

By way of registration of transfer

This is the most-preferred method, as it is clear that ownership of the asset has changed from the originator to the SPE. However, this typically applies to real estate assets only.

By way of assignment (equitable or legal)
A legal assignment is preferable compared to an equitable assignment, as under Malaysian law the holder of the legal assignment would have priority above the holder of an equitable assignment over the same asset. However, the perfection of legal assignments in a securitisation transaction may be difficult if there is a large pool of assets. This is because in order to create a legal assignment in Malaysia, a written notice of assignment must be served to the obligors/debtors to the asset, which proves to be a problem when there are a lot of obligors/debtors to such asset.

As such, another way transfer of assets from the originator to the SPE is performed in Malaysia is by way of an equitable assignment. While there is a risk that the originator may transfer the asset to a third party and register such transfer or serve a notice of assignment (whereby a legal assignment is deemed to have been created), such risk can be mitigated by imposing restrictive covenants on the originator in the sale agreement, such as:

- a restriction on creating security interests over the asset; and
- a restriction from disposing, transferring or selling the asset to a third party.

By way of novation
This is the cleanest way to transfer, as both the originator and its counterparty/obligor/debtor acknowledge (and the SPE agrees) that all the rights, title, interests and obligations of the originator are novated to the SPE, and that the SPE shall be the "replacement" for the originator.

However, this method may be time-consuming and difficult to complete if there are a large number of counterparties/obligors/debtors involved, as their signatures and agreement to the novation are required.

6.4 Construction of Bankruptcy-Remote Transactions

There are no means of constructing a bankruptcy-remote transaction in Malaysia other than by the requirements set out in paragraph 2.17 of Part 4 of the LOLA Guidelines. In order to determine whether an SPE is sufficiently "bankruptcy-remote", the following must be taken into account:

- the SPE cannot include in its objectives the power to enter into any other activities that are not incidental to its function as a special purpose vehicle in relation to the securitisation transaction;
- the SPE must subcontract to third parties all services that may be required by it to maintain the SPE and its assets;
- the SPE is not permitted to have employees or incur fiduciary responsibilities to third parties other than to parties involved in the securitisation transaction; and
- all present and future liabilities of the SPE (including tax) must be quantifiable and capable of being met out of resources available to it.

Additionally, an SPE will be considered "bankruptcy-remote" if the chances of proceedings being brought against it for liquidation are remote. This would be fulfilled if the SPE complies with the covenants set out in the trust deed for the ABS, which would, among others, restrict the SPE from incurring any further liabilities. Additionally, the transaction documents for the securitisation transaction may also provide for the service providers' agreement with the SPE that their claims be limited to the assets of the

SPE, and that they will not be in a position to file any winding-up proceedings against the SPE.

A bankruptcy-remoteness legal opinion is obtained from counsel to confirm whether the SPE is sufficiently "bankruptcy-remote" for the purposes of the securitisation transaction in Malaysia.

6.5 Bankruptcy-Remote SPE

Please refer to **6.4 Construction of Bankruptcy-Remote Transactions**.

7. Tax Laws and Issues

7.1 Transfer Taxes

Stamp duty exemptions are available for all instruments relating to the securitisation transaction, including:

- any instrument for the transfer or assignment of rights in any asset to or from the SPE; and
- any instrument or document that the SPE is a party to.

7.2 Taxes on Profit

Real Property Gains Tax

In Malaysia, real property gains tax exemption is available in respect of chargeable gains accruing on the disposal of any chargeable assets to or in favour of the SPE, or in connection with the repurchase of such chargeable assets to or in favour of the originator for the purpose of the securitisation transaction.

Income Tax

Pursuant to the Income Tax (Asset-Backed Securitisation) Regulations 2014 (the "ABS Income Tax Regulations") of Malaysia, the SPE's income from all sources shall be treated as gross income of the SPE from a single source consisting of a business in the basis period for a year of assessment. Any expenses incurred by the SPE for the acquisition of trade receivables or stock in trade pursuant to the securitisation transaction that is deductible under the Income Tax Act 1967 shall be deemed to have been incurred throughout the period of the securitisation transaction, and is allowed to be deducted in arriving at the SPE's adjusted income in the basis period for a year of assessment that relates to the period of the securitisation transaction.

For the originator, the ABS Income Tax Regulations provide that the proceeds, gains or losses from the disposal by the originator of trade receivables or stock in trade pursuant to the securitisation transaction are deemed to accrue evenly throughout the period of the securitisation transaction, and shall constitute the gross income (or be allowed as deduction, as the case may be) of the originator in the basis period for a year of assessment that relates to the period of the securitisation transaction.

Notwithstanding the foregoing, for a property developer originator where any stock in trade in respect of such property development business is disposed of by the originator pursuant to the securitisation transaction, and where there is a call option for the originator to buy back such stock in trade, the proceeds, gains or losses from such disposal shall constitute the gross income (or be allowed as deduction, as the case may be) of the originator in any basis period for a year of assessment in which the call option expires. Additionally, any expenses incurred by the SPE for the acquisition of stock in trade that is deductible under the ITA are allowed as deduction in computing adjusted income of the SPV in the basis period for that year of assessment in which the call option expires.

Additionally, any balancing charge or allowance under Schedule 3 of the Income Tax Act 1967 of Malaysia arising from disposal of fixed assets is deemed to have been made in the basis period for a year of assessment that relates to the period of the securitisation transaction, in accordance with a prescribed formula.

7.3 Withholding Taxes

In general, interest payable to a non-resident is subject to withholding tax at the rate of 15% (or such other rate as prescribed under the relevant tax treaty between Malaysia and the country where the non-resident is a tax resident). However, an exemption exists for interest income earned by non-residents from ringgit-denominated corporate bonds/sukuk approved or authorised by (or lodged with) the SC.

7.4 Other Taxes

In Malaysia, law firms do not typically advise on tax matters. Advice is usually given by the tax advisers appointed for the securitisation transaction.

7.5 Obtaining Legal Opinions

In Malaysia, tax opinions are obtained for securitisation transactions from the tax adviser.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Common issues that may arise in connection with accounting rules that apply to securitisation transactions in Malaysia include:

- the treatment of the transfer of the assets as a true sale;
- the originator's off-balance sheet treatment; and
- the consolidation of the SPE for accounting purposes into the originator's group of companies.

8.2 Dealing with Legal Issues

In Malaysia, accounting issues are addressed by accountants, and lawyers do not give legal opinions in this respect.

Trends and Developments

Contributed by:
Dilys Tan
Adnan Sundra & Low

Adnan Sundra & Low is one of the largest firms in Malaysia. The firm's ability to deliver practical legal advice and customised solutions have earned it many local and international awards, as well as top-tier ranking in various publications. Structured finance is one of the firm's key strengths, and it advises on all aspects thereof, including securitisation and quasi-securitisations. The firm is among the few firms in Malaysia to have advised on asset-backed securitisations (ABS), and was involved in one of the earliest ABS transactions in the country – namely, the collateralised bond obligations securitisation by CBO One Berhad. With the growth of the securitisation market in Malaysia, leading to securitisations being undertaken in relation to various asset classes, the firm has advised on several market-firsts, such as the securitisation of charge card receivables for Diners Club (M) Sdn Bhd, the securitisation of non-performing loans issued by ABS Enterprise One Berhad and the synthetic securitisation by Cagamas SME Berhad.

Author

Dilys Tan is a partner in Adnan Sundra & Low's capital markets and banking and finance practice group. She is primarily involved in corporate banking and finance, and in debt capital markets work, where she advises local and foreign financial institutions in bilateral and syndicated banking transactions (both conventional and Islamic), project financing transactions, debt capital market issuances (both conventional and Islamic), government-guaranteed debt issuances by government-linked companies, perpetual securities issuances and asset-backed securitisation transactions (involving various assets such as hire purchase receivables, real property and debt receivables). Dilys was admitted to the Bar of England and Wales (Lincoln's Inn) in 2005 and to the Malaysian Bar in 2006.

Adnan Sundra & Low

Level 25, Menara Etiqa
No 3, Jalan Bangsar Utama 1
59000 Kuala Lumpur
Malaysia

Tel: +603 2279 3288
Fax: +603 2279 3228
Email: enquiry@adnansundralow.com
Web: www.asl.com.my

Introduction and History of Securitisation Transactions in Malaysia

The capital market in Malaysia plays an important role in financing and supporting the sustainability of the domestic economy. As such, it must continue to be innovative in order to remain relevant, for the purpose of the economy and to attract more investors. Malaysia was one of the first few countries in the region to introduce new financing alternatives to cater to various businesses.

The issuance of asset-backed securities (ABS) in connection with a securitisation transaction forms part of the capital markets in Malaysia, and is regulated by the Securities Commission Malaysia (SC). However, the securitisation market in Malaysia only really began two decades ago, with the introduction of the Guidelines on the Offering of Asset-Backed Debt Securities (the "ABS Guidelines") by the SC on 10 April 2001. Prior to this, securitisation in Malaysia commenced in October 1987 through the operations of Cagamas Berhad, the national mortgage corporation, purchasing loans and debts by raising debt securities at the secondary level. However, such securitisation by Cagamas Berhad was not a true securitisation transaction in the sense that the debt securities were not strictly backed by the cash flows from the loans and debts.

The ABS Guidelines were introduced as part of the SC's initiatives to develop the corporate bond market, and sought to ensure that the features of securitisation transactions (such as true sale of assets and bankruptcy remoteness of the issuer) be set out clearly for any person who intends to undertake a securitisation exercise. Under the ABS Guidelines, any person who intends to issue, offer for subscription or purchase, or make an invitation to subscribe for or purchase ABS must obtain the SC's prior approval and comply with the requirements set out under the ABS Guidelines. Additionally, given that ABS constitute private debt securities, the SC's Guidelines on the Offering of Private Debt Securities (the "PDS Guidelines") (for conventional issuances) or the SC's Guidelines on the Offering of Islamic Securities (the "Sukuk Guidelines") (for sukuk issuances) are also applicable and would need to be complied with for securitisation transactions.

In April 2003, Bank Negara Malaysia (BNM) issued the Prudential Standards on Asset-Backed Securitisation Transactions. In June 2013, the Prudential Standards on Asset-Backed Securitisation Transactions for Islamic Banks were also introduced by BNM. These standards were intended to govern the supervisory expectations of licensed financial institutions relating to securitisation exposures, and to be read together with:

- the Capital Adequacy Framework (Capital Components);
- the Capital Adequacy Framework for Islamic Banks (Capital Components);
- the Capital Adequacy Framework (Risk-Weighted Assets); and
- the Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets).

The Current Legal Framework for Securitisation Transactions

The lodge and launch framework

On 9 March 2015, the SC issued the Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework (the "LOLA Guidelines") whereupon issuances of unlisted capital market products (which would include ABS) to sophisticated investors in Malaysia and to persons outside Malaysia no longer required

the prior approval, authorisation or recognition of the SC under Section 212 of the Capital Markets and Services Act 2007 (CMSA), provided that all applicable requirements under the LOLA Guidelines were complied with. To that end, the LOLA Guidelines supersede the ABS Guidelines, the PDS Guidelines and the Sukuk Guidelines in relation to the making available of unlisted capital market products in Malaysia.

Since the introduction of the LOLA Guidelines, all unlisted ABS only need the issuer to lodge with the SC via its online submission system the required information and documents prior to the launch (ie, the making available, offering for subscription or purchase, or the issuance of an invitation to subscribe for or purchase) of such unlisted ABS. Under the lodge and launch framework, the time to market for unlisted capital market products is shortened, as such products are capable of being launched the moment the required information and documents are lodged with the SC. Pursuant to the LOLA Guidelines, a lodged product must be issued within 90 business days from the date of lodgement. The requirement that the first issuance take place within 90 business days from the date of lodgement was extended from its original 60 business days on 20 March 2020, following the Movement Control Order imposed by the government of Malaysia in response to the COVID-19 pandemic.

The Guidelines on Islamic Capital Market Products and Services

In addition to complying with the requirements under the LOLA Guidelines, any proposals for the issuance of unlisted asset-backed sukuk would also need to comply with the Guidelines on Islamic Capital Market Products and Services (the "ICMPS Guidelines") issued by the SC on 28 November 2022. The ICMPS Guidelines consolidate all the existing Shariah requirements, which were previously set out in various guidelines issued by the SC with the aim of providing a single point of reference for those offering or intending to offer Islamic capital market products and services.

Pursuant to the ICMPS Guidelines, the Shariah structure of asset-backed sukuk would require the prior endorsement of the SC's Shariah Advisory Council before it may be lodged with the SC. The prior endorsement is obtained by submitting information and documents as specified in the ICMPS Guidelines to the Islamic Capital Markets Development of the SC at least ten business days before the intended lodgement date. Additionally, the assets to be securitised under the securitisation transaction must be Shariah-compliant and approved by the Shariah adviser appointed for such transaction. Such Shariah adviser must be registered with the SC, and is expected to issue a pronouncement confirming that the assets to be securitised and the structure of the ABS are compliant with Shariah principles.

Taxes

Under the ABS Guidelines and, subsequently, the LOLA Guidelines, the special purpose vehicle (SPV) incorporated for the purpose of the securitisation transaction must be resident in Malaysia for tax purposes. As such, the Budget 2001 of Malaysia proposed abolishing the imposition of stamp duty and real property gains tax relating to issuances of ABS, in order to strengthen the bond market in Malaysia.

Following this, the Stamp Duty (Exemption) (No 12) Order 2001 and the Real Property Gains Tax (Exemption) Order 2001 were gazetted. Pursuant to the Stamp Duty (Exemption) (No 12) Order 2001, all instruments that operate to convey,

transfer, assign, vest, effect or complete a disposition of any legal or equitable rights or interests in, or title to, any asset to or in favour of an SPV incorporated for the purpose of a securitisation transaction, and any other instrument or document to which such SPV is a party, are exempted from stamp duty. The chargeable gains accruing on the disposal of any chargeable assets to or in favour of an SPV, or in connection with the repurchase of chargeable assets to or in favour of the originator, for the purpose of the securitisation transaction are exempted from the payment of real property gains tax pursuant to the Real Property Gains Tax (Exemption) Order 2001.

Subsequently, in the Budget 2004 of Malaysia, with the intention of continuous stimulation of the capital market and diversification of the sources of financing for further economic development, it was announced that the Malaysian government planned to ensure neutrality in the tax treatment between ABS and other capital market products approved by the SC.

Following this, in addition to the stamp duty and real property gains tax exemptions granted for securitisation transactions, the Income Tax (Asset-Backed Securitisation) Regulations 2014 (the “ABS Regulations”) were gazetted on 24 June 2014. The ABS Regulations were intended to apply to originators and the SPV incorporated for the purpose of a securitisation transaction approved/authorised by the SC on or after 1 January 2013, whereby the income of the SPV from all sources would be treated as gross income of the SPV from a single source consisting of a business in the basis period for a year of assessment. Any expenses incurred by the SPV for the acquisition of trade receivables or stock in trade pursuant to a securitisation transaction that is deductible under the Income Tax Act 1967 (ITA) are deemed to have been incurred throughout the period of the securitisation transaction, and are allowed in ascertaining the adjusted income of the SPV in the basis period for a year of assessment that relates to the period of the securitisation transaction.

Additionally, where the originator has a call option to buy back stock in trade, any expenses incurred by the SPV for the acquisition of stock in trade that is deductible under the ITA are allowed as deduction in computing adjusted income of the SPV in the basis period for that year of assessment in which the call option expires.

Regarding the originator in securitisation transactions, the ABS Regulations also provide that the proceeds, gains or losses from the disposal by the originator of trade receivables or stock in trade pursuant to the securitisation transaction are deemed to accrue evenly throughout the period of the securitisation transaction, and shall constitute the gross income (or be allowed as deduction, as the case may be) of the originator in the basis period for a year of assessment that relates to the period of the securitisation transaction. Notwithstanding the foregoing, in the case of a property developer originator where any stock in trade in respect of such property development business is disposed of by the originator pursuant to the securitisation transaction, and where there is a call option for the originator to buy back such stock in trade, the proceeds, gains or losses from such disposal shall constitute the gross income (or be allowed as deduction, as the case may be) of the originator in any basis period for a year of assessment in which the call option expires.

The Income Tax Leasing Regulations 1986 were also revised by the Income Tax Leasing (Amendment) Regulations 2014 to exclude lease trans-

actions in relation to a securitisation transaction authorised or approved by the SC on or after 1 January 2013.

The Year in Review and Outlook

In spite of the pessimistic global economic outlook and tighter global financial conditions, Malaysia's capital markets remained resilient. Their size increased in 2022 due to the increase in outstanding bonds and sukuk, and in the first half of 2023 the domestic market conditions continued to be preserved. This was supported by several key factors, including the deep and liquid domestic capital markets. The Malaysian bond and sukuk markets stood at a total outstanding value of MYR2 trillion as of 31 October 2023, amounting to more than half of the Malaysian capital markets, with an increase of 12.52% of issuance of corporate bonds and sukuk in the third quarter of 2023 from the second quarter of 2023.

The securitisation market in Malaysia remains slow to grow (as compared to other capital market products) with only a few issuances of ABS a year. In 2022, commercial mortgage-backed securities and ABS were still the most popular asset classes, accounting for 58% and 42%, respectively, of new issuances of structured finance. A single large issuance by an issuer contributed to 77% of the total issuances of commercial mortgage-backed securities due to the sheer size of the value of the underlying collateral. For ABS, there was more activity, comprised largely of personal-financing receivables-backed issuances, and there was no issuance of residential mortgage-backed securities. As of the end of 2022, ABS accounted for close to 65% of issuances and 43% of issuance value.

However, the Malaysian capital market is still expected to be resilient and supportive of the economy, maintained by strong macroeconomic fundamentals, high domestic liquidity and a well-developed capital markets infrastructure. The introduction of the Capital Market Masterplan 3, issued by the SC in 2021, intends to make the Malaysian capital markets more relevant to the economic development of Malaysia by the year 2025. However, it remains to be seen whether the intended revitalisation of the capital markets in Malaysia will lead to the further growth of Malaysia's securitisation market.

NEW ZEALAND

Law and Practice

Contributed by:
Fred Ward, Matt Kersey, Deemple Budhia and Ling Yan Pang
Russell McVeagh

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Russell McVeagh is the premier law firm in New Zealand and employs approximately 300 staff and partners. The firm is committed to operating on the cutting edge of legal practice and boasts award-winning lawyers who are internationally recognised for their thought-leadership, depth of experience and ability to translate complex legal issues into client success stories. Main specialties include banking and finance (including securitisation and financial markets regulation), corporate and commercial, competition/antitrust, employment, health and safety, environment and resource management (including energy), litigation, restructuring and insolvency, property and construction, tax, technology and digital, and public law and regulation. The banking and finance team provides comprehensive advice to local market participants, inbound lenders and investors, and inbound financial service providers, and has accumulated significant experience advising on leveraged and other acquisition financing, takeover finance, securitisations and repackaging transactions, structured derivatives, and project and asset finance.

Authors

Fred Ward has been a partner with Russell McVeagh since 1995. With more than 25 years' experience with the firm, his work has involved offering clients a broad range of taxation services, including advice on cross-border financing structures; mergers and acquisitions; and dealing with the Inland Revenue at all levels of the investigation process, including negotiating settlements. A member of the International Fiscal Association, Fred's key practice areas are taxation, particularly financing transactions; cross-border transactions; mergers and acquisitions; and tax dispute work.

Matt Kersey is a partner with Russell McVeagh in the firm's national litigation practice group. Matt specialises in general commercial litigation and insolvency, restructuring and finance litigation. His practice includes advising banks and trustees in relation to structuring and enforcement of security, recovery, insolvency and restructuring strategies, and banker/customer disputes. Matt is a member of the Restructuring, Insolvency & Turnaround Association New Zealand (RITANZ), the International Association of Insolvency professionals (INSOL) and the Banking and Financial Services Law Association (BFSLA).

Deemple Budhia is a partner with Russell McVeagh. Her key practice areas are securitisation; debt capital markets; banking and finance (including derivatives); and financial markets regulation, including bank regulation. Deemple is a member of the New Zealand sub-committee for the Australian Securitisation Forum, and chairs the NZ Markets Disciplinary Tribunal (NZMDT), an independent regulatory body that ensures that the integrity of the country's markets is maintained through determining whether an issuer or market participant has breached NZX's market rules.

Ling Yan Pang is a senior associate in Russell McVeagh's banking and finance group. She returned to Russell McVeagh in 2017 after working in the structured finance group at Linklaters in London. Her practice focuses on structured finance and capital markets, and she also advises on financial markets regulation and derivatives. Ling Yan has acted on securitisations and on listed covered bonds programmes.

Russell McVeagh

Level 30, Vero Centre
48 Shortland Street
PO Box 8
Auckland 1140
DX CX 10085
New Zealand

Tel: +64 9 367 8000
Fax: +64 9 367 8163
Web: www.russellmcveagh.com

Russell McVeagh

Contributed by: Fred Ward, Matt Kersey, Deemple Budhia and Ling Yan Pang, **Russell McVeagh**

1. Specific Financial Asset Types

1.1 Common Financial Assets

The most common financial assets securitised in New Zealand include auto leases, auto receivables, trade and equipment receivables and other receivables such as revolving credit (including credit cards). Residential mortgage-backed securitisations are also commonly seen in New Zealand, including a registered bank's internal residential mortgage-backed securities (RMBS) programme or covered bond programmes.

1.2 Structures Relating to Financial Assets

In New Zealand, securitisations are usually structured using a trust as the special-purpose entity (SPE), which is intended to be bankruptcy remote from the originator. An independent trustee company will generally act as the trustee, holding the trust assets for a beneficiary (which may be a charitable entity but is usually associated with the originator). A trust manager (generally the originator or an affiliate of the originator) will also be appointed to oversee the day-to-day operations of the trust. The trustee grants security over the trust assets to a security trustee for the benefit of secured creditors (the investors and other parties to the securitisation).

The programme documents include detailed provisions around the operation of the trust and the securitisation, and leave little or no discretion for any of the parties – in particular, the trustee. Where New Zealand securitisations are structured using a trust, a trustee may only exercise its powers in accordance with the trust documentation.

Company SPEs can also be used in the New Zealand market; however, these structures are less common.

1.3 Applicable Laws and Regulations

The operation of a trust SPE, being an express trust, is regulated by the Trusts Act 2019. The trust documentation will usually explicitly or implicitly exclude or modify the application of the Trusts Act 2019.

Company SPEs are regulated by the Companies Act 1993.

Other relevant laws and regulations include the following.

- The originator may structure the SPE in order to elect into the debt funding special purpose vehicle (DF SPV) regime in the Income Tax Act 2007, which would impact the tax treatment of the SPE – see **7.1 Transfer Taxes**.
- Where the SPE is an "overseas person" for the purposes of the Overseas Investment Act 2005, the requirements of that Act will need to be complied with, although there are exemptions for most types of financial assets.
- Any regulatory regime applicable to securitised assets will need to be complied with, for example the Privacy Act 2020 and the Credit Contracts and Consumer Finance Act 2003 (CCCFA) – see **2.5 Servicers**.
- The originator, servicer and SPE will generally need to be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA).

1.4 Special-Purpose Entity (SPE) Jurisdiction

Where a trust SPE is used, the trust company would be incorporated in New Zealand and the trust documentation governed by New Zealand law.

A company SPE would be incorporated in New Zealand.

1.5 Material Forms of Credit Enhancement

The most common forms of credit enhancement for securitisations in New Zealand are subordination, cash reserves and over-collateralisation. In addition to credit enhancement, securitisations in New Zealand often have liquidity support in the form of a liquidity facility and the use of reserves (funded on day one and/or by trapping excess spread in the transaction).

Where an RMBS is intended to be eligible for the Reserve Bank of New Zealand's (RBNZ) repurchase facility, the RBNZ imposes requirements in relation to potential credit enhancement within the structure. These are a 5% limit on non-mortgage assets that can be held by the trust and an expectation that no more than 1% of the outstanding pool amount is comprised of non-performing loans or loans with a loan-to-value ratio over 80%.

2. Roles and Responsibilities of the Parties

2.1 Issuers

As mentioned in **1.2 Structures Relating to Financial Assets**, the issuer for a securitisation in New Zealand is most commonly a bankruptcy-remote trust.

2.2 Sponsors

Generally, the originator is the sponsor on a securitisation.

2.3 Originators/Sellers

The originator is the entity that generated the receivables as the original lender of the receivables. Originators in the New Zealand market are typically registered banks and non-bank lenders.

The seller of the receivables to the trust SPE may be the originator, another trust SPE or both.

2.4 Underwriters and Placement Agents

The underwriters and placement agents are financial institutions, commonly banks. Where the originator is itself a bank, it may also act as a dealer/placement agent on the securitisation.

A dealer/placement agent would only be required for a term securitisation.

2.5 Servicers

The originators usually provide the management and collection services with respect to the receivables. In some non-bank securitisations, back-up servicers or standby servicers may also be appointed at the outset of a securitisation.

Where the securitised financial assets are consumer credit contracts (which can include leases) for the purposes of the CCCFA, the servicer will need to be registered under the FSPA in order to transfer the financial assets to the SPE without notice to the underlying obligor.

2.6 Investors

Investors directly lend to an SPE (on a warehouse securitisation) or acquire the notes issued by the SPE.

Typically, investors in New Zealand securitisations are institutional or other sophisticated investors who are able to take part in a wholesale offer – see **4.13 Entities Investing in Securitisation**.

2.7 Bond/Note Trustees

As discussed further in **4.2 General Disclosure Laws or Regulations**, securitisations in New Zealand are generally not public offers and so there is no need for a bond/note trustee or oth-

er supervisor. To the extent that decisions are required of investors during the course of a term securitisation, the programme documents provide a process for investors to make such decisions, usually through a meeting.

2.8 Security Trustees/Agents

In New Zealand, securitisations will have a security trustee (rather than a security agent) that is generally an independent trustee company. The security trustee holds the security on trust for secured creditors of the securitisation (the investors and other parties to the securitisation).

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

Please see the descriptions in **1.2 Structures Relating to Financial Assets**, **6.1 Insolvency Laws**, **6.2 SPEs** and **6.3 Transfer of Financial Assets** regarding the use of trusts, trustee companies, trust managers and true sale.

3.2 Principal Warranties

Warranties vary, depending on the role of the party that is giving the relevant warranties.

Most importantly from a sale perspective, an originator will warrant:

- the existence and validity of receivables and related security;
- that it complied with all material laws in relation to the origination process;
- as to key characteristics of the receivables and related security; and
- that the receivables and related security meet defined eligibility criteria.

The most common remedies for breach of such warranties are repurchase by the originator and/or an indemnity or other compensatory payment from the originator.

The warranties given by the trustee of an SPE are focused on (among other things) the validity of the trust, its status as the sole trustee of the trust and its solvency.

3.3 Principal Perfection Provisions

Perfection is required to occur when certain perfection triggers exist. For example:

- insolvency of the originator;
- a termination of the appointment of the originator as servicer where an appropriate substitute has not been appointed; or
- where required by law or a relevant court.

Following such a perfection trigger, the SPE must notify the relevant obligors of the transfer, ensure the related security is transferred into its own name and potentially require the receivables files to be delivered to it.

To the extent the originator's assistance is required to perfect the SPE's title to the receivables and related security, the originator covenants to provide such assistance. In addition, it will grant a power of attorney in favour of the SPE to enable it to undertake any perfection action the originator is required to do.

3.4 Principal Covenants

As with warranties, the covenants given in a securitisation depend on the party's role in the structure.

Usual covenants given by the originator include covenants about how the sale process for future receivables will be undertaken, its repurchase

obligations in the event of a warranty breach and assistance with any perfection process.

Trustee and Trust Manager Covenants

As described in **1.2 Structures Relating to Financial Assets**, the trustee of an SPE will also be subject to restrictions on its activities in order to limit the number of potential creditors and manage insolvency risk, among other objectives. This limitation of trustee discretion is combined with obligations on the trust manager to operate the trust adequately in accordance with the parameters set out in the programme documents. For example:

- determining amounts payable under the waterfalls;
- directing the trustee regarding acquisitions of authorised investments (including new receivables); and
- confirming whether certain actions may trigger a ratings downgrade.

Servicer Covenants

The principal covenants given by the servicer relate to how it will service the portfolio, including:

- collecting the receivables;
- transfer of funds to the SPE;
- holding funds on trust for the SPE;
- compliance with the originator's servicing guidelines; and
- compliance with material laws.

Warehouse securitisations usually have more bespoke covenants (including additional reporting obligations) as required by the particular warehouse lenders.

3.5 Principal Servicing Provisions

Servicing of the relevant portfolio is usually undertaken by the originator acting as servicer. A detailed servicing agreement is agreed at the outset of the securitisation. In addition, the originator's servicing standards are also reviewed by the warehouse lenders or (in the case of rated securitisations) the rating agencies. Under the servicing agreement, the servicer provides both day-to-day management and collection services for the portfolio.

The servicer's appointment can be terminated in certain circumstances, ranging from unremedied breaches of a material covenant to insolvency of the servicer.

In some non-bank securitisations, back-up servicers or standby servicers may also be appointed at the outset of the securitisation.

3.6 Principal Defaults

The usual defaults used in securitisations include:

- failure to pay interest and principal when due (in respect of the most senior class of debt);
- failure to perform obligations which have a material adverse effect;
- insolvency of the SPE;
- withdrawal of material consents; and
- invalidity of key programme documents.

Covered bond programmes have both issuer-level (the registered bank) and SPE-level events of default. In such cases, additional defaults include a failure to meet asset coverage or amortisation tests in relation to the cover pool.

Upon an event of default, the notes or warehouse debt is accelerated and the security over the

assets becomes enforceable. A post-enforcement waterfall is used following such defaults.

Warehouse securitisations typically have a multi-step process prior to a default being triggered, comprising:

- stop-funding events, when the warehouse facility ceases to be available;
- amortisation events, when the warehouse facility must be amortised; and
- events of default, when the warehouse facility is accelerated and the security becomes enforceable.

3.7 Principal Indemnities

A number of indemnities can be given in a securitisation. By way of example, it is common for the originator to undertake to repurchase "ineligible" receivables from an SPE or provide an indemnity where it fails to do so. In addition, the trustee of an SPE will also give indemnities under the programme documents – although in such a case the indemnity is limited to its recourse to the trust assets. It is also common for the trust manager and trustee to indemnify lead managers/dealers to any note issuance.

3.8 Bonds/Notes/Securities

The terms and conditions relating to the notes are typically contained in a note deed poll or securitisation-specific document, such as a series notice or series supplement.

The terms and conditions relating to the notes include:

- form and status of the notes;
- provisions for payment of interest and principal; and
- events of default and consequences of these (see **3.6 Principal Defaults**).

3.9 Derivatives

The most common derivatives used in securitisations are to manage risks arising from the cashflows of the securitised assets, most typically interest rate swaps. These swaps are used to swap the interest rate of the receivables (typically a fixed rate) for the floating interest rate payable on the notes.

Where the currency of the receivables differs from the currency of the notes, currency swaps would also be used.

3.10 Offering Memoranda

As discussed further in **4.2 General Disclosure Laws and Regulations**, securitisations in New Zealand are generally not public offers and so offering memoranda or other offering documentation are not required. However, these are often provided to potential investors in a term securitisation. They typically contain a summary of the securitisation documentation, information about the SPE and originator and identify key risks that may impact the likelihood of the notes issued by the SPE being repaid.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

There are currently no securitisation-specific disclosure laws or regulations in New Zealand.

4.2 General Disclosure Laws or Regulations

The primary legislation that regulates the New Zealand capital markets is the Financial Markets Conduct Act 2013 (FMC Act). The FMC Act applies to any offer of financial products in New

Zealand regardless of where the resulting issue or transfer occurs or where the issuer is resident, incorporated or carries on business. The FMC Act sets out the disclosure requirements for offers of financial products, which includes the debt securities offered in a securitisation.

"Retail" and "Wholesale" Investors

For an offer of financial products to "retail investors" (a regulated offer), among other requirements, a product disclosure statement (PDS) must be prepared and certain information relating to the offer must be contained in a publicly available register entry for the offer.

Securitisations in New Zealand are not marketed to retail investors. Other than a registered bank's internal RMBS and covered bond programmes, the market is dominated by warehouse securitisations and, depending on market conditions, term outs of those warehouse securitisations.

Accordingly, the obligations imposed on regulated offers do not apply. Instead, securitisations are marketed to sophisticated "wholesale investors", in particular:

- "investment businesses";
- "large entities" (those with net assets exceeding NZD5 million or consolidated turnover exceeding NZD5 million in each of the two most recently completed financial years); and
- "government agencies",

each as defined in the FMC Act. Securitisations are not marketed to all categories of wholesale investors, as capturing certain other investors would trigger other regulatory requirements.

Fair Dealing Provisions

An offer that is not a regulated offer will still be subject to the general fair dealing provisions in the FMC Act. Broadly, these fair dealing provisions prohibit an issuer from engaging in conduct that is misleading or deceptive or likely to mislead or deceive in relation to a financial product, from making a false or misleading representation in relation to certain aspects of a financial product, or from making "unsubstantiated" representations.

Contraventions of a fair dealing provision in the FMC Act may give rise to civil liability in respect of which a court or the Financial Markets Authority (FMA) may make certain declarations and orders. Such orders include a pecuniary penalty not exceeding the greatest of:

- the consideration for the relevant transaction;
- three times the amount of the gain made or the loss avoided; and
- NZD1 million in the case of an individual or NZD5 million in any other case.

Regulatory Bodies

The principal regulatory bodies for securitisations are:

- the FMA – whose functions include monitoring compliance with, and investigating conduct that constitutes or may constitute breaches of, financial markets legislation; and
- the RBNZ – which is responsible for the prudential regulation of banks, non-bank deposit takers and insurance providers.

Registered banks in New Zealand are regulated by the RBNZ, and a registered bank's exposure to any securitisations will impact on its capital adequacy requirements, as discussed in **4.3 Credit Risk Retention** and **4.6 Treatment of Securitisation in Financial Entities**.

APS 120

In addition, the "big four" New Zealand banks (ANZ Bank New Zealand Limited, ASB Bank Limited, Bank of New Zealand and Westpac New Zealand Limited) are owned by Australian parent banks. These Australian parent banks are subject to the Australian Prudential Regulation Authority's Prudential Standard APS 120 (APS 120) in relation to securitisations. As subsidiaries of these regulated Australian parent banks, the big four New Zealand banks may be required to comply with APS 120.

Covered Bonds

A significant use of securitisation technology in New Zealand for registered banks is through the issuance of covered bonds. Similar to the United Kingdom, New Zealand has a legislative framework for covered bonds which provides legal certainty as to the treatment of cover pool assets in the event of an originator's liquidation or statutory management. However, as this legislation was not passed until 2013, the New Zealand covered bond programmes share certain key features with securitisations, namely a bankruptcy-remote SPE and true sale of the underlying assets.

4.3 Credit Risk Retention

There are no specific laws or regulations in New Zealand with respect to credit risk retention in relation to non-bank issuers. However, the RBNZ does impose limits on the aggregate funding registered banks can provide to non-consolidated associated SPEs under its current capital adequacy framework (see **4.6 Treatment of Securitisation in Financial Entities**).

In addition, as also discussed in **4.2 General Disclosure Laws or Regulations**, the big four banks may be affected by APS 120. For capital-relief securitisations, APS 120 caps the level of holding or funding of non-senior notes issued in a securitisation or provision of other loss positions or credit enhancements.

4.4 Periodic Reporting

As noted in **4.2 General Disclosure Laws or Regulations**, securitisations in New Zealand are structured to avoid being a regulated offer. This also means that the issuer would not be subject to the majority of statutory ongoing governance and periodic reporting requirements set out in the FMC Act.

While there are no specific legislative requirements for periodic reporting, the warehouse programme documents would usually impose such requirements. For term securitisations, periodic reporting is also provided (usually on the payment dates for the notes).

In addition, where an RMBS is intended to be eligible for the RBNZ's repurchase facility, one of the ongoing requirements is to submit a monthly report to the RBNZ. For asset-backed commercial paper or asset-backed securities, originators need to update the RBNZ regularly on the net value of the underlying asset pool and any changes to the assets in that pool.

Registered banks also include disclosures about securitisations/covered bond programmes in their publicly available disclosure statements.

4.5 Activities of Rating Agencies

There are no laws or regulations in New Zealand with respect to rating agencies' securitisation activities.

4.6 Treatment of Securitisation in Financial Entities

The RBNZ prudentially regulates the banking sector in New Zealand. It imposes conditions in

respect of a bank's registration as a registered bank, which include a requirement to comply with capital and liquidity requirements. If a registered bank has not complied with its conditions of registration, the RBNZ can recommend to the government that the bank should have its registration as a registered bank cancelled. Criminal penalties may also apply in respect of a breach of a registered bank's conditions of registration.

New Zealand's capital adequacy framework, with which locally incorporated registered banks are required to comply, sets out how a registered bank is required to account for its securitisation activities in determining its capital adequacy compliance obligations.

A registered bank must consolidate an SPE when determining the banking group for the purposes of the capital adequacy framework if:

- the banking group is required under New Zealand generally accepted accounting practice to consolidate the SPE for the purposes of its group financial statements;
- the SPE is a "covered bond SPV" for the purposes of the New Zealand legislative framework for covered bonds;
- the registered bank or a member of its banking group has provided credit enhancement in the form of a guarantee, or in such a form that the maximum extent of the liability cannot be quantified;
- there is insufficient separation between the bank and the securitisation; or
- the securities issued by the SPE have a shorter maturity profile than the underlying assets, and the registered bank may be required to fund some of the assets when the securities mature.

If a registered bank provides credit enhancement to an SPE but is not required to consolidate the SPE, it still must take this into account in its calculations of capital, for example as a deduction from Common Equity Tier 1 Capital.

The amount of aggregate funding provided to all associated SPEs not consolidated as described above and all affiliated insurance groups must not exceed 10% of the registered bank's Common Equity Tier 1 Capital. Where the 10% limit is breached, the full amount of funding must be deducted from Common Equity Tier 1 Capital.

Non-bank Deposit Takers

The RBNZ also imposes restrictions on related-party exposures and imposes capital requirements on non-bank deposit takers. For these purposes, a non-bank deposit taker must consolidate an SPE for the purposes of its capital and related party calculations if this would be required under New Zealand accounting standards for the purposes of group financial statements.

Deposit Takers Act

The regulation of deposit takers and banks has recently been reviewed and resulted in the Deposit Takers Act 2023 (DTA) which will implement, among other things, capital requirements to be set through standards or as conditions of licences on individual deposit takers once it is fully in force. Consultation on the DTA's application to develop policy, standards and regulations have commenced and will continue ahead of the DTA's full commencement by no later than 2029.

4.7 Use of Derivatives

There are no specific rules in New Zealand regarding the use of derivatives in securitisations.

4.8 Investor Protection

There are no specific investor protection rules applicable to securitisations. However, the fair dealing provisions (described in **4.2 General Disclosure Laws or Regulations**) apply to securitisations.

4.9 Banks Securitising Financial Assets

There are no other specific rules that apply to registered banks that securitise their financial assets, except for the impact of APS 120 (in relation to the "big four" banks) referred to in **4.2 General Disclosure Laws or Regulations** and **4.3 Credit Risk Retention**.

4.10 SPEs or Other Entities

The most common form of SPE used in securitisations is a trust, as described in **1.2 Structures Relating to Financial Assets**. Companies have also been used, but are less common.

Please see the description in **1.2 Structures Relating to Financial Assets** in relation to the use of trusts, which are generally accepted and well-established for New Zealand securitisations. Trusts were originally used in the New Zealand market for tax reasons, particularly in relation to achieving tax neutrality.

Separately, as discussed in **4.2 General Disclosure Laws or Regulations**, securitisations are not offered to all types of wholesale investor in order to ensure the SPE is not subject to other regulatory requirements.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Other than selling restrictions to ensure that any offer of notes, and any subsequent sales, are only made to certain categories of wholesale investors, as described in **4.2 General Disclosure Laws or Regulations** and **4.10 SPEs or Other Entities**, there are no particular activities that a securitisation entity would try to avoid.

4.12 Participation of Government-Sponsored Entities

No government-sponsored entities in New Zealand participate in the securitisation market other than the RBNZ through its repurchase facility (which applies to various types of debt securities) or as a potential investor.

4.13 Entities Investing in Securitisation

Typical investors in a securitisation include banks, fixed income managers, insurance companies (including life insurance companies), superannuation funds (such as KiwiSaver funds), hedge funds and government agencies. Any restrictions on these investments will depend on the rules of the particular entity, such as statutory requirements, constitutional documents and/or investment policies.

4.14 Other Principal Laws and Regulations

There are no further details to discuss.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

There is no express prohibition on carrying out synthetic securitisations in New Zealand. However, in recent years such transactions have generally not been seen in the New Zealand market.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

In New Zealand, financial assets must be the subject of a true sale by the originator to the relevant SPE in order to insulate the SPE from the financial risk of the insolvency of the originator. If the transfer is not a true sale (and could be characterised as a secured loan), certain creditors of the originator may have recourse to the SPE's assets such that the assets would form part of the originator's insolvent estate.

6.2 SPEs

As mentioned in **1.2 Structures Relating to Financial Assets**, securitisations in New Zealand are usually structured using a trust as the SPE. Companies have also been used, but are less common.

There are a number of risks of some form of consolidation in insolvency proceedings of the originator, the most likely of which are set out below.

Statutory Management

Currently, statutory managers can be appointed under four statutes, depending on whether the originator is a licensed insurer, registered bank, an overseas person with an interest in sensitive assets or is otherwise a "corporation". The equivalent provisions of the DTA use the term "resolution managers" instead, who are appointed by the RBNZ acting as the resolution authority. If a statutory manager is appointed to the originator, there is a risk that the assets of the SPE will be consolidated with the assets of the originator. For this to occur, the SPE must be a subsidiary or an "associated person" of the originator. The definition of an associated person varies depending on the relevant operative statute. Whether the SPE is an associated person of the originator is broadly a question of whether the originator exercises ownership or control over the SPE. It is not possible to assess or address this risk in the abstract – consideration of all the circumstances of the structure of the securitisation is required and a legal opinion from counsel is usually necessary.

Liquidation

Unwinding

In certain circumstances, a liquidator appointed to the originator could unwind the transfer of assets from the originator to the SPE or the granting of security by the SPE to the security trustee. The originator or SPE (as applicable) usually gives various solvency certifications upon the transfer of the assets to the SPE, or the granting of security (as applicable), to mitigate these risks.

Pooling

There is also the risk that a liquidator appointed to the originator may seek a court order to "pool" the SPE's assets together with the originator's assets such that the total pool of assets is available to satisfy the claims of the originator's creditors. This can occur if the SPE is "related" to the originator. This risk can be addressed by ensuring that the affairs of the originator and the SPE are operated in such a manner as to avoid the operation of the pooling provisions of the Companies Act 1993.

Registered Banks

Where the SPE is established in respect of a registered bank's covered bond programme, the analysis is simplified by the legislative framework noted in **4.2 General Disclosure Laws or Regulations**, which means that, if properly structured, the risks of the SPE being caught by the statutory management and liquidation of the originator should not exist.

As noted in **4.6 Treatment of Securitisation in Financial Entities**, the DTA will implement a new regime for the regulation of registered banks (and other deposit takers), including crisis management and resolution of such entities and their associated persons. Full details of such provisions, in particular how they may apply to SPEs, are still to be confirmed.

6.3 Transfer of Financial Assets

The two essential elements of a true sale are an absolute transfer of property (rather than a transfer by way of security) and the payment of a price. In determining whether a transaction is a true sale or is more properly characterised as creating a security interest, it is necessary to first consider the intention of the parties, and second to consider the substance of the transaction taken as a whole. A court will give effect to the intention of the parties unless it reaches the conclusion that the form of the transaction is a sham and the transaction is more properly characterised as the creation of security.

Ultimately, it is a factual matter as to whether a transaction is characterised as a true sale or a secured loan.

Assignment

The transfer of financial assets for a securitisation is generally done via two possible methods:

- in relation to receivables (eg, a mortgage loan), this would be an absolute assignment of a legal thing in action for the purposes of Section 50(1) of the Property Law Act 2007 (an absolute assignment); and
- in relation to certain types of security supporting receivables (eg, the mortgage over land that secures the mortgage loan), this would be an equitable assignment.

Neither of these methods requires notice to the underlying obligors to be effective as a true sale.

Under an absolute assignment, the originator passes on to an SPE all its rights and remedies in relation to the receivables and the power to give a good discharge to the relevant obligor.

It is not necessary for notice to be provided to the relevant obligor before these rights, remedies and powers pass to the SPE. However, the passing of those rights, remedies and powers is subject to any equities in relation to the receivables that arise before the relevant obligor has actual notice of the assignment.

Notice to the relevant obligor is required to "perfect" the assignment and thereby prevent further equities arising that have priority over the SPE's claim. In the case of certain underlying security (eg, a mortgage over land), additional steps are also required to perfect the assignment (such as registration of a transfer in respect of a mortgage over land). The originator usually grants a power of attorney to allow these perfection steps to take place upon certain perfection triggers occurring (as discussed further in **3.3 Principal Perfection Provisions**).

If a transfer does not comply with the above requirements for a true sale, the SPE may face the risk that the receivables are recovered by an insolvency practitioner appointed to the originator (because of the bankruptcy remoteness risks discussed in **6.1 Insolvency Laws** and **6.2 SPEs**).

The Personal Property Securities Act 1999

In contrast, for a secured loan, the secured party would take a security interest over the relevant receivables. This is a much simpler process under the Personal Property Securities Act 1999

(PPSA) than the true sale of a receivable and requires perfection, usually by registration of a financing statement on the Personal Property Securities Register or the taking "possession" of the relevant receivables. However, merely taking security over the receivables exposes the SPE to the bankruptcy risk of the originator (which is described in **6.1 Insolvency Laws** and **6.2 SPEs**), and so is not used in securitisations in New Zealand.

The PPSA does, however, need to be considered when undertaking a securitisation in New Zealand. For example, the security granted by the SPE to the security trustee needs to be perfected (this is usually achieved via registration of a financing statement on the Personal Property Securities Register). In addition, transfers of accounts receivable, chattel paper and leases of greater than one year are deemed to be security interests under the PPSA. Accordingly, the perfection and priority regime of the PPSA needs careful consideration when structuring a securitisation. For example, when transferring chattel paper under a securitisation, the best form of perfection is the SPE taking possession of the underlying chattel paper in order to ensure it obtains the best priority against competing interests in the chattel paper.

6.4 Construction of Bankruptcy-Remote Transactions

There are no other means of constructing a bankruptcy-remote transaction that are commonly used in New Zealand.

A legal opinion would be obtained from counsel to support the true sale characterisation and bankruptcy remoteness of the transfer. The legal opinion may qualify the conclusions based on known facts and matters.

6.5 Bankruptcy-Remote SPE

As mentioned in **6.1 Insolvency Laws**, the transfer of the financial assets to the trust SPE is structured as a true sale to ensure the bankruptcy remoteness of the trust SPE from the originator. See **6.3 Transfer of Financial Assets** for further discussion regarding the true sale. These arrangements will be reflected in the securitisation documents. In addition, the securitisation documentation will include provisions that any recourse to the SPE is limited to the assets held by it (limited recourse provisions) and that no insolvency proceedings may be taken against the SPE (non-petition provisions).

7. Tax Laws and Issues

7.1 Transfer Taxes

In a New Zealand context, financial assets are typically transferred directly from the originator to an SPE as the ultimate transferee (ie, the SPE is not an intermediate entity in the chain of transactions).

For an originator, the transfer of financial assets (other than operating leases) may give rise to tax where there is a disposal of the relevant financial asset.

If the financial asset is a trade receivable, in respect of which income has already been recognised, no further income should arise from the transfer of the trade receivable. If the financial asset is treated, effectively, as a debt instrument for the purposes of the financial arrangements rules contained in the Income Tax Act 2007, the transfer will be treated as a disposal for the agreed consideration. The net difference between the cost of the financial asset (eg, principal advanced) and the consideration for the financial arrangement will give rise to income

where the consideration exceeds the cost (or, where the reverse is the case, will give rise to deductible expenditure).

The tax treatment of the transfer of operating leases is somewhat more complex, as the consideration for the transfer gives rise to income, typically with no offsetting costs basis, and therefore acceleration of the income for the originator.

The DF SPV regime in the Income Tax Act 2007 can be used to ensure that income acceleration (for both debt instruments referred to above and operating leases) does not arise. The DF SPV regime, in short, allows the originator to elect to treat the SPE as transparent for tax purposes, thereby attributing the SPE's property, purposes, activities and arrangements to the originator. The effect is that no tax consequences attach to transactions occurring between the SPE and the originator. In order to use the DF SPV regime, the SPE must be consolidated with the originator for financial reporting purposes.

The originator is able to elect into the DF SPV regime under the Income Tax Act 2007 from the commencement of its securitisation arrangements. Alternately, it can elect into the regime from when it files its tax return for the relevant income year (and the election then has effect for that year).

7.2 Taxes on Profit

SPEs are subject to income tax in relation to the income earned from those financial assets which are subject to securitisation. Typically, the SPE is debt funded in such a manner that its deductions offset substantially all of the income derived. The consequence is that generally no net income (or no material net income) arises for an SPE for New Zealand income tax purposes.

7.3 Withholding Taxes

In relation to withholding taxes, where an SPE is non-resident and acquires financial assets which are interest bearing, and obligors are New Zealand resident, non-resident withholding tax is applicable, for example, where the financial assets constitute residential backed mortgages. There is no practical manner in which the withholding tax can be dealt with. Consequently, for such securitisations, the SPE is generally a resident entity for New Zealand income tax purposes to ensure that non-resident withholding tax is not applicable to interest flows which may arise from the financial assets transferred to the SPE. New Zealand does have a withholding tax for residents, but the SPE will typically be able to avail itself of an exemption for this tax.

7.4 Other Taxes

New Zealand has no stamp duty or other transfer taxes which apply to the transfers of financial assets. Similarly, New Zealand goods and services tax (GST) generally does not apply to the transfer of financial assets as such a transfer is treated as an exempt supply for GST purposes.

No other material tax issues arise in connection with securitisations in New Zealand.

7.5 Obtaining Legal Opinions

Legal opinions are obtained for securitisations and those legal opinions are generally focused on the tax neutrality of an SPE (ie, to ensure that it has no – or materially no – net income on an annual basis from the securitisation). That conclusion is typically reached in relation to securitisations in New Zealand.

The opinion is typically given subject to a range of qualifications, based on the circumstances of the particular structure of the securitisation.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Issues may arise in connection with the accounting rules that apply to securitisations in New Zealand. A common issue is whether it is possible for the originator to achieve off-balance sheet treatment. Accounting issues are dealt with by the originator's accounting firm. In the case of registered banks and non-bank deposit takers in New Zealand, the RBNZ's rules also take accounting treatment into account in determining the impact of securitisations on the entity's capital adequacy requirements. This is described in more detail in **4.6 Treatment of Securitisation in Financial Entities**.

8.2 Dealing with Legal Issues

The primary legal issues arising in relation to New Zealand securitisations are addressed elsewhere in this chapter.

NORWAY

Law and Practice

Contributed by:
Markus Nilssen, Vanessa Kalvenes and Marcus Cordero-Moss
BAHR

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BAHR is one of the best-known firms in Norway, and has been successfully advising leading Norwegian and global clients since 1966. The firm has, on multiple occasions, assisted Norwegian and foreign clients with questions regarding securitisation, and the firm assisted in the first ever securitisations under Norwegian law by a Norwegian bank and by a Norwegian bank's foreign branch. BAHR's banking and finance team, with over 40 specialists, advises banks and borrowers on many of the largest and most innovative transactions in the region. The firm assists financial institutions, including investment and retail banks, insurers, asset managers, investment funds and leasing companies, as well as borrowers, on the full range of financing transactions. This is supported by one of the region's leading financial regulatory practices.

Authors

Markus Nilssen is a partner in BAHR with a special focus on capital markets and financial regulations. He regularly advises clients on various regulatory matters and corporate finance transactions in the DCM and ECM markets. Markus is an expert on Norwegian covered bonds legislation and regularly acts for several of Norway's largest covered bond issuers. He also has a broad experience from advising on various types of corporate and financial arrangements and transactions, including securitisation and other structured finance transactions, factoring, public M&A, corporate restructurings and general corporate finance work.

Vanessa Kalvenes is a managing associate with BAHR and regularly advises on capital markets transactions and all aspects of financial regulations. She has broad experience on various regulatory matters, capital management and transactions in the debt capital markets. Vanessa specialises in capital requirements for banks, regulatory capital and various forms of securitisation. She also advises on covered bonds legislation and frequently acts for Norway's largest covered bond issuers. She has experience from advising on various types of finance and capital markets transactions, including traditional and synthetic securitisations, syndicated bank loans, bond loans and mergers and acquisitions of prudentially regulated financial entities.

Marcus Cordero-Moss is a senior associate specialising in banking and finance, with a particular emphasis on financial services regulation and structured finance.

Contributed by: Markus Nilssen, Vanessa Kalvenes and Marcus Cordero-Moss, **BAHR**

BAHR

Tjuvholmen Allé 16
0252 Oslo
Norway

Tel: +47 21 00 00 50
Email: post@bahr.no
Web: www.bahr.no

1. Specific Financial Asset Types

1.1 Common Financial Assets

There is no active securitisation market in Norway for the time being and therefore no market practice exists regarding commonly securitised financial assets.

1.2 Structures Relating to Financial Assets

See **1.1 Common Financial Assets**.

1.3 Applicable Laws and Regulations

See **1.1 Common Financial Assets**.

1.4 Special-Purpose Entity (SPE) Jurisdiction

See **1.1 Common Financial Assets**.

1.5 Material Forms of Credit Enhancement

See **1.1 Common Financial Assets**.

2. Roles and Responsibilities of the Parties

2.1 Issuers

In a traditional securitisation transaction, the issuer is a bankruptcy-remote SPE which acquires the underlying financial assets from the originator by way of a true sale. The issuer finances the acquisition of the financial assets with proceeds from notes issued by it to investors in the capital markets. In synthetic securitisation, the credit risk associated with the financial assets is transferred to the SPE with the use of financial guarantees or credit derivatives. If it is a funded transaction, the SPE issues credit-linked notes to investors to put up the cash that is required as collateral for the SPE's obligations as credit protection seller. For further details on SPEs, see **6.2 SPEs**.

2.2 Sponsors

The original lender, originator, servicer and sponsor will typically be the same entity, normally a bank. In these circumstances, the original lender/originator will normally remain the debtors' primary point of contact for dealings with their loan after the securitisation.

Under Regulation (EU) 2017/2402 (the "Securitisation Regulation"), it is required that the sponsor either be an investment firm or a credit institution.

2.3 Originators/Sellers

The originator/seller is the entity which was involved in the original agreement which created the financial assets being securitised or which has purchased a third party's financial assets on its own account and then securitised them.

2.4 Underwriters and Placement Agents

To fund the acquisition of the underlying portfolio in a securitisation, the SPE issues notes in the capital markets. In this process it is assisted by placement agents and underwriters, commonly referred to as arrangers and/or mangers (usually investment banks). They are responsible for structuring the securitisation transaction, marketing the notes and may also act as underwriters. If the originator itself is an investment bank, it may act on its own behalf in this role.

2.5 Servicers

The servicer manages the pool of purchased receivables or the underlying credit exposures on a day-to-day basis. To protect the rights and interests of the debtors under securitised loans, recently adopted Norwegian legislation requires the servicer of a securitised loan portfolio to be either a bank, a non-banking credit institution or a finance company, if the originator is a financial institution. The requirement ensures that the servicer is proper and fit to service and collect the securitised loans.

As a general rule, there are no restrictions on the replacement of the servicer with another entity, for example if the servicer does not comply with its contractual obligations or becomes insolvent. The Norwegian Ministry of Finance (the Ministry of Finance) noted in the preparatory works to the recently adopted Norwegian legislation that the replacement should be executed in an orderly manner. Among other things, this entails protecting the rights and interests of the debtors and providing for continued reporting under the Norwegian Act on Debt Information following a replacement.

The servicer is under an obligation to take necessary steps to protect the rights and interests of the debtors under the securitised loans and to secure that the debtors are not treated differently than if the underlying loans had been transferred to a financial institution.

To ensure a sound treatment of complaints from debtors under the securitised loans arising after the transfer of the loans to the SPE, the servicer shall represent the SPE in non-judiciary dispute resolution mechanisms organised by the state.

2.6 Investors

By subscribing for the issued notes, investors of securitisation positions fund the SPE's acquisition of the corresponding underlying financial assets. Further, the investors assume the credit risk of the securitised portfolio as investors only have recourse to the cash flows generated by the portfolio.

The Securitisation Regulation includes a number of due diligence and monitoring requirements for investors.

2.7 Bond/Note Trustees

The trustee is appointed to safeguard the noteholders' rights and interests and to be their representative in dealings with the issuer. Further, the trustee monitors the conduct of other parties during the life of the transaction and the distribution of cash flows generated by the underlying

pool of assets. In an enforcement scenario, the trustee will act on behalf of the noteholder community.

2.8 Security Trustees/Agents

The role of the security agent is to create, manage and, if necessary, enforce security on behalf of the noteholder community.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

As outlined in more detail in **6.1 Insolvency Laws**, under Norwegian law, bankruptcy-remote transfers require a legal, valid and binding transfer agreement between the originator and the SPE. Further, the transfer must be considered a "true sale", meaning that the substantial risk on the underlying financial assets must be transferred to the SPE.

There are no specific requirements to ensure that a transfer of financial assets is valid and enforceable. For a legal charge to be valid it must be established in accordance with the Norwegian Pledge Act. To obtain legal perfection, additional requirements must be met; see **6.3 Transfer of Financial Assets**.

As there is currently no active securitisation market in Norway and the adopted securitisation framework has still to enter into force, it is not possible to indicate the principal subject matters covered in documentation for securitisation transactions.

3.2 Principal Warranties

See **3.1 Bankruptcy-Remote Transfer of Financial Assets.**

3.3 Principal Perfection Provisions

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.4 Principal Covenants

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.5 Principal Servicing Provisions

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.6 Principal Defaults

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.7 Principal Indemnities

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.8 Bonds/Notes/Securities

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.9 Derivatives

See **3.1 Bankruptcy-Remote Transfer of Financial Assets**.

3.10 Offering Memoranda

See **4.2 General Disclosure Laws or Regulations**.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

The recently adopted Norwegian legislation includes a requirement to inform the debtors under securitised loans of the identity of the SPE,

of the servicer, and of the rights and obligations of the SPE and the servicer towards the debtor. The information must be provided no later than three weeks before the loans are sold and transferred from the originator to the SPE. The rules do not afford the debtors any right to object to the transfer or opt out of the securitisation.

4.2 General Disclosure Laws or Regulations

In addition to the legislative acts outlined in **4.1 Specific Disclosure Laws or Regulations**, Regulation (EU) 2017/1129 (the "Prospectus Regulation") has been incorporated in Norwegian law and will be the main source of general disclosure obligations for public securitisation transactions undertaken by Norwegian originators.

Under the Prospectus Regulation, a prospectus shall contain the necessary information which is material to an investor for making an informed assessment of:

- the assets and liabilities, profits and losses, financial position, and prospects of the issuer and of any guarantor;
- the rights attaching to the securities; and
- the reasons for the issuance and its impact on the issuer.

The prospectus shall also include risk factors, but only those risks which are material and specific to the issuer and its securities.

The application of the Prospectus Regulation depends on whether the offering or listing of securities in a securitisation requires a prospectus to be published. This is the case where there is a non-exempt public offering or a listing of the SPE's securities on a regulated market.

4.3 Credit Risk Retention

The recently adopted Norwegian legislation does not contain requirements on credit risk retention above and beyond what is set out in the Securitisation Regulation.

To secure a certain degree of alignment between the investors' and the originator's interests in a securitisation transaction, the Securitisation Regulation requires the originator, sponsor or original lender to comply with certain risk-retention requirements. In general, a minimum of 5% of the net economic credit risk related to the securitisation must be retained.

The Securitisation Regulation includes an exhaustive list of five acceptable risk retention techniques. It is expected that many parties will prefer the less complex risk-retention methods – ie, first loss exposure (where the parties retain a first loss exposure of at least 5% of every securitised exposure in the securitisation) and vertical slice (where the parties retain at least 5% of the nominal value of each tranche sold or transferred to investors).

The Securitisation Regulation also sets out certain exemptions from the risk-retention requirement – eg, in cases where the securities are fully, unconditionally and irrevocably guaranteed by central banks or central governments.

4.4 Periodic Reporting

Under the Norwegian Act on Debt Information, Norwegian financial institutions are required to report certain information to an authorised debt registry institution. As the SPE is exempted from the local licensing requirement, and thus not a financial institution for these purposes, the recently adopted Norwegian legislation instead imposes the reporting obligation on the servicer

of the securitised portfolio (usually the originator).

The transparency requirements under the Securitisation Regulation include periodic reporting obligations. Pursuant to Article 7, the responsible entity in a securitisation transaction shall make quarterly investor reports available, or, in the case of asset-backed commercial paper, monthly investor reports.

4.5 Activities of Rating Agencies

The activities of rating agencies are regulated in Regulation (EU) 1060/2009 (CRA Regulation), amended by Regulation (EU) 513/2011 (CRA 2) and Regulation (EU) 462/2013 (CRA 3). These regulations provide the regulatory framework for credit rating agencies and are incorporated by reference in Norwegian law. Among other things, credit rating agencies are required to be registered and supervised, and are required to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing.

Notably, Article 8c in the CRA Regulation requires the issuer in securitisation transactions to obtain a double credit rating, issued by two different credit rating agencies. Further, the issuer should consider appointing at least one credit rating agency which does not have more than 10% of the total market share.

ESMA is responsible for registration and supervision of credit rating agencies in the EU. In Norway, the Financial Supervisory Authority of Norway (FSAN) is the competent authority under the CRA Regulation.

4.6 Treatment of Securitisation in Financial Entities

Norwegian credit institutions and investment firms are subject to the regulatory capital requirements under Regulation (EU) 575/2013 (the "Capital Requirements Regulation" or CRR). The CRR has been amended by the so-called "banking package" consisting of Regulation (EU) 2019/876 (CRR II), Directive (EU) 2019/878 (CRD V) and Directive (EU) 2019/879 (BRRD II).

Norwegian legislation implementing the "banking package" entered into force in June 2022.

Under the CRR, the originator may exclude the underlying exposures in a securitisation from the calculation of its risk-weighted exposure amounts and expected loss amounts if:

- significant credit risk associated with the securitised exposures is considered to have been transferred to third parties (significant risk transfer or SRT); or
- the originator institution applies a 1.250% risk weight to all securitisation positions it holds in the securitisation or deducts these securitisation positions from its Common Equity Tier 1 items.

If any of these requirements are met, credit institutions and investment firms will only be required to hold regulatory capital for the securitisation positions they retain in the transaction. The retained securitisation positions receive risk-weights which are calculated under the applicable approach set out in the CRR.

As competent authority under the CRR, the FSAN may decide on a case-by-case basis that significant credit risk shall not be considered to have been transferred from the originator to the SPE (the commensurate risk transfer test). How-

ever, where the originator is able to demonstrate that the reduction in capital it needs to hold after the securitisation is justified by a corresponding and true credit risk transfer from the originator to third parties, this test will be passed.

4.7 Use of Derivatives

The recently adopted Norwegian legislation does not include any specific provisions relating to the use of derivatives in securitisation transactions other than what follows from the Securitisation Regulation.

Norway has implemented Regulation (EU) 648/2012 (EMIR).

4.8 Investor Protection

The key elements of investor protection consist of asset segregation, bankruptcy remoteness, risk retention and disclosure provisions in the Securitisation Regulation as well as the disclosure requirements in the Prospectus Regulation.

Further, the Securitisation Regulation requires a minimum standard of due-diligence measures from institutional investors before investing in securitisation positions. This includes a comprehensive and thorough understanding of the securitisation position and its underlying exposures. The investor is also required to monitor the positions on an ongoing basis and implement written policies and procedures for the risk management of the securitisation position.

4.9 Banks Securitising Financial Assets

Under Norwegian law, there are no specific rules applicable to securitisations performed by banks as compared to other financial institutions. Norwegian banks will be permitted to securitise their financial assets and also invest in securitisation positions. Accordingly, any such transactions will be subject to the same legal framework as described elsewhere in this chapter, with the overriding legal framework being the Securitisation Regulation and the CRR.

4.10 SPEs or Other Entities

There are no special rules that apply to the form of SPEs accomplishing securitisations in Norway. As noted in **6.2 SPEs**, Norwegian corporate or similar law is not very well suited for SPEs in securitisation transactions and it is assumed that Norwegian financial institutions wishing to use securitisation would utilise SPEs registered outside of Norway, for instance in Ireland or Luxembourg.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

There are no specific provisions under Norwegian law which relate to activities that should be avoided by SPEs in relation to securitisations.

Under the Securitisation Regulation, the SPE may only perform activities appropriate to accomplishing the purpose of carrying out securitisations.

4.12 Participation of Government-Sponsored Entities

There is currently no active securitisation market in Norway and thus no government-sponsored entities participate in the Norwegian securitisation market.

The new Norwegian legislation does not contain any particular rules preventing securitisation from being carried out by government-sponsored entities.

4.13 Entities Investing in Securitisation

Norwegian investors are not restricted from investing in foreign securitisation positions. The impact of the new securitisation framework on

the Norwegian capital market is difficult to predict. Generally, the investor base for securitisation positions in true sale securitisations are expected to consist mainly of large and institutional investors, such as financial institutions, pension funds and insurance companies. The riskier tranches of true sale securitisations and synthetic securitisations are expected to be placed with investors demanding a higher rate of return on their investment and who are willing to accept higher risk – eg, specialised funds.

4.14 Other Principal Laws and Regulations

See **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisation is a securitisation whereby the credit risk associated with the underlying financial assets is transferred to an SPE and/or investors without a true sale. This can be achieved either by the use of credit derivatives or financial guarantees.

Compared to traditional securitisation, synthetic securitisation is both more flexible and faster to implement, mostly due to the fact that the underlying financial assets are not transferred by way of a true sale transaction. Thus, the costs related to the transaction may be lower than for a traditional securitisation. In contrast to traditional securitisations, the purpose of a synthetic securitisation is almost always capital management and very rarely funding.

Synthetic securitisation will be subject to the same legal framework as traditional securitisation in Norway. Applicable laws depend on the structure of the transaction. For instance, the provision of a financial guarantee in a synthetic securitisation may trigger a local licensing requirement and the use of credit derivatives to transfer credit risk may be subject to the requirements under EMIR.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

The Norwegian legislation currently in force does not explicitly provide for securitisation and, in practice, securitisation is therefore impossible for Norwegian financial institutions.

Prior to 2016, Norwegian securitisation rules existed but were viewed as inflexible and inadequate to promote an active securitisation market in Norway. However, following the implementation of the Securitisation Regulation in the EU, the Ministry of Finance published a legislative proposal on 4 December 2020, to implement expected corresponding EEA rules into Norwegian law by cross-reference in Norwegian legislation. The legislative proposal was passed by the Norwegian Parliament on 23 April 2021, but has not entered into force at time of writing in November 2023. It is expected that the new legislation will take effect at the same time as the Securitisation Regulation is implemented in the EEA Agreement, the timing of which is still unknown. The new legislation will allow Norwegian financial institutions to securitise financial assets under the same legal framework as other financial institutions in the EU.

From the outset, the Securitisation Regulation only provided for simple, transparent and standardised (STS) designation for traditional securitisations. However, in April 2021, the EU

passed Regulation (EU) 2021/557 and Regulation (EU) 2021/558 amending the Securitisation Regulation and the CRR to also provide an STS framework for synthetic securitisation transactions. On 7 September 2021, the Ministry of Finance published a consultation paper on new legislation to implement these two regulations in Norway. The consultation paper was prepared by the FSAN and follows on from the Norwegian Parliament's adoption, on 23 April 2021, of the new legislation to implement the Securitisation Regulation in Norwegian law. It is expected that this legislation will enter into force simultaneously with the legislation implementing the Securitisation Regulation.

6.2 SPEs

Norwegian corporate or similar law is not particularly well-suited to facilitate the use of Norwegian SPEs in securitisation transactions. Based on feedback received in the legislative hearing, the Ministry of Finance assumed in its legislative proposal that Norwegian financial institutions will likely prefer to use SPEs registered outside of Norway in securitisation transactions, for instance SPEs registered in Ireland or Luxembourg. Consequently, amendments to Norwegian corporate or similar law have not been proposed and adopted at this stage.

6.3 Transfer of Financial Assets

There are no specific requirements to ensure a transfer of financial assets is valid and enforceable by the transferee against the transferor under Norwegian law. However, legal perfection rules must be observed to ensure protection against the transferor's creditors. In case of transfer of monetary claims, the debtor to such claims must be notified, as further described below.

Legal charges must be established pursuant to the terms of the Norwegian Pledge Act. Certain requirements must be fulfilled for the legal charge to be valid between the parties. Notably, it is not permitted to establish a "floating" charge over all the chargor's assets. Furthermore, the chargor may not grant security over less than the chargor's entire ownership in the charged asset.

6.4 Construction of Bankruptcy-Remote Transactions

As outlined in **6.1 Insolvency Laws**, the securitised financial assets would, as a general rule, not form part of the originator's insolvency estate as they do not "belong to" the insolvent originator following a true sale of the assets. To ensure that the underlying assets are bankruptcy remote, it is key that the substantial risks associated with them are transferred to the SPE. Further, the overriding claw-back provisions in Norwegian insolvency legislation must be observed.

6.5 Bankruptcy-Remote SPE

See **6.1 Insolvency Laws**.

7. Tax Laws and Issues

7.1 Transfer Taxes

There is no stamp duty or other documentary taxes on the transfer of financial assets. Certain fees must be paid for registering title transfers in the relevant mortgage registers and there are maximum fees for electronic mass-registration of multiple title transfers.

7.2 Taxes on Profit

As outlined in **6.2 SPEs**, it is expected that Norwegian securitisations will utilise SPEs registered outside of Norway. Generally, Norwegian income tax would not apply to the non-Norwegian SPE's income which is derived from the acquired underlying financial assets.

7.3 Withholding Taxes

Effective from 1 July 2021, a 15% withholding tax applies to interest payments made to related parties in low tax jurisdictions. Payments to entities genuinely established and conducting real economic activity in an EU/EEA member state are exempt from such withholding tax.

7.4 Other Taxes

The Norwegian legislation implementing the Securitisation Regulation does not address the tax treatment of securitisation transactions. Currently, there is no active securitisation market in Norway and historically the activity in the Norwegian securitisation market has been low mainly due to an impractical framework. Thus, there is very little guidance and certainty on the tax treatment of securitisation transactions in Norway.

7.5 Obtaining Legal Opinions

There is no active securitisation market in Norway for the time being.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The recently adopted legislation does not include any securitisation-specific accounting rules.

In general, the accounting analysis would be independent of the legal analysis. Consequently, a securitisation may be considered off-balance sheet from a legal perspective but on-balance sheet for accounting purposes.

With respect to the de-recognition of the underlying financial assets in the originator's balance sheet, the preparatory work to the recently adopted Norwegian legislation refers to the accounting for financial instruments under International Financial Reporting Standards 9 (IFRS 9).

8.2 Dealing with Legal Issues

As already noted, there is no active securitisation market in Norway for the time being. However, it is not market practice in Norway for legal opinions to also address accounting matters.

PERU

Trends and Developments

Contributed by:
Andrés Kuan-Veng
Rubio Leguia Normand

Rubio Leguia Normand is a leading Peruvian law firm with a team of over 70 lawyers, with presence in three different offices across Peru, located in Lima (principal office), Cajamarca and Trujillo. The firm has more than 40 years' experience advising national and international companies in practice areas such as banking and finance, capital markets, corporate law, M&A, project finance, real estate, labour and employment, tax, mining, environment, and dispute resolutions, among others. The 2023 "PEN Deal of the Year", granted by Bonds, Loans & ESG Capital Markets – Latin America & Caribbean, was recently awarded to our clients Citi, JP Morgan, Santander and HSBC for the "New Issue and Exchange and Tender Offer Targeting Soberanos1 with maturities in 2023, 2024, 2026 and 2028; and a cash tender offer targeting Global Bonds with maturities 2025, 2026, 2027, 2030 and 2031" transaction in which Rubio Leguia Normand acted as advisers.

Author

Andrés Kuan-Veng is partner and head of the financial and corporate practice at Rubio Leguia Normand, specialising in capital markets, sovereign debt, corporate law, securities, M&A and banking law, among others. With more than 20 years of experience, he has participated in public and private securities issuances in the international market (including IPOs and issues under Regulation S and Rule 144-A), acquisition of companies (including listed companies through public tender offers), financing of projects with special concentration in energy sectors and infrastructure (health, ports and roads), asset-backed financing (including securitisations), and banking regulation.

Rubio Leguia Normand

Av. Dos de Mayo 1321
San Isidro
Lima
Peru

Tel: +51 208 3000
Fax: +51 208 3000
Email: abogados@rubio.pe
Web: www.rubio.pe

Contributed by: Andrés Kuan-Veng, **Rubio Leguia Normand**

Introduction

The Peruvian economy is experiencing a mild growth across the different sectors and activities. For 2023, Peruvian GDP is expected to grow by 0.8%, due to the impact of commodities prices, political uncertainty and meteorological phenomena, among others. Notwithstanding this, the securitisation structure continues to be a useful tool in order to reduce (at least partially) the risks inherent to all financing structures.

The main developments in securitisation trends and practices for 2023 include the following.

- The development of opportunities to carry out asset securitisation processes given the economic effects of the COVID-19 pandemic.
- At the pinnacle of the COVID-19 crisis, the adoption by the Peruvian government of securitisation programmes created to serve as guarantee to safeguard the stability of the economy.
- The development of asset securitisation processes given the economic effects of "El Niño", the meteorological phenomenon ("Climate Event") consisting of increased rainfall that currently affects road infrastructure, urbanisations, supply chains and agribusiness development, among others.
- The Municipality of Lima has announced the issuance of bonds to finance urban transport projects.
- The creation of a securitisation trust for urban transport infrastructure development in Lima and Callao, as safeguard to obtaining loans and financial resources for the aforementioned projects.
- The growth of local REITs (Real Estate Investment Trust – FIBRA by its acronym in Spanish).
- The initiative to develop a secondary market for low-income housing by the Peruvian Housing Development Bank (Fondo MIVIVIENDA).
- During 2023 Dina Boluarte, Peruvian President, announced the creation of the first securitisation trust, for infrastructure projects promotion and the execution of the National Sustainable Infrastructure Plan for Competitiveness 2022–2025 (PNISC 2022–2025 by its acronym in Spanish).

Market Developments

MML securitisation bonds

The Municipality of Lima has announced, in December 2023, the issuance of bonds to finance urban transport projects, for the sum of PEN1,205 million, which is part of an issuance programme totalling PEN4 billion. This strategic initiative aims to prioritise four crucial infrastructure projects. The transaction represents the largest local currency capital market issuance of the year.

The funds raised through the above-mentioned securitisation bonds issuance will be used to finance several key initiatives. Among said initiatives are:

- the expansion of the Metropolitano bus network (transit bus system that operates in Lima);
- the construction of the San Juan de Miraflores–Independencia (two peripherical districts) aerial cable car urban transit system;
- the development of a new train system; and
- the development of retaining walls to mitigate potential risks of river overflows.

This comprehensive approach underscores the municipality's commitment to carry out essential infrastructure projects for the benefit of the community.

Securitisation trust for urban transport infrastructure development in Lima and Callao

The urban transport system in Lima (capital city) and Callao (nearest province) lacks developed infrastructure, leading to security concerns and elevated transport costs, among other issues. To address these, Legislative Decree No 1613 has been enacted. According to the provisions of this Legislative Decree, the Urban Transportation Authority for Lima and Callao (ATU, by its acronym in Spanish) will act as trustor, enabling the transfer of specific assets and rights to a securitisation trust. The primary objective of this transfer is to secure credits and financial resources, with the purpose of developing urban transport infrastructure projects in Lima and Callao.

Projects initiated under this securitisation trust may be executed through various modalities, including:

- Government-to-Government;
- the National Supply System regime;
- Private Investment National System regime; or
- Public Works Tax Deduction modality.

Comparison between the amount of offers registered with the SMV in 2019, 2020, 2021 and 2022

In 2019, securitisation bonds amounting to PEN230 million were placed through primary public offerings; in 2020, 2021 and 2022, there were no securitisation bonds placed through primary public offerings. Likewise, in 2023, no securitisation bonds were placed through primary public offerings.

However, the above does not mean that the market is stagnant. Private placement of securitisation bonds/certificates are not public and publicly disclosed filings of existing REITs show that the securitisation market remains profitable.

Further, even though new issuances have not occurred through public primary offerings in the past three years, the Peruvian market as of November 2023, had over USD420 million in placed securities issued through securitisation structures through primary public offerings.

Comments on leading cases

The first and main regulated REIT in Peru has a USD500 million framework programme registered before the SMV. As of November 2021, a total of USD60 million of securitisation bonds backed up by said trust had been placed on the market.

On the other hand, on 27 November 2020, the SMV registered the largest programme in the history of the Peruvian securities market for up to USD2 billion with respect to a REIT.

Comments about the development of private offers

Although as a general rule private offerings of securities are outside the scope of supervision of the SMV, according to Article 333 of the Securities Market Law (LMV by its acronym in Spanish, and Article 332 of its Unified Text (*Texto Único Ordenado*) published in 2023), private offerings of securitised instruments may only be offered to institutional investors. Likewise, the securities acquired by these investors may not be transferred to third parties, unless they do so in favour of another institutional investor or the security is previously registered before the Public Registry of the Securities Market.

According to the Income Tax Law, in cases of securitisation carried out through REITs, it is the

investor who must pay the tax and not the trust itself. In this sense, the rates that the law has established (which are listed in Resolution SMV No 021-2013-SMV-01) have been quite attractive for the market:

- 5% for individuals;
- 29.5% for companies; and
- 0% for institutional investors.

The preferential rate for institutional investors serves as an incentive to structure financing schemes through securitisation programmes aimed at institutional investors.

In addition, the average time for approval of a public offering is usually approximately 30 business days and the registration of securities entails the obligation to periodically disclose information as a material event (*hecho de importancia*). Such additional costs and obligation to disclose information on a periodic basis have in certain cases led companies to opt for securitisation schemes through private offerings.

Reactiva Perú

Description of the programme through the securitisation scheme

The Peruvian declaration of emergency and mandatory social distancing generated a negative impact on the local economy, decreasing spending and affecting the income of Peruvian companies. With this in mind, to protect the payment chain, the Peruvian government approved a guarantee programme to provide working capital, named Reactiva Perú, for up to PEN60 billion, through Legislative Decree 1455. This programme has two financing forms: (i) individual guarantee and (ii) portfolio guarantee, the latter being a securitisation trust that facilitates the granting of national government guarantees. It should be noted that, notwithstanding termination of the emergency regime, the Peruvian economy continues to be affected, which is why the programme has been expanded by regulations issued in September 2023. In November 2023, the Peruvian Prime Minister announced that amendments to the above-mentioned programme shall take place in the next few months.

The programme allows companies in the financial system (ESF by its acronym in Spanish) (with their own funding) to choose to provide working capital loans to those companies that meet the programme's eligibility requirements. In turn, the ESFs enter into a guarantee agreement with *Corporación Financiera de Desarrollo* (a Peruvian state-owned development bank – COFIDE by its acronym in Spanish) that establishes the terms for granting the national government's guarantee to the loans placed by the ESFs, which will be transferred to a securitisation trust to be administered by COFIDE as trustee and securitisation company and whose trustee is the Ministry of Economy and Finance.

In that sense, the ESFs transfer to the trust the credit portfolios they have placed under the programme. In consideration for the transfer of the loan portfolio, two certificates of participation of the trust are issued: (i) for the percentage covered and (ii) for the balance of the portfolio without additional guarantees.

The guarantees of the programme only serve as a back-up as long as they are used, exclusively, in operations of the Central Reserve Bank of Peru (BCRP by its acronym in Spanish).

Why securitisation is the ideal mechanism (security for autonomous assets, feasibility of issuing participation certificates in favour of banks and the government)

Securitisation is an ideal mechanism for the guarantee programme because it allows ESFs to obtain greater immediate cash flow by being able to trade the certificates issued that are backed by the government.

Likewise, even though the financial entity granted the loan portfolio in a pass-through capacity, it will continue to be in charge of collecting payments from the loans and the companies that have obtained the loans from the ESFs, under the terms and conditions agreed upon.

COFIDE's involvement and regulatory changes that allow it to be a trustee

Given that the SMV is the authorised regulator for securitisation companies, by means of Superintendent's Resolution No 00041-2020-SMV/02, provisions were approved so that COFIDE may act as a securitisation company in the guarantee programme of Reactiva Perú and in the National Government's Guarantee Programme for the Credit Portfolio of the Companies of the Financial System under Legislative Decree No 1508.

Future Market Trends: What To Expect

Securitisations to restructure debts

Companies have been using securitisation structures to improve the management of their liabilities. A good example is that of a group of Peruvian schools that in October of 2020 placed a second issue of social bonds through a private offering under its First Securitised Bond Programme for an amount of USD17 million and a term of 15 years, thereby redeeming and cancelling securitisation bonds that were outstanding and issued in 2014.

It is worth highlighting the particularity of this case because it was not only a securitisation process but also a securitisation process with the issuance of thematic (social) bonds certified by an independent verifier, which has been increasing in the local market in recent years.

Securitisation for Peruvian Housing Development Bank (Fondo MIVIVIENDA)

There is an initiative to develop a secondary market for low-income housing by the Peruvian Housing Development Bank (Fondo MIVIVIENDA) loans. In the Peruvian market, securitisation trusts can help provide cash flow to Fondo MIVIVIENDA, as local regulation offers legal instruments to bolster the secondary trade of mortgages. At the present time, the housing market faces a lack of liquidity.

Securitisation for small to medium-sized enterprises (SMEs)

In the Peruvian market, securitisation trusts can help provide cash flow to SMEs, as local regulation does not limit their use to only originator companies with large-scale assets. The current lack of liquidity of local companies and the increased risk aversion of banks create an ideal space for SMEs to seek new financing schemes that allow them to obtain liquidity in the short term.

PNISC 2022–2025 public–private securitisation trust

The PNISC 2022–2025 incorporates a sustainability approach, with the Peruvian government actively promoting inclusive and sustainable development of infrastructure. This plan is designed to serve as a catalyst for economic growth, enhance competitiveness, address disparities, and to allow the implementation of infrastructure projects. Additionally, it aims to provide widespread access to public services, ultimately

improving the quality of life for citizens and placing them at the core of the State's priorities.

Prioritising 72 projects with a total investment of PEN146 billion, the PNISC 2022–2025 spans key sectors such as transportation, communications, water and sanitation, energy, oil and gas, environment, production, agribusiness, education, and health.

In line with these objectives, President Dina Boluarte announced, on 28 July 2023, the creation of the first public–private securitisation trust. This pioneering structure aims to allow the execution of PNISC 2022–2025 projects without jeopardising Peru's fiscal stability.

PORTUGAL

Law and Practice

Contributed by:
Benedita Aires, Orlando Vogler Guiné and Beatriz Francisco da Costa
VdA

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Authors

Benedita Aires is a partner in VdA's banking and finance practice. She has been actively involved in several transactions in Portugal and abroad, mainly focused on the issue and placement of debt and equity instruments and other structured financial products, as well as classic financing. She has also been actively working in securitisation transactions, covered bonds issuances, other types of asset-backed transactions and real estate financing. Benedita has been involved in public recapitalisation transactions and the application of resolution measures to Portuguese banks, including the incorporation of bridge banks and the approval of the state aid and restructuring plans for those banks by the European Commission. She regularly contributes to industry publications.

Orlando Vogler Guiné is of counsel in VdA's banking and finance practice, where he has been actively involved in several capital markets transactions, including corporate bonds and covered bonds issues, securitisations, liability managements, undertakings for collective investment, and derivatives – assisting some of the leading institutions in the financial and non-financial sectors. He also regularly advises on banking capitalisation and resolution matters, and is a recognised author on securities and corporate law matters.

Beatriz Francisco da Costa is an associate in the banking and finance practice at VdA, where she has been actively involved in cross-border and domestic transactions, advising issuers, originators, arrangers and other market players, particularly on securitisation and warehousing. She also plays an active role in real estate finance transactions (including those financed by bond issuances), the issuance and placement of debt instruments in several jurisdictions and advising leading institutions in the financial and non-financial sectors on derivatives-related matters.

VdA

Rua Dom Luís I 28
1200-151 Lisboa
Portugal

Tel: +351 21 311 3400
Email: vieiradealmeida@vda.pt
Web: www.vda.pt

1. Specific Financial Asset Types

1.1 Common Financial Assets

In recent years, the most common securitised performing assets among financial institutions have been:

- mortgage loans (both retained and market deals);
- commercial mortgage loans;
- consumer loans (secure and unsecured, including auto loans); and
- SME loans.

For non-financial institutions, electricity receivables (tariff deficits and the like) have been the most commonly securitised asset, along with highway toll receivables, tax and social security credits and TV broadcasting rights receivables.

In the non-performing loan (NPL) segment, the most significant assets have been secured loans from banks (in particular, non-performing mortgage loans), without prejudice to unsecured loan transactions. This market segment has been very active over the years and banks have significantly reduced their stock of NPLs. This momentum is expected to continue, particularly considering the high interest rates across Europe and Portugal and the potential increase of the NPL ratio.

As the sustainable finance trend progresses swiftly, sustainable securitisation is expected to grow, noting that the first Iberian green RMBS was originated and issued out of Portugal in 2020.

1.2 Structures Relating to Financial Assets

The structure and documentation package is essentially the same regardless of the asset class, with the relevant adjustments dictated by the type of assets.

1.3 Applicable Laws and Regulations

The applicable legal framework is the same regardless of the asset class.

1.4 Special-Purpose Entity (SPE) Jurisdiction

Portuguese regulated securitisation companies (multi-issue SPEs) known as STCs are used for cash securitisation (please see **6.2 Transfer of Financial Assets**). Where an SPE is used in synthetic securitisations, it is typically incorporated in Ireland, which is a legal and tax-friendly jurisdiction for SPEs.

1.5 Material Forms of Credit Enhancement

The same types of credit enhancement forms are typically found in Portuguese securitisations as in other jurisdictions, including:

- tranching of the notes;
- subordination of the claims of different noteholders and transaction creditors in the payment waterfalls;
- various types of cash reserves held in a specified cash reserve account;
- over-collateralisation; and
- hedging instruments (most commonly IRS or caps).

Guarantees and letters of credit (which can only come from unrelated parties under the Securitisation Law) are not common and may trigger unintended tax consequences.

2. Roles and Responsibilities of the Parties

2.1 Issuers

Please see **6.2 SPEs**. As noted, STCs are the typical vehicles used to purchase receivables portfolios and issue securitisation notes, as FTCs add an unnecessary layer of complexity. STCs are to be used exclusively as securitisation vehicles, by entering into transactions with the above features, which always require the prior approval of the Portuguese Securities Market Commission (the CMVM).

For reference, there are several STCs in the Portuguese market – some are more directed to the performing securitisation market and others are more devoted to the NPL segment. In any case, the legal object of any STC can comprise both types of deals.

2.2 Sponsors

No parties have exclusively taken on the role of sponsor (and certainly not within the meaning of the Securitisation Regulation). To some extent, the role one would consider to be that of a sponsor is normally split between the originator (for the retention obligation, for instance) and the relevant arranger or lead manager.

2.3 Originators/Sellers

These roles are the same as those found in other jurisdictions. Typically, originators have been commercial banks and other credit institutions but also non-financial institutions such as energy distributors, highway concessionaires and football clubs. The originators are responsible for generating the data tape relating to the pool of assets being securitised, and for complying with the applicable risk retention and transparency requirements.

2.4 Underwriters and Placement Agents

These roles are the same as those found in other jurisdictions. Underwriters have typically been investment banks, but in more recent years other parties have stepped into the market (eg, financial boutiques). Although these parties are not banks, they are typically regulated and arrange the transaction, source investors and place the notes (but do not subscribe them, in the sense that the risk of lack of placement remains with the issuer/originator and not the placement agent).

2.5 Servicers

The roles of servicers are generally the same as those found in other jurisdictions. Regarding performing assets, the servicers will normally be the originators but can be other entities, as provided for in the Securitisation Law, provided that the entity has obtained the approval of the CMVM. The mandated servicer is expected to act with a degree of diligence as a prudent lender of the specific type of assets, and the law expressly sets out that the servicer will carry out all the acts necessary or adequate to the proper management of the assets and their respective guarantees, on behalf of the assigning entity, including collection services, administrative services and ensuring all relationships with the debtors. In the NPL segment, and also for deconsolidation purposes, the servicers tend to be independent specialised third parties instead of the originator.

A project Decree-Law on the activity of servicing companies has been discussed in Portugal but its submission for approval has not yet occurred, so its contents are not taken into account herein.

2.6 Investors

Investors in securitisations can be regulated or non-regulated investors. Typically, there is a wholesale denomination of the securitisation

notes (EUR100,000), and no Key Investor Information Document (KIID) under Regulation (EU) 1286/2014 of 26 November 2014 (the PRIIPs Regulation) is expected to be produced, so the target market of the securitisation notes does not include retail investors. Regulated investors will need to ensure that they properly perform diligence for the transaction, including by confirming that the originator (or another eligible entity) has agreed to retain a relevant economic net exposure (under the applicable EU, US or other laws).

2.7 Bond/Note Trustees

Bondholders' Common Representative

Portuguese law does not recognise the concept of a common law trustee, but it does have the concept of the bondholders' common representative, who performs a similar role of representing the interests of the noteholders. Even though the common representative legally enjoys less discretion and more limited powers than a trustee, in practice the difference is mitigated, given that trustees under English law usually tend to avoid taking material action without a noteholder direction.

The common representative's role is documented in the terms and conditions of the notes and in a common representative appointment agreement, which follows the structure and contents applicable to trustees under English law, to the extent possible.

The role of the common representative can be performed by, inter alia, credit institutions and entities specifically set up for the trustee business. In any case, it is advisable for trustees to obtain Portuguese law advice on their role and responsibilities, particularly trustees entering into this business in Portugal for the first time.

According to Article 65 of the Securitisation Law and Article 359 of the Portuguese Commercial Companies Code, the common representative is generally entitled to perform all the necessary acts and operations in order to ensure the protection of the interests and rights of the noteholders in the context of the issuance of the notes, acting as a representative of the noteholders, as follows:

- to represent the noteholders in respect of all matters arising from the issuance of the notes and to exercise their legal or contractual entitlements on their behalf, under the terms set forth in the documents;
- to enforce any decision taken by the noteholders' meetings calling for the delivery of an enforcement notice declaring the notes capable of being accelerated;
- to represent the noteholders in any judicial proceedings, including in judicial proceedings against the issuer and, in particular, in the context of any execution proceedings and insolvency proceedings commenced against the issuer;
- to collect and examine all the relevant documentation in respect of the issuer that is provided to the shareholder(s) of the issuer; and
- to provide the noteholders with all the known relevant information regarding the issuance of the notes.

Representative's rights

The rights of the common representative under the documents will be enforceable in Portuguese courts by the common representative against the purchaser, the originator and the servicer (in these latter two cases under the terms set forth in the co-ordination agreement), by virtue of the applicable legal regime and further to the provisions in this respect contained in the documents, with the common representa-

tive being entitled to enforce the noteholders' rights thereunder acting on their behalf. Upon the enforcement of any given right, Portuguese courts will require the relevant entity to provide enough evidence of its right to claim. The duties and obligations of the common representative under the documents that are expressed to be governed by Portuguese law (including the co-ordination agreement) will be enforceable in Portuguese courts.

As a matter of Portuguese law, the common representative would also be entitled to give notice to the CMVM of any event that could give rise to the CMVM revoking the authorisation granted to the issuer to operate as a credit securitisation company, without incurring any costs. However, as this matter is subject to the discretion of the regulators and may only be ascertained in specific contexts, no assurance can be given as to the position the CMVM would ultimately take in this respect.

Appointment

It is important to stress that, in similar terms to those that have been provided for in the Italian context, the assets segregation principle and the legal creditor's privilege over the assets exclusively allocated to a given issue of securitisation notes, which are clearly established in the Securitisation Law, seem to dispense with the need for the function of a "security trustee" in connection with this transaction, with the common representative of the noteholders acting rather like a "spokesperson" or co-ordinator of the noteholders in respect of certain matters, performing the type of role that is usually played by "trustees" in transactions designed under common law jurisdictions.

In the case of insolvency, an infringement of contractual duties and obligations or any other default situation occurring in respect of the common representative, the retirement thereof and the corresponding appointment of a substitute common representative would happen simply following a decision by the meeting of noteholders, as provided for in Article 65.3 of the Securitisation Law.

According to Article 65.6 of the Securitisation Law, the isolated enforcement of the noteholders' entitlements may be restricted by the documents, whenever it is in contradiction of the valid decisions taken at the meeting of noteholders.

There is no legal requirement for there to be a common representative, and some private deals have avoided this, having the usual rights of a common representative directly vested in the noteholders.

2.8 Security Trustees/Agents

Portuguese law does not recognise the concept of a common law trustee, and typical securitisation structures in Portugal do not have a security agent. In any case, the Securitisation Law provides for the direct creation of security over the transaction assets to the benefit of the investors.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The receivables are assigned (sold) under a certain type of specific Receivables Sale Agreement (or a transfer document with a similar name and purpose). This agreement essentially mirrors the terms and structure found in other jurisdictions, including the identification of the assets and a package of representations and warranties on the relevant receivables portfolio and their origination, given as of the relevant collateral deter-

mination date (and sometimes repeated on the closing date).

3.2 Principal Warranties

The warranties package is much in line with other jurisdictions, considering that the relevant concerns are essentially the same. In light of the Securitisation Law, the originator will represent and warrant that:

- the legal requirements applicable to securitised receivables are met;
- the receivables have been duly originated and serviced;
- the relevant consumer and data protection laws (where applicable) have been respected;
- there are no defaults at all or in excess of a given number of days (except for NPLs);
- the relevant security is in force and perfected, etc.

The typical remedy under Portuguese law for a breach of contract, including incorrect representations, is the indemnification of the other party, even if the contract does not expressly provide for this. In any case, indemnities are always provided for in receivables sale agreements. For a breach of representations in respect of the receivables portfolio, the originator may also have to repurchase the relevant receivables and/or substitute them for other eligible receivables (as is more common), as an alternative to indemnification.

3.3 Principal Perfection Provisions

The assignment of the receivables takes place once the parties have entered into the receivables sale agreement and all conditions precedent are met. A specific formality applies in cases where there is security subject to public registration (such as mortgages), as the parties' signatures must be notarised or certified by a lawyer or the company secretary.

As discussed in **6.3 Transfer of Financial Assets**, except in the NPL market, the perfection of security vis-à-vis third parties is usually not conducted immediately by the issuer (in order to avoid costs in a context where the originator retains the servicing), even though it holds the right to do so. Thus far, there have been no performing securitisations where the issuer has actually followed these steps.

3.4 Principal Covenants

Covenants exist across all the documentation from the various parties. The key covenants are normally legal obligations already under the Securitisation Law and/or Portuguese law generally, so it is more a matter of the documentation providing detail on how they shall be complied with. It is also worth noting that the covenants package is much in line with what would be expected in other jurisdictions, notably under English law agreements, which were the original inspiration for Portuguese securitisation documentation.

Among others, the documentation always includes:

- a covenant from the relevant issuer to pay, under the terms and conditions of the securitisation notes and/or in the common representative appointment agreement;
- a covenant from the originator to repurchase or substitute receivables not meeting the relevant eligibility criteria (see **3.2 Principal Warranties**); and
- various covenants from the servicer (see **3.5 Principal Servicing Provisions**).

As far as is known, there has been no actual litigation where the principal covenants package has been discussed in court between transaction parties. When a possible matter arises, the transaction parties negotiate and have so far always reached an amicable outcome, including by granting waivers or amending the transaction documentation, with the benefit (where applicable) of a noteholders' resolution.

3.5 Principal Servicing Provisions

The Securitisation Law already sets out the key obligations of the servicer – ie, to diligently service the assets, and to collect the relevant monies and pass them on to the issuer. The servicing agreements then add further detail, with provisions much in line with what can be expected in other jurisdictions, notably under English law agreements, which were the original inspiration for the Portuguese securitisation documentation.

A common key provision requires the servicer to service the assets under the same criteria as if they were its own, but the documentation may also contain certain provisions on changes to the servicer's operating procedures. This typically includes the servicer being restricted from agreeing to certain variations to the receivables agreements with the borrowers, unless the originator repurchases or substitutes them (and that repurchase or substitution is normally capped by a certain threshold, which is usually a certain percentage – eg, 10%, 20% – of the initial principal outstanding amount of the receivables portfolio).

The servicing agreements always include a schedule with detailed servicing provisions, including on the segregation and transfer of funds received by the applicable issuer account (and respective periodicity – daily is the most common), to avoid commingling risk within the servicer's estate.

Provisions on information and reporting, including the servicer report, are also necessary (and even more so following the reporting requirements under the Securitisation Regulation). Following the publication of Regulation (EU) 2016/679 of 27 April 2016 (GDPR), it is also key to have detailed provisions on data protection procedures and the allocation of responsibilities between the servicer and the issuer (in performing securitisations, the servicer will actively manage such data and the issuer will essentially be passive and have no actual access to such data, except in cases of servicer event/default, which so far have not arisen).

As far as is known, there has been no actual litigation where the principal servicing provisions have been discussed in court between transaction parties. When a possible matter arises, the transaction parties negotiate and have so far always reached an amicable outcome, including by granting waivers or amending the transaction documentation, with the benefit (where applicable) of a noteholders' resolution.

3.6 Principal Defaults

Under Portuguese law, it is not necessary for default provisions to be specified in a contract in order for a default to have legally taken place (and a claim to be based thereupon), if a given obligation that is written in or implied into that contract is breached. In any case, the documentation will show the typical default events also found in the same type of agreements in other jurisdictions, and notably under English law, including the terms and conditions of the notes, the servicing agreement or the accounts agreement. These include default for non-payment, a breach of other obligations and an insol-

vency event, among others (sometimes a rating downgrade). Normally (except in some cases for insolvency), the occurrence of the event will not automatically lead to termination or acceleration, but will rather entitle the counterparty to serve a notice to that effect. It is also usual to find certain default events being qualified by a material adverse effect concept.

As far as is known, there has been no actual litigation where the principal servicing provisions have been discussed in court between transaction parties. When a possible matter arises, the transaction parties negotiate and have so far reached an amicable outcome, including by granting waivers or amending the transaction documentation, with the benefit (where applicable) of a noteholders' resolution.

3.7 Principal Indemnities

Under Portuguese law, the contracts are not required to contain indemnity language in order for a party that breaches its obligations to be legally required to indemnify the counterparty. In any case, and as one would expect in this sort of transaction, the agreements contain indemnity language (sometimes quite long language), which is a direct influence of the English law templates that inspired the first Portuguese securitisation documents.

It is also common to include indemnity limitation language, including in terms of amount (eg, for certain matters the servicer is not required to indemnify above a certain multiple of the servicer fee) or in terms of conduct. In this latter respect, under Portuguese law, indemnification cannot be excluded if the default is wilfully attributable to the breaching party or if it acted with gross negligence, but it is possible to exclude for "mere" negligence. It is also worth noting that indemnities by the issuer to other transaction parties are usually contained within the transaction and are payable as issuer expenses, and thus in priority over payments to noteholders in the payments waterfall and without contaminating other securitisations or the issuer's own funds.

As far as is known, there has been no actual litigation where the indemnity provisions have been discussed in court between transaction parties. When a possible matter arises, the transaction parties negotiate and have so far reached an amicable outcome.

3.8 Bonds/Notes/Securities

Terms and conditions will generally cover all matters relating to the notes as would generally be found in other jurisdictions, including:

- the relevant payment priorities;
- applicable events of default;
- the conditions for early redemption of the notes;
- the applicable taxation regime; and
- general provisions for noteholders' meetings.

3.9 Derivatives

Derivatives may be contracted for SPEs to hedge risks, notably currency and interest rate risks. It is also possible to enter into credit default swaps or other derivatives with a hedging purpose, on the side of the SPE. Before the financial crisis, it was quite common to have an interest rate swap (IRS) in place for rated deals, in order to hedge the floating or fixed component of interest rates. Hedging was not used during the years when securitisations were generally retained deals. There is now a renewed and increased use of derivatives, more often in the form of interest rate cap transactions.

3.10 Offering Memoranda

The material forms of disclosure include a duly approved prospectus, prepared in accordance with the EU Prospectus Regulation (and its complementing Regulation (EU) 2017/1129), unless the transaction does not require a prospectus (ie, no admission to trading on a regulated market, or public offering requiring such). In this case (ie, private offerings, where there is no public visibility of the transaction through the means of a prospectus that is normally available at the regulator or stock exchange's website, free of charge), certain transactions include an information memorandum (as in the case of deals listed on a multilateral trading facility/unregulated market) or a transaction summary (which may resemble a prospectus, but is not approved by a regulator), while others just rely on the contractual documentation, without the need for a more comprehensive key information document. In this respect, it is relevant to consider the requirements set out under Article 7(1) c) of the Securitisation Regulation.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Regulations

Disclosure matters are generally governed by EU legislation or have an EU law source. The EU prospectus requirements are of a more general nature and will be addressed in **4.2 General Disclosure Laws or Regulations**, but the following regulations should be highlighted.

Certain disclosures need to be made and documented; their absence prevents regulated entities investing in asset-backed securities (ABS), or makes it much more burdensome for them to do so. This entails disclosure on exposure retention and ongoing information requirements.

Securitisation Regulation

On 28 December 2017, Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 was published, laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (STS 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 (the Securitisation Regulation). Such regulation became applicable on 1 January 2019 and, in the Portuguese jurisdiction, has been complemented by Law No 69/2019, of 28 August 2019, which has been amended by the Securitisation Law.

The requirements for a securitisation to be compliant with the "simple, transparent and standardised" criteria are set forth in Article 18 et seq of the Securitisation Regulation. According to these provisions, originators, sponsors and issuers will be jointly responsible for assigning the STS Securitisation designation. The final step in the labelling process is to notify regulators of the STS Securitisation designation. In Portugal, the Securitisation Law has recognised the STS Securitisation concept and the first STS Securitisation occurred in 2020, with 2021 witnessing the first STS synthetic securitisation, following the latest regulatory amendments in this respect.

Disclosure Requirements

Returning to the reporting topic, and although the Securitisation Law does not contain specific requirements, disclosure obligations for securitisation transactions are directly applicable via the Securitisation Regulation.

Article 7 of the Securitisation Regulation sets out a new set of disclosure requirements that are commonly applicable across EU member states. The details and standardised templates to be used to fulfil these requirements were published on 3 September 2020 by means of two regulations, which have applied since 23 September 2020.

These regulations further elaborate on the information to be provided to investors, competent authorities and potential investors in securitisation transactions that fall under the scope of the Securitisation Regulation, providing greater certainty and accuracy to these players.

Annexes to the Disclosure Regulatory Technical Standards (RTS) detail which information is to be provided on underlying exposures and investor reports for securitisation transactions, and on inside information and significant events for public securitisation transactions.

In turn, annexes to the Disclosure Implementing Technical Standards (ITS) contain the standardised templates for making such information available.

"No Data" Options

The Disclosure RTS also set out guidance on those cases where certain information cannot be made available or is not applicable, allowing the use of specific "No Data" options. The use of these "No Data" options is limited to those situations in which there are justifiable reasons to do so, and they should not be used to circumvent the reporting requirements set out under the Securitisation Regulation.

Securitisation repositories are required to verify the completeness and consistency of the information provided with respect to public securitisations, and that the use of the "No Data" options does not prevent the reported information from being sufficiently representative of the underlying exposures; they must also verify compliance with certain percentage thresholds.

Securitisation Repositories

Securitisation repositories centrally collect and maintain the records of securitisations, and are registered and supervised by the European Securities and Markets Authority (ESMA). Multiple technical standards on securitisation repository registration and supervisory fees were published on 3 September 2020 and entered into force on 23 September 2020, allowing for the registration of securitisation repositories with ESMA as of such date. In June 2021, ESMA informed market participants that it had approved the registrations of the first two securitisation repositories under the Securitisation Regulation (European DataWarehouse GmbH based in Germany, and SecRep B.V. based in the Netherlands), with reporting entities having to make their reports available through one of them as of 30 June 2021.

These reports shall be based on the standardised templates used since 23 September 2020 to report the relevant information in respect of the existing securitisation transactions, given that the transitional provisions that were previously in force – namely Article 43(8) of the Securitisation Regulation, which allowed for the use of the so-called "CRA III" reporting templates – have ceased to apply.

The publication of the Disclosure RTS and Disclosure ITS and the entry into force of these reporting templates was long-awaited by securitisation market stakeholders and brought a greater level of homogeneity and certainty in the information disclosed to the investors, thereby

reducing due diligence costs and increasing comparability across transactions.

4.2 General Disclosure Laws or Regulations

In the context of more general frameworks, the EU Prospectus Regulation (and its complementing Regulation (EU) 2017/1129) should be borne in mind when a prospectus is required (particularly when the listing on regulated markets of more senior tranches is involved). Note that a prospectus will only mandatorily apply to listings on regulated markets (ie, the primary trading venue of stock exchanges) or in cases where there is a public offer in place that is not exempt.

The securities issued are normally wholesale (ie, EUR100,000 minimum denomination), in which case there is a public offer exemption. However, there is no similar exemption for the listing of those securities on regulated markets, even if they are placed with sophisticated investors only. In order to obtain European Central Bank (ECB) eligibility for the most senior notes (Class A) in accordance with the ECB Guidelines, these securities shall be listed on a regulated market.

4.3 Credit Risk Retention

Although the Securitisation Law does not contain specific requirements regarding retention obligations for securitisation transactions, the Securitisation Regulation applies in respect of risk retention rules.

As such, and as is the case in other jurisdictions (such as the USA or the UK), the EU has credit risk retention obligations in place, which are framed to enhance the quality of the assets an originator securitises, from the outset. This applies from a regulated investor's perspective and entails disclosure on exposure retention and ongoing information requirements under the Securitisation Regulation.

Such investors are not allowed to invest in securitisations without such a retention obligation being ensured, or are heavily restricted when doing so. The retention obligation can be fulfilled in different ways, but the end result is the holding of no less than 5% of the risk position of the securitisation (ie, no less than 5% of a net economic interest in the securitisation). In most cases, the originator will hold 5% of the securities issued, starting from the more junior class, but it is also possible, for instance, to hold a similar position outside the securitisation (ie, an originator securitises 100 loans and commits to retaining five similar loans until the securitisation notes have been redeemed – this is the typical way for the originator to retain in NPL deals, when the originator has agreed to a retention obligation). The originator will be required not to hedge, sell or in any other way mitigate its credit risk in relation to such retained exposure.

As mentioned above, where the originator, sponsor and original lender have not agreed who will retain the material net economic interest, the originator shall do so. Multiple applications of the retention requirements for any given securitisation are not allowed, and the material net economic interest may not be split among different types of retainers (nor, likewise, subject to credit risk mitigation or hedging).

The retention obligation and the related disclosures are described in the prospectus (or other information memorandum), including in the risk factors section, and are then contractually undertaken by (typically) the originator and servicer, and by any other relevant parties (such as the transaction manager, who would typically report this information in the periodical investor

report) in the transaction agreements, notably the receivables sale agreement, the servicing agreement and the transaction management agreement.

In addition to the consequences from a risk-weighted assets (RWA) or capital ratios perspective, non-compliance may lead to fines, among other penalties.

Supervision

The retention legal requirements are typically supervised by the relevant banking, securities or insurance supervisor of the originator/investors. In Portugal, this would be the Bank of Portugal, the CMVM or the Financial Supervisory Authority (ASF), respectively. Foreign investors should look to the laws of their own jurisdiction to assess whether similar rules apply and whether it is possible to comply with those rules if the issuer or originator is subject to and complies with substantially similar rules.

4.4 Periodic Reporting

SPEs are regularly required to report information to the CMVM, including monthly information on the underlying receivables portfolio, when applicable. Accordingly, the servicing agreements should contractually require the servicers to provide monthly servicing reports, in addition to the quarterly or semi-annual reports that serve as a basis for the investor report from the transaction manager, seeing as the interest payment dates do not tend to be monthly.

The most relevant reporting requirements are set out under Article 7 of the Securitisation Regulation, which is commonly applied across the EU. According to Article 7(2) of the Securitisation Regulation, the mechanisms for disclosure depend on the type of transaction, as follows:

- for public transactions (ie, where a prospectus is required to be published under the Prospectus Directive), disclosure must be through a regulated securitisation repository; and
- for private transactions, disclosure may be done through a repository but can also be done privately.

4.5 Activities of Rating Agencies

After the outbreak of the financial crisis, legislation was published at the EU level to regulate rating agencies, the first of which was Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (CRAs) (the "CRA Regulation"). This legislation applies to their activities in general, including their rating of securitisations.

The first Credit Rating Agency Regulation was passed in 2009, and there have since been two substantial amendments. There is also the so-called CRA III framework, including the CRA III Regulation (Regulation 462/2013) and the CRA III Directive (Directive 2013/14/EU), which entailed significant amendments to the CRA Regulation on issues such as the reliance of firms on external credit ratings, sovereign debt ratings, competition in the CRA industry, the civil liability of CRAs and the independence of CRAs.

Regulated investors may only rely on ratings issued by rating agencies that are registered with ESMA or endorsed by a rating agency that is registered with ESMA. The three big rating agencies all have registered entities in the EU, and there are several other registered agencies, including DBRS Morningstar.

CRA III has introduced a requirement establishing that any issuer or related third party (such as sponsors and originators) that intends to solicit

a credit rating of a structured finance instrument must appoint at least two CRAs to provide independent ratings, and should also consider appointing at least one rating agency holding no more than a 10% total market share (a small CRA), provided that a small CRA is capable of rating the relevant issuance or entity.

ESMA is ultimately in charge of registering and supervising rating agencies and their relevant rules, with any breaches possibly leading to sanctions, including fines. It should be noted that a failure to comply with certain requirements may also prevent regulated investors investing in securities that are not duly rated in accordance with the CRA, or make it more burdensome for them to do so.

4.6 Treatment of Securitisation in Financial Entities

Under the so-called CRD IV framework (Capital Requirements Directive IV, which includes the Capital Requirements Regulation, or CRR), institutions are subject to the holding of regulatory capital against their RWAs. In this context, the CRR specifically addresses securitisations. Similar concepts will be found under the Alternative Investment Fund Managers Directive framework for other regulated entities, such as alternative asset managers, including hedge funds, or under the Insolvency II Directive framework for insurance and reinsurance undertakings.

The CRD IV framework has been amended by Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019, and implemented in Portugal by Law No 23-A/2022, of 9 December 2022. Regulation (EU) 2017/2401 of 12 December 2017 has consolidated certain sections of the above legislative acts, and shall also be considered.

In respect of credit institutions in particular, the treatment of off-balance sheet securitised exposures assigned to the issuer (receivables), regarding the calculation of the originator's capital requirements, should be highlighted, as should the treatment of securitisation positions, regarding the calculation of the relevant owner's own funds.

4.7 Use of Derivatives

The derivatives are contracted in the ISDA format, and SPEs do not normally place collateral, even though they may be receiving it from the swap counterparty, usually if certain rating triggers are met.

The CMVM supervises the use of derivatives in Portugal by SPEs under the Securitisation Law and the European Market Infrastructure Regulation.

4.8 Investor Protection

The key statutes for investor protection are the Securitisation Regulation, the Securitisation Law and, where applicable, the Prospectus Regulation, as complemented by the relevant secondary and other legislation.

4.9 Banks Securitising Financial Assets

The key statutes applicable to securitising banks are the Securitisation Regulation, the Securitisation Law, the Civil Code and the CRR, as complemented by the relevant secondary and other legislation (including Bank of Portugal and ECB regulations and guidance, which provide, inter alia, for pre-notification of the transaction and ongoing reporting, on top of the Securitisation Regulation disclosure requirements).

4.10 SPEs or Other Entities

There are only two specified SPEs in the Portuguese jurisdiction that may be assignees in

securitisations under the umbrella of the Securitisation Law: STCs and FTCs. STCs have been used consistently over the last decade (both SPEs were used previously) as they are more efficient than FTCs, which require an additional vehicle to hold the FTC's units and then issue asset-backed notes to the investors.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Portuguese securitisations are conducted using regulated SPEs. However, regulatory issues often arise stemming from other jurisdictions, notably the US, including whether or not the SPE can be considered an investment company under the Securities Act or a covered fund under the Volcker Rule. This depends on a US law analysis, but the answers have typically been negative.

The analysis of the second matter is more complex, and issuers sometimes require a US legal opinion confirming that they fall outside the scope of a covered fund. Such matters are addressed in the prospectus and also in the relevant subscription agreement and/or master framework agreement.

4.12 Participation of Government-Sponsored Entities

There are no government-sponsored entities actively participating in the Portuguese securitisation market as yet, even though there has been one significant transaction with tax and social security credits securitised by the Portuguese tax and social security authorities.

4.13 Entities Investing in Securitisation

Following the financial crisis, during which there was no real investor appetite (other than for private deals in the NPL market), new transactions have come to the market and started to be publicly placed. Placement is conducted by the relevant lead manager or placement agent. In any case, investors can include institutional investors, family offices, private equities, funds and others. EU-regulated entities are subject to certain constraints, such as due diligence on the transaction, including by confirming that the originator (or another eligible entity) agreed to retain a relevant net economic exposure (under the applicable EU, US or other laws).

4.14 Other Principal Laws and Regulations

Other than has been covered herein, there is nothing material to note in respect of securitisation transactions in Portugal.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisation is permitted but remains less common. Such transactions are defined as securitisations under Article 1 (3), paragraph b) of the Securitisation Law and under Article 2 (10) of the Securitisation Regulation. In such securitisations, there are no receivables actually being assigned, but only a transfer of credit risk on a bilateral basis. In addition, they are provided for as securitisation transactions in the banking laws and regulations, which provide the framework thereof in terms of capital treatment. They serve the same type of purpose as a credit default swap, with the relevant assets remaining in the originator's balance sheet. The principal laws to take into account are the Securitisation Regulation, the Securitisation Law and the CRR.

These transactions allow for the transfer of the credit risk of the underlying portfolio (even though there may then be exposure to the credit risk of the originator's counterparties in the syn-

thetic securitisation), which is why there is still interest in this sort of transaction among originators.

Article 8(4) of the Securitisation Law sets out specific provisions regarding the segregation of the assets included in the underlying portfolio of a synthetic securitisation. However, under the established interpretation discussed with the CMVM, the Securitisation Law will only apply if a regulated SPE is used in Portugal, and not, for instance, in the case of a direct credit-linked note issuance by the originator, which instrument has been used in the market.

As the originators are credit institutions, they are supervised by the relevant banking supervisors (and by the relevant securities regulator if a prospectus is required).

As noted above, synthetic securitisations are fairly limited in the Portuguese market and, as such, no substantiated trend can be identified but 2019 saw the first synthetic securitisation carried out in compliance with CRR requirements, while 2021 witnessed the first synthetic STS deal. Interested parties may also look into the structures commonly used in other jurisdictions for guidance, but Portuguese legal requirements may entail some adjustments.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

The Securitisation Law

The Securitisation Law (enacted by Decree-Law No 453/99, dated 5 November 1999, as republished by Law No 69/2019, of 28 August 2019 and amended from time to time) provides specific protections vis-à-vis the general legal regime of insolvency, compared to both an ordinary assignment of receivables under the Portuguese Civil Code (enacted by Decree-Law No 47/344, dated 25 November 1966, as amended from time to time) and a secured loan, which can be exposed to general claw-back rights during the applicable hardening periods, contained in the Portuguese Insolvency Code (enacted by Decree-Law No 53/2004, dated 18 March 2004, as amended from time to time), as far as the transaction or the relevant security is concerned.

Upon an assignment of receivables made pursuant to the Securitisation Law, the relevant assigned receivables portfolio – which is no longer an asset of the originator – will not form part of the originator's insolvency estate, and the assignment is not generally subject to claw-back rights and hardening period provisions. Furthermore, any amounts held by the originator for any reason will not be part of its insolvency estate, but will rather belong to the assignee. The same applies to the entity performing the role of servicer of the assigned receivables (which may or may not be the originator, depending on the circumstances and regulatory approvals). The Securitisation Law clearly provides that, in an insolvency event, the amounts held by the servicer that pertain to the assigned receivables (ie, amounts relating to payments made under the assigned receivables) do not form part of the servicer's insolvency estate. The assignee fully bears the credit risk of the underlying borrowers of the assigned receivables, so there is no recourse to the originator.

The assignment of receivables for securitisation purposes may only be invalidated in the case of fraud against creditors. This is subject to very demanding requirements, including fraudulent intent and bad faith on the part of both parties (assignor and assignee), which are extremely dif-

ficult to meet in the context of a market transaction that is carried out and executed with the approval of the regulatory authorities, and under their supervision. Similarly, and in the absence of bad-faith activity by both parties, the transaction is also not subject to termination or revocation in the insolvency of the originator (ie, there are no claw-back rights and no hardening periods in cases of insolvency).

The Securitisation Law also provides specific protections with regard to the insolvency of the assignee (which is a regulated SPE – see **6.2 SPEs**), which would otherwise work to the detriment of the investors who have acquired the relevant ABS.

Even though the SPE itself can be subject to insolvency (but bearing in mind that its limited corporate purpose and regulated nature make this highly unlikely to occur), in respect of rights and obligations within its general estate, such an insolvency would not affect the relevant securitisation(s) undertaken by the SPE, given that each securitisation corresponds to a segregated and autonomous pool of assets, comprised of the assigned receivables, and that each such pool of assets is only available to meet the liabilities arising from that securitisation transaction.

In fact, the pool of assets backing the relevant ABS issuance, including the relevant receivables portfolio, forms an autonomous pool of assets (segregated from other autonomous pools of assets pertaining to other securitisation transactions) that is only available to meet the liabilities due from the SPE (either a securitisation fund (FTC) or a securitisation company (STC), as defined in **6.2 SPEs**) to its security holders and other creditors (service providers, swap counterparties, etc) in respect of that transaction only.

In multi-transaction SPEs (which is the case for STCs), such parties are not entitled to claim payments from the SPE out of its general estate, nor to claim out of other autonomous and segregated pools of assets backing other securitisations. This means that each pool of assets is only available to meet the liabilities arising from the respective securitisation transaction and, moreover, that the liabilities of any given securitisation transaction can only be satisfied by its respective autonomous pool of assets. In addition, there is a special creditor's privileged entitlement (the strongest possible form of security provided by law) protecting the interests and payment rights of such parties in these situations – ie, securing the liabilities of the creditors of a given securitisation transaction.

Finally, it should be noted that the autonomous pool of assets is codified and granted an asset digit code by the competent regulator (the CMVM), which allows for the identification of the pool at any given time by the respective creditors.

The insolvency analysis is a typical component of legal opinions issued in the context of securitisations, which details and analyses the above-discussed insolvency protections. This analysis should be (and normally is) carved out from the ordinary insolvency law qualification included in such legal opinions. Opinions normally also include a reference to searches undertaken in the relevant courts, and/or regulatory authorities' confirmation that at the time of assignment there were no insolvency proceedings pending against the originator in the competent courts.

6.2 SPEs

A regulated SPE is typically used in a securitisation, as noted in **6.1 Insolvency Laws**. The Securitisation Law provides for two possible

SPE types, which both come under the supervision of the CMVM (the local securities market regulator). Accordingly, the assignee's SPE in a securitisation may be an FTC or an STC. The creation of any such SPE is subject to prior authorisation from the CMVM, and the securitisation (the transaction) itself is also subject to the CMVM's approval.

FTCs

An FTC is an autonomous pool of assets without separate legal personality (ie, a unit trust-like format). For this reason, it is required to have a fund manager (ie, a securitisation funds management company – an SGFTC); such entities have been authorised and supervised by only one regulator (the CMVM) since 1 January 2020. An FTC must also have a custodian (an authorised credit institution), which is mandated to hold its assets. Certain share capital and minimum own funds requirements apply to both entities.

When an FTC structure is used, securitisation units are issued, each representing a similar undivided ownership interest in the FTC. The legal rationale would be for these to be issued directly to investors. However, since the units are qualified as equity instruments, this would be detrimental for many investors (particularly regulated investors, notably due to equity instruments consuming more regulatory capital than debt instruments). Accordingly, in the Portuguese market, and in cases where these structures have been used in the past (some of which are still outstanding transactions), a double SPE structure has been used. An orphan SPE would usually be set up in another jurisdiction (for tax reasons) – normally Ireland or Luxembourg – and would acquire all the units and then issue notes to investors backed by such units (and indirectly by all the FTC's assets). This type of structure also involved additional costs and normally entailed obtaining approval of the prospectus for the offer of the notes from a competent regulator outside Portugal.

For these reasons, the Portuguese securitisation market has generally only seen transactions using the other type of SPE (the STC) since 2008, which is considered in more detail below.

STCs

STCs have the special and unique legal purpose of acquiring receivables and issuing notes (called securitisation notes) in the context of securitisation transactions carried out under the Securitisation Law. They are limited liability commercial companies, set up under Portuguese company law and legally framed under limited-recourse principles set out in the Securitisation Law. They are supervised by the CMVM, which authorises their incorporation, undertakes a fit and proper assessment of their shareholders and corporate body members, and monitors their own funds requirements.

Besides a minimum share capital of EUR125,000, STCs must have additional own funds (typically ancillary capital contributions with the features of regulatory capital under the CRR), which, in practice, are set in light of a certain percentage of their annual fixed expenses or a certain percentage of the amount of the securitisation notes issued by them, whichever is highest.

Whenever a new securitisation is entered into, the STC shall confirm in advance whether it will have sufficient own funds to cover the additional requirements stemming from the new transaction and new notes to be issued; if not, it must increase its own funds by the necessary amount.

STCs are multi-securitisation SPEs, operating on a silo-by-silo basis. Each securitisation trans-

action corresponds to a separate silo, without cross-contamination across silos. When entering into a transaction, the STC will acquire a receivables portfolio and fund it through the issuance of securitisation notes, normally tranched in two or more classes. This receivables portfolio will be used to pay the liabilities under the issued securitisation notes, with the notes only being repaid by means of the cash flows generated by the receivables portfolio. Since these are notes, these ABS can be placed and held directly by the investors as debt instruments, without the need to employ a double structure, as is the case with the FTCs described above.

In light of the Securitisation Law, and notably the concept of autonomous estates exclusively allocated to the security holders and other creditors of the transaction assets of a given securitisation, any assets and liabilities pertaining to the securitisation will not be consolidated with the originator, the parent or an affiliate in the case of the former's insolvency.

6.3 Transfer of Financial Assets

Assignment of Receivables

The assignment of receivables between the assignor and the assignee (ie, the originator and the issuer) is effective upon execution of the assignment agreement, which is in line with general law. However, under the Securitisation Law, as a general rule (ie, covering most types of originators active in the market, including the State, the social security, credit institutions, financial companies, insurance companies and pension funds or pension funds management entities), the assignment is also effective towards the debtors (ie, the borrowers, who owe the receivables that have been assigned) upon execution of the receivables assignment (sale) agreement without notice to the debtors, whereas under general law the debtors would need to be notified in order for the assignment to become effective towards them.

This Securitisation Law framework endures even after the originator's insolvency, and the assignment can only be set aside under very exceptional circumstances of fraud and bad-faith activity by the parties, as described in **6.1 Insolvency Laws**.

Security

In many securitisations, the relevant receivables are secured. The relevant security can be of several types, depending on the deal in question and the underlying assets, with the most common being mortgages, pledges and personal guarantees.

In a residential mortgage-backed security (RMBS) or a commercial mortgage-backed security (CMBS) deal, the security will be represented by mortgages over the relevant housing properties or commercial real estate, but in other deals there may be mortgages over other assets (such as cars, ships or aircrafts, seeing as these are subject to registration, as with real estate), or pledges over shares, securities, bank accounts or other forms of security.

Security rights, and notably any mortgage or pledge, require perfection steps vis-à-vis third parties, even though the transfer of the security is fully effective between assignor and assignee. However, in most cases, the originator retains the servicing of the assets and the commercial relationship with the borrowers, and therefore the relevant security transfer is not registered immediately (also for cost-related reasons and reasons relating to the ongoing relationship between the originator and its clients, who do not know of the assignment).

The issuer holds the right to implement this registration but, due to the respective costs, the originator roles detailed above and the envisaged neutrality of the transaction towards the borrowers, the parties rely on the originator's good faith to avoid having to register immediately, accepting the risk of a bad-faith action by the originator, which could, in theory, assign the same receivables and security to unrelated third parties. In practice, that risk has thus far never materialised, having been accepted by rating agencies and discussed in legal opinions.

NPL Securitisations

The exception to the above is NPL securitisations, where the originator normally does not retain – and is not willing to retain (also for full deconsolidation purposes) – the servicing of the assets upon the assignment (sale) agreement. In this case, borrowers are notified of the new creditor and respective payee bank account, and registration of the security assignment takes place after the closing date.

The above-mentioned exemption of not requiring borrower notification of the assignment does not apply to assignments of rights under secured loans that are not being securitised.

"True Sales"

Under the Securitisation Law, a "true sale" (a non-recourse sale) of financial assets must take place. Legally, this is construed as an assignment of receivables, whereby the assignee acquires full legal title over the receivables, not dependent on any condition or term, and whereby the assignor does not guarantee or accept any responsibility for the performance of the assigned receivables. These receivables may already exist (which is typically the case), but the Securitisation Law also allows the assignment of future receivables, provided they arise under existing or reasonably expected legal relationships and are in a determinable (known or estimated) amount.

To be eligible for securitisation, the receivables must meet the following requirements:

- they must not be subject to legal or contractual assignment restrictions;
- they must convey stable, quantifiable or predictable monetary flows, based on statistical models;
- their existence and enforceability must be warranted by the assignor; and
- they are not litigious and are not pledged as security or judicially attached or seized.

As mentioned above, the assignment must be without recourse (or guarantee) to the originator or any group entity, and must not be subject to any conditions or terms.

Securitisation transactions have been conducted under the Securitisation Law for around 20 years; before the entry into force of this Law, they were conducted under the general Civil Code provisions, with no specific tax framework. It is not generally preferable to execute such transactions outside the legal securitisation framework (and respective tax regime, as discussed in **7. Tax Laws and Issues**), so this analysis will focus only on securitisations carried out under the Securitisation Law, which corresponds to the established market practice.

As in other jurisdictions, a secured loan granted by a bank (or other entity) represents a liability of the relevant borrower. Accordingly, there is no detachment from the borrower's credit risk, without prejudice to any applicable credit enhancement achieved by any applicable guarantee or security attaching to the loan.

In a securitisation, there is a true sale of receivables from the originator and a detachment of such receivables from the originator's balance sheet. Accordingly, the assignee fully bears the credit risk of the underlying borrowers of such assigned receivables and, as such, there is no recourse to the originator/assignor. The Securitisation Law awards specific protections to safeguard that detachment, including in the insolvency of the assignor/originator.

The true sale analysis is a typical component of legal opinions issued in the context of securitisations.

6.4 Construction of Bankruptcy-Remote Transactions

A securitisation is the more typical way to detach a receivables assignment from the insolvency of the originator/transferor. If the assignment is done under general law, there may be exposure to general insolvency hardening periods and claw-back rights. This can include the retroactive termination of transactions that were not entered into on arm's-length terms or that were entered into in the year preceding the insolvency proceedings, or of security provided by the insolvent entity when it entered into the transaction if this took place in the 60 days prior to the commencement of the insolvency proceedings.

6.5 Bankruptcy-Remote SPE

As mentioned under **6.2 SPEs**, STCs are limited liability commercial companies, set up under Portuguese company law and legally framed under limited-recourse principles set out in the Securitisation Law. Nonetheless, limited recourse and non-petition provisions are typically included in the documentation.

A typical limited recourse provision establishes that the SPE's obligations are limited to the assets allocated to the specific transaction and the parties have no claim against the remaining assets of the SPE. Furthermore, it is common for these provisions to also establish a cap for the SPE's liability, which often corresponds to the lesser of (a) the aggregate of all amounts due and payable to a transaction creditor or (b) the aggregate amounts recovered by the SPE in respect of the assets allocated to the specific transaction.

Non-petition provisions generally set out an agreement between the parties to the transaction, stating that no proceedings shall be brought against the SPE in respect of its obligations under the transaction and that no steps shall be taken for the purpose of obtaining payment of any amount due from the SPE to such other party to the transactions.

7. Tax Laws and Issues

7.1 Transfer Taxes

Generally, the transfer of receivables generates potential exposure to:

- corporate income tax (CIT) or withholding tax (WHT);
- stamp duty; and
- value-added tax (VAT).

However, provided that the transfer complies with the requirements set out in the Securitisation Law, under which transfers must occur exclusively from the originator to the SPEs, its tax treatment should be neutral from a CIT/WHT, stamp duty and VAT perspective, pursuant to the Securitisation Tax Law, approved by Decree-Law No 219/2001, of 4 August 2001, as follows:

- no WHT applies to:

(a) payments made by the SPEs (purchasers) to the originator (seller) in respect of the purchase of the receivables;
(b) payments made by the obligors under the receivables; and
(c) the payment of collections by the servicer (who is usually also the originator) to the SPEs;

- no stamp duty applies to the transfer of receivables being securitised; and
- the transfer of receivables is VAT-exempt under the Portuguese VAT Code.

Therefore, practitioners usually ensure that the transfer qualifies as a securitisation under the Securitisation Law.

7.2 Taxes on Profit

Interest income paid by the debtors should not be subject to WHT under the Securitisation Tax Law, assuming that the relevant SPEs are located in Portugal, pursuant to the requirements of the Securitisation Law.

SPEs are designed as pass-through vehicles, passing on the proceeds they receive under the receivables portfolio (and other transaction assets) to investors/transaction creditors. Thus, the taxable income arising for the issuer under a particular transaction will tend to be limited to the transaction fee it retains. In any case, this pass-through nature of the vehicle must be properly reflected in its respective accounts.

7.3 Withholding Taxes

When dealing with locally regulated SPEs, the nature or characteristics of the receivables and the location of the originator (seller) do not have any influence on the tax regime.

An important issue to consider is the WHT in respect of payments made under the securitisation notes. Payments of principal are not subject to any WHT. Interest payments are payments of income that could generally be subject to WHT. Under both the Securitisation Tax Law regime and the special debt securities tax regime approved by Decree-Law No 193/2005, of 7 November 2005, there are income exemptions for payments made to foreign investors, provided that certain requirements are met. The most important income tax exemption applies to non-resident investors, where certain tax procedures are met through the custody chain, and provided that the noteholder (the ultimate beneficiary of the income) is not resident in a blacklisted (tax haven) jurisdiction with which Portugal has no double taxation treaty or information exchange in force. These requirements are normally described in the relevant prospectus.

7.4 Other Taxes

Pursuant to the Securitisation Tax Law, no stamp duty or VAT is due on servicers' fees. In addition, no documentary taxes are due in Portugal.

When hedging instruments are entered into, typically in the form of swaps or cap agreements, and particularly where the hedging counterparty is a foreign bank (which is normally the case for rating purposes), it is prudent to detail certain tax form delivery obligations in the Schedule to the International Swaps and Derivatives Association (ISDA) Master Agreement, in order to avoid WHT issues. In any case, it is advisable for the negotiation of the derivative documentation to also involve tax lawyers.

7.5 Obtaining Legal Opinions

The transaction legal opinion usually covers taxation matters, and also often addresses tax disclosure under the prospectus or offering memorandum.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Provided that the securitisation is regulated, the accounting treatment will not affect the legal status of the assets nor the rights of the SPE.

Under the Securitisation Law, any collections in the possession of the originator or the servicer that relate to receivables already assigned to the SPE will not form part of the insolvency estate of the originator or the servicer. In any case, in the event of the insolvency of the originator/servicer, the SPE may need to provide evidence (to the insolvency administrator) of its entitlement to those collections and receivables. This process is swifter if the collections are properly segregated in the originator/servicer's systems and accounts, which is usually the case.

8.2 Dealing with Legal Issues

Legal opinions do not cover accounting matters, but may include certain qualifications or assumptions related thereto, presented to sustain opinions or risk assessments.

SINGAPORE

Law and Practice

Contributed by:
Lee Xin Mei, Cheryl Tan, Eugene Lee and Benjamin Liew
Rajah & Tann Singapore LLP

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Rajah & Tann Singapore LLP ("Rajah & Tann") is recognised in the field of debt capital markets as having highly creative lawyers with strong technical knowledge who can handle the full spectrum of complex and innovative debt capital market transactions. It represents issuers and underwriters in domestic and international offerings, exchange offers, and liability management exercises, leveraging the local law expertise of its network of leading ASEAN firms. It leads various first-of-its-kind transactions, including the first catastrophe bond transaction in Singapore and the first auto asset-backed securitisation in Singapore.

Authors

Lee Xin Mei is a banking and finance, and debt capital markets specialist. She is a partner in Rajah & Tann and heads the Debt Capital Markets practice in the firm. Xin Mei regularly advises on a wide range of debt-related transactions. She has a strong interest in structured debt and securitisation transactions and has advised on several novel transactions including the first issuance of catastrophe bonds by a Singapore special purpose reinsurance vehicle.

Cheryl Tan is a banking and finance, and debt capital markets specialist. She is a partner in Rajah & Tann with more than a decade of experience, Cheryl is a dynamic and responsive lawyer who regularly acts for both lenders and borrowers in an extensive range of financing transactions, with a particular focus and interest in acquisition financings and venture debt financings. Cheryl also has considerable expertise in a variety of debt transactions, including the issuance of private bonds, structured debt and asset-backed securities.

Eugene Lee is an international business lawyer who has practised at the world's top law firms and financial centres. Eugene is a partner in Rajah & Tann and has led a variety of complex, cross-border transactions, including SEC registered and unregistered offerings of secured and unsecured debt, equity and equity-linked securities. Eugene's experience also includes SEC, NYSE, NASDAQ, HKSE and SGX-ST compliance issues, leveraged finance, high-yield and loan covenant analysis, liability management exercises, take private transactions, poison pill plans, share buybacks, and acquisitions of private and public companies.

Benjamin Liew is a partner with Rajah & Tann's Financial Institutions practice and has acted for a diverse range of financial institutions including retail and private banks, investment advisers, fund managers, fintech companies, brokers and derivatives dealers. As a financial regulatory and derivatives specialist, Benjamin has advised on financial regulations for securitisations in Singapore.

Contributed by: Lee Xin Mei, Cheryl Tan, Eugene Lee and Benjamin Liew, **Rajah & Tann Singapore LLP**

Rajah & Tann Singapore LLP

9 Straits View #06-07
Marina One West Tower
018937
Singapore

Tel: +65 6535 3600
Email: info@rajahtannasia.com
Web: www.rajahtannasia.com

RAJAH & TANN ASIA

1. Specific Financial Asset Types

1.1 Common Financial Assets

In Singapore, the most commonly securitised financial assets are receivables, in particular credit card receivables and loan receivables. Recent securitisation transactions in the market have also included other asset classes such as vehicle fleets and related receivables.

The Monetary Authority of Singapore (MAS) has also established a regime for Singapore banks to issue covered bonds in Singapore. The largest banks in Singapore have established several covered bond programmes, which are backed by retail mortgages.

1.2 Structures Relating to Financial Assets

The most usual securitisation structure in the Singapore market involves the issuance of listed and rated debt securities to investors.

In a typical securitisation transaction in Singapore, the issuer would be an orphan special purpose entity (SPE) that is neither affiliated with the originator nor a member of any corporate group.

1.3 Applicable Laws and Regulations

The legal and regulatory system in Singapore provides the framework within which securitisation transactions are structured and documented, under contractual principles based on the common law. There are generally no Singapore laws specifically related to securitisation, other than certain MAS Notices. Please see **4.9 Banks and Securitising Financial Assets**.

Depending on the securitisation structure and the underlying assets to be securitised, additional legislation and regulations may apply.

Debt securities are issued typically in reliance on exemptions from the prospectus registration requirements under the Securities and Futures Act 2001 (SFA).

Debt issuances are typically structured as "qualifying debt securities" under the Income Tax Act 1947 (the "ITA"), which (amongst other things) exempts interest, discount, early redemption fee or redemption premium to non-Singapore tax residents from Singapore withholding tax, and provides Singapore corporate investors with a preferential 10% tax rate on their income derived from the debt securities.

The Approved Special Purpose Vehicle (ASPV) Engaged in Asset Securitisation Transactions (the "ASPV Scheme") was introduced to support the development of Singapore as a structured finance centre in Asia. The scheme grants a suite of tax concessions to an ASPV engaged in asset securitisation transactions including a tax exemption on income derived by an ASPV from asset securitisation transactions, a fixed Goods and Services Tax (GST) recovery rate on its qualifying business expenses at the prevailing GST recovery rate/methodology accorded to licensed full banks under MAS for the specific year in question and a withholding tax exemption on payments to qualifying non-residents on over-the-counter financial derivatives under certain conditions.

The ASPV Scheme also includes a new sub-scheme named ASPV (Covered Bonds) ("ASPV (Covered Bonds) Sub-scheme"), for special purpose vehicles holding the "cover pool" in relation to the issuance of covered bonds under MAS Notice 648. The ASPV (Covered Bonds) Sub-scheme takes effect from 15 February 2023 to 31 December 2028 and is administered by the MAS.

1.4 Special-Purpose Entity (SPE) Jurisdiction

It is common for SPEs to be established in Singapore for the following factors.

- Low corporate tax rate (which is potentially reduced under the ASPV scheme), and tax benefits, such as exemptions from withholding tax.
- Ease of incorporation.
- Relative political and social stability.
- Investor preference.

Another common jurisdiction for the establishment of offshore SPEs for Singapore transactions would be the Cayman Islands.

1.5 Material Forms of Credit Enhancement

The credit enhancement used in each transaction depends on the parties involved and the rating requirements.

Some techniques used in Singapore securitisation transactions include:

- subordination of junior notes/subordinated loans;
- over-collateralisation;
- cash reserves;
- deferred purchase price;
- credit insurance;
- collateral or guarantees;
- letters of credit; and
- guaranteed liquidity facilities.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer (typically an SPE) issues debt securities, the proceeds of which will be used to finance the issuer's purchase of the assets being securitised.

As the SPE is structured as an orphan entity that does not form part of the same corporate group as any other party to the transaction (including the originator), typically, a third-party entity (a corporate services provider) would hold the legal title to the shares in the orphan entity, held on discretionary trust for certain charitable beneficiaries.

2.2 Sponsors

The sponsor initiates the securitisation transaction, and is usually the originator or an affiliate of the originator. Please also see **2.3 Originators/Sellers**.

2.3 Originators/Sellers

The term "originator" is used to describe the entity that originates the financial assets to be securitised or acquires the financial assets for the purpose of securitising them. The originator is usually the entity seeking to raise the financing provided by a securitisation structure and will sell the assets to be securitised to the issuer.

2.4 Underwriters and Placement Agents

The underwriter/placement agent acts as an intermediary between the issuer and the investors in an offering.

The underwriter/placement agent usually performs the following functions:

- analysing investor demand;
- advising on structuring of the transaction;
- liaising with investors; and
- after a successful bookbuilding exercise, underwriting the debt issuance by subscribing for the debt securities, for subsequent resale to investors.

The role of an underwriter/placement agent is typically performed by an investment bank.

2.5 Servicers

A servicer is usually appointed to provide ongoing servicing of the securitised assets in accordance with specifically agreed policies. Please see **3.5 Principal Servicing Provisions**.

The originator typically performs the role of the servicer, but a third party may also be appointed to perform the role of a servicer.

The servicer generally does not require any licence or permit to enforce and collect on the securitised assets in Singapore.

2.6 Investors

The investors subscribe to notes issued by the issuer.

In Singapore, the investors are typically accredited investors or institutional investors because the notes are typically offered in reliance on the wholesale exemption from prospectus registration requirements under the SFA.

2.7 Bond/Note Trustees

A bond/note trustee is typically appointed, and a fiscal agency structure is not common for securitisation transactions.

The bond/notes trustee acts as trustee for the noteholders and represents their interests. The responsibilities of the trustee will vary from case to case and are expressly spelled out in the trust deed. They normally involve facilitating communication between the issuer and the holders. In Singapore, the trustee typically refrains from exercising discretion and acts on instructions from holders.

Professional trustees will usually perform the role of a bond/note trustee.

2.8 Security Trustees/Agents

Security trustees hold the benefit of the security in a securitisation transaction on behalf of the holders. If required, the security trustee will take action to enforce the security and distribute the

proceeds of enforcement in accordance with the terms of the transaction documents.

Professional trustees will usually perform the role of a security trustee.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The transfer of assets is generally effected through a sale agreement (such as a receivables purchase agreement) that includes clauses which address the following principal subject matters:

- the assets to be transferred by the originator to the SPE;
- the consideration for the purchased assets;
- any conditions precedent;
- any circumstances in which the SPE has the right to perfect its title to the assets;
- any limited circumstances where the originator is obliged to repurchase the assets or indemnify the SPE; and
- any other undertakings, representations and warranties in respect of the originator and/or the assets.

3.2 Principal Warranties

Warranties provided by the originator can generally be categorised into two categories:

- its corporate status (including its capacity, power and authority to enter into the transaction, licensing status and solvency) ("corporate warranties"); and
- the assets being transferred ("asset warranties").

Asset warranties generally address matters such as title to the assets and compliance with the selection/eligibility criteria set out in the transaction documentation.

Breach of a corporate warranty would generally trigger an event of default and/or early amortisation of the notes, and a claim in damages. Breach of an asset warranty could potentially trigger a repurchase obligation.

3.3 Principal Perfection Provisions

Please see **6.3 Transfer of Financial Assets**.

3.4 Principal Covenants

The key covenants in every transaction would differ and are subject to negotiations between parties.

Generally, the SPE's activities will be limited by negative covenants. The SPE will also provide positive covenants relating to, inter alia, its corporate status, the transferred assets and compliance with various obligations under applicable law and the transaction documents. Failure to comply with any such covenant would generally trigger an early amortisation event or event of default under the notes.

3.5 Principal Servicing Provisions

The servicer is appointed under a servicing agreement entered into with the issuer to service the transferred assets on a day-to-day basis, including collections and enforcements.

The main obligations/role of a servicer include:

- servicing the receivables owed to the originator by the underlying contract counterparties in accordance with the relevant collection policies;

- ensuring that the collected receivables are paid into the issuer's account(s);
- administering the enforcement of the obligations of contract counterparties in the underlying contracts; and
- maintenance of servicing records.

A fee is usually paid to the servicers for the services rendered (subject to any relevant priorities of payment). Any failure of the servicer to comply with its obligations under the servicing agreement may result in a back-up servicer being appointed to replace it, early amortisation, or an event of default under the notes.

3.6 Principal Defaults

Typical events of default will include:

- non-payment by the SPE of payments as they fall due under the transaction documents;
- material breaches by the SPE of its obligations under the transaction documents; and
- insolvency of or insolvency proceedings in respect of the SPE.

When an event of default is triggered under the notes, the noteholders are entitled to declare all amounts outstanding under the notes to be immediately due and payable, and trigger any enforcement of security given by the SPE (if applicable) and enforce its rights under the transaction documents in respect of the notes.

3.7 Principal Indemnities

Indemnities are extensively negotiated in Singapore but generally fall within the following two categories:

- indemnities from the originator in relation to the sold assets – this would cover (i) breaches of representations or warranties made by the originator under the transaction documents and (ii) instances where the originator include ineligible receivables within the sold pool of assets; and
- indemnities from the servicer in relation to the transaction documents – this would cover (i) breaches of representations or warranties made by the servicer under the transaction documents and (ii) failure by the servicer to comply with its servicing obligations under the transaction documents.

3.8 Bonds/Notes/Securities

The terms and conditions of the notes would be contained within the notes trust deed.

The terms and conditions of the notes would typically address the following:

- form, denomination and title;
- status and ranking;
- security;
- issuer covenants;
- interest;
- redemption;
- payments;
- taxation;
- events of default/early amortisation events;
- limited recourse and non-petition;
- application of monies/priorities of payment; and
- enforcement.

3.9 Derivatives

The derivative instruments that are used would differ depending on the structure of securitisation transaction, but their function is primarily to address currency and/or interest rate mismatches between the assets and the notes.

3.10 Offering Memoranda

An offering memorandum is typically used to market the notes to investors.

It is also required for purposes of listing the notes on the Singapore Exchange Securities Trading Limited (the "SGX-ST"), whose rules relating to the listing of wholesale debt requires that an offering document contains information that investors customarily expect to see.

As notes are typically not sold to the retail public in reliance on the wholesale exemption from prospectus registration, there are no express rules on the contents of the offering document.

The offering document in a securitisation transaction customarily provides information on the issuer, and outlines in detail the terms of the securities and the characteristics of the securitised assets.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

There are no specific disclosure requirements relating to securitisation under Singapore law. Depending on the nature of the securitisation transaction, consideration should be given to any applicable disclosure rules in other jurisdictions which could be relevant.

Please also see **4.2 General Disclosure Laws or Regulations**.

4.2 General Disclosure Laws or Regulations

All offers of debt securities must comply with the prospectus requirements set out in the SFA, unless the offer is either excluded or exempted from the prospectus requirements.

Most securitisation transactions are structured in reliance on Sections 274 and 275 of the SFA, where the offer is made to institutional or specified persons (including accredited investors) and so do not require a registered prospectus.

4.3 Credit Risk Retention

Singapore has not implemented express legislation or regulatory requirements on credit risk retention which are similar to the credit-risk retention rules effected in other jurisdictions in Europe and the United States of America.

4.4 Periodic Reporting

There are no laws or regulations requiring any periodic reporting on a securitisation transaction. However, please note that MAS Notice 628 – Securitisation does set out investor disclosure and MAS notification requirements after completion of the securitisation transaction. Please refer to **4.9 Banks Securitising Financial Assets** for further information.

Companies whose debt securities are listed on the SGX-ST are required to comply with the obligations set out in the Listing Manual of the SGX-ST (the "Listing Manual") and the eligibility to list letter issued by the SGX-ST.

Under Rule 323 of the Listing Manual, a debt issuer must immediately disclose to the SGX-ST via SGXNet any information which may have a material effect on the price or value of its debt securities or on an investor's decision whether to trade in such debt securities.

Under Rule 324 of the Listing Manual, a debt issuer must also immediately announce the following:

- the redemption or cancellation of debt securities when every 5% of the total principal

amount of debt securities is redeemed or cancelled;
- the details of any interest payments to be made (except for fixed-rate debt securities offered only to specified investors and traded in a minimum board lot size of SGD200,000); and/or
- any appointment of a replacement trustee.

There are generally no periodic reporting requirements imposed on issuers of wholesale debt under the rules of the SGX-ST or under Singapore law. The frequency of financing reporting to noteholders would be governed by the contractual provisions of the relevant trust deed.

Under Chapter 14 of the Listing Manual, the SGX-ST can initiate disciplinary proceedings against issuers for the contravention of the Listing Manual and upon conclusion of the hearing, impose sanctions against an issuer, which include:

- issuing a private warning;
- issuing a public reprimand;
- requiring the issuer to perform remedial action to rectify the consequences of contraventions;
- issuing an order for the denial of facilities of the market, prohibiting an issuer from accessing the facilities of the market for a specified period;
- imposing fines on the issuer payable to the SGX-ST of up to SGD250,000 per contravention, subject to a maximum of SGD1 million per hearing for multiple charges, which are to be paid by way of instalments which shall not exceed 12 months from the date of the imposition of the fine;
- issuing an order for the suspension of the trading of an issuer's securities for a specified period; and
- issuing an order for the removal of an issuer from the Official List.

Section 25 of the SFA also grants power to the court to order observance or enforcement of the rules in the Listing Manual.

Further, it is an offence under Section 203(2) of the SFA for companies to intentionally, recklessly or negligently fail to notify the SGX-ST of such information as is required to be disclosed by the SGX-ST under the Listing Manual or other requirement of the SGX-ST. A person found to have contravened Section 203(2) of the SFA shall be liable on conviction to a fine not exceeding SGD250,000 or to imprisonment for a term not exceeding seven years or to both.

4.5 Activities of Rating Agencies

Credit rating agencies in Singapore who provide credit rating services ("CR services") are regulated as capital markets services (CMS) licence holders. As with all other CMS licensees, licensed credit rating agencies in Singapore are required to comply with regulations, guidelines and notices issued by the MAS under the SFA.

Additionally, the MAS has prescribed a Code of Conduct for Credit Rating Agencies (the "Code") under Section 321 of the SFA which applies to CMS licensees who provide CR services. The Code, which is based largely on the IOSCO credit rating agencies code, seeks to:

- promote quality and integrity of the rating process;
- strengthen rating agencies (RA) independence and avoidance of conflicts of interest;
- ensure timely disclosures to investors on rating and the procedures, methodologies and assumptions; and

- promote procedures and mechanisms to protect non-public information from premature disclosure or by use unrelated to a RA's rating.

The Code is non-statutory in nature. A failure by any person to comply with any requirement in the Code shall not of itself render that person liable to criminal proceedings. However, a failure by an RA to comply with the Code will be taken into account by the MAS in determining whether an RA satisfies the requirement that it is fit and proper to remain licensed and whether to revoke or suspend the RA's licence under Section 95 of the SFA.

4.6 Treatment of Securitisation in Financial Entities

The MAS administers the international Basel III regulatory framework in Singapore and provides requirements for the capital treatment that financial institutions in Singapore can give to securitisation positions taken, as well as circumstances in which capital relief can be obtained when such financial institutions undertake a securitisation. In connection with securitisation transactions, Singapore incorporated banks are required to comply with the regulatory capital adequacy requirements set out under MAS Notice 637 (Risk-based capital adequacy requirements for banks incorporated in Singapore) ("Notice 637").

Separately, outside the scope of this guide, there is a separate framework for the issuance of insurance-linked securities set out in the Insurance (General Provisions and Exemptions for Special Purpose Reinsurance Vehicles) Regulations 2018. In particular, there are separate capital adequacy requirements for special purpose reinsurance vehicles (SPRV), which are set out in the Regulations. An SPRV is an insurer licensed under the Insurance Act 1966 of Singapore as a reinsurer to carry on life or general business or both classes of business and:

- is created for the sole purpose of entering into contracts of reinsurance with one or more ceding insurers; and
- at all times fully funds its obligations under the contracts of reinsurance with the ceding insurer or insurers (mentioned in the paragraph above) through insurance securitisation.

4.7 Use of Derivatives

The SPE may enter into derivatives with a swap provider to hedge certain exposures.

There are no specific laws or regulations that apply to the use of derivatives in securitisations or with regard to SPEs. However, the separation requirements in the MAS Notice 628 contemplate that any transaction (including interest rate swaps and currency swaps) entered into between the SPE and the bank in Singapore which the notice applies to must be conducted at arm's length and on market terms and conditions. Regulatory requirements for OTC derivatives, including mandatory trade reporting and regulatory margin, may also apply.

It should be noted that for an SPE to qualify under the ASPV scheme (unless waived by the MAS), any cross-currency or interest rates swaps carried out by the SPE are to be transacted with a swap counterparty in Singapore.

4.8 Investor Protection

Investor protection in Singapore is generally achieved through restrictions in the SFA on the offer and sale of securities, prospectus requirements, and provisions prohibiting making false or misleading statements in the offer of securities, market manipulation, false trading and mar-

ket rigging transactions. The SFA is enforced by the MAS.

See also **4.1 Specific Disclosure Laws or Regulations** and **4.2 General Disclosure Laws or Regulations.**

4.9 Banks Securitising Financial Assets

The MAS Notice 628 – Securitisation ("Notice 628"), which applies to Singapore incorporated banks and branches and offices of a bank located within Singapore, sets out requirements on such banks when acting in securitisations. Banks in Singapore who act as an "ABCP programme sponsor" (as defined in Notice 637), "manager" (as defined in Notice 628) or an "originator" (as defined in Notice 637) have to comply with the separation requirements set out in Annex A and disclosure requirements set out in Annex B of Notice 628. Additionally, post-issuance MAS notification requirements in accordance with Annex C of Notice 628 also apply. Where the bank in Singapore acts as a servicer (as defined in Notice 637), or provides liquidity facilities or credit enhancements (as defined in Notice 637) must comply with the requirements set out in Annex D and Annex E of the notice respectively. Where Annex D and Annex E are not complied with, these banks are deemed to be providing implicit support to the securitisation and will have to calculate its credit risk-weighted assets pursuant to MAS Notice 637 as though the underlying exposures of the securitisation were on its balance sheet.

Singapore incorporated banks which issue covered bonds must comply with MAS Notice 648 ("Notice 648"), and in such case, Notice 628 does not apply. A bank incorporated outside Singapore may not issue any covered bonds through its branch in Singapore. Notice 648 sets out requirements on the composition of the cover pool assets and encumbrance limits. Risk management requirements set out in Notice 648 must also be put in place. Lastly, the notice also sets out MAS notification requirements, including the requirement to submit a memorandum of compliance to set out how the bank has complied with the notice.

4.10 SPEs or Other Entities

While there are no particular regulatory requirements that apply to the form of an SPE, an SPE must meet certain conditions to fall under the Approved Special Purpose Vehicle scheme for certain tax exemptions under the ITA.

In addition, the structure of the transaction and nature of the underlying securitisation assets dictates whether the SPE requires any regulatory approvals or other licences.

Typically, the material factors considered in the choice of the form of an SPE include tax treatment, investor preference, bankruptcy remoteness and certainty of enforcement.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

The business undertaken by SPEs is usually restricted in the transaction documents and in the constitution of the company. Typically, the securitisation transaction will be structured in such manner that the SPE does not require any licences in order to carry on the transaction. Please note that this does not apply to Special Purpose Reinsurance Vehicles, which is outside the scope of this guide.

There is no regime under Singapore law comparable to the US Investment Company Act of 1940.

4.12 Participation of Government-Sponsored Entities

In Singapore, government-sponsored entities have issued notes to finance the purchase of securitised assets, which includes project and infrastructure loans and infrastructure asset-backed securities.

Government-sponsored entities are also not prohibited from participating as investors in the securitisation market.

There are no particular laws or regulations in Singapore that will apply differently to the government-sponsored entities (whether as issuer or investor) as compared with other regular participants in the securitisation market in Singapore. Such entities remain subject to regulations applicable to other entities that are not government sponsored.

4.13 Entities Investing in Securitisation

Typically, securitisation investors include financial institutions, insurance companies and private funds. Such entities are usually licensed and already subject to the applicable regulations and licence conditions.

4.14 Other Principal Laws and Regulations

The key principal laws and regulations are discussed in **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are not prohibited under Singapore law, although these are not common in the Singapore market. Such securitisations must comply with the regulatory requirements which similarly apply to traditional securitisations, including, if applicable, regulatory capital requirements under MAS Notice 637.

In the context of a financial institution, such deals are structured to enable it to achieve a reduction of the amount of regulatory capital it is required to retain. This involves the transfer of the credit risk of the financial institution's assets to investors while retaining the assets on its balance sheet.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Securitisation transactions in Singapore are typically structured to be insolvency remote in order to, among other reasons, obtain better credit ratings and pricing terms. To achieve this, insolvency laws will need to enable such a structure, such that the underlying assets of the securitisation are insulated from any risk of insolvency of the originator/seller of the assets, and to ensure that the creditors/liquidators of the originator/seller of the assets will not have recourse to the assets.

6.2 SPEs

Aspects of an SPE

For Singapore securitisation transactions, the SPE will purchase assets from the originator and issue notes to the investors.

The SPE is usually established as a bankruptcy remote entity, to prevent the originator's creditors from bringing claims against the SPE, in the event of the originator's insolvency. This is typically achieved by structuring the SPE as an orphan vehicle (whose shares are held by a trust company for charitable beneficiaries), so that the

SPE falls outside the corporate groups of other parties to the transaction (in particular the originator).

The other usual characteristics of an SPE are as follows.

- Appointment of a third-party corporate administrator, whose directors are placed on the board of the SPE.
- Imposing restrictions on the activities that the SPE can undertake, by ring-fencing its activities in the constitution of the company as well as subjecting it to restrictive covenants in the transaction documents.
- Including limited recourse and non-petition provisions in the transaction documents so that secured creditors have limited recourse to the SPE's assets and that none of the secured creditors are able to bring claims against the SPE or petition its insolvency.
- Providing the assets and cashflow generated from the assets as security for the securitisation transaction.

Substantive Consolidation

Under Singapore law, SPEs are treated as having their own separate legal personality. In other words, their rights, obligations, assets and liabilities will not be consolidated with those of the originator. The Singapore courts have been slow to disregard a company's separate legal personality, and are only willing to pierce the corporate veil in limited circumstances, such as fraud.

6.3 Transfer of Financial Assets

Transfer of Assets

In the context of a Singapore securitisation transaction, the originator and the SPE will typically enter into an asset purchase agreement which sets out details of the underlying assets being transferred to the SPE, the consideration for the transfer, and other key terms relating to the sale of such assets to the SPE.

The transfer is most commonly effected by way of assignment (which can be legal or equitable), and can also be effected by way of novation or a declaration of trust under Singapore law. Whether an assignment is structured as a legal or equitable assignment ultimately depends on the transaction in question.

In the context of a securitisation transaction involving receivables, transfers are effective only in equity and will not take effect as a legal assignment if written notice of such assignment is not given to each of the underlying debtors. The absence of such notice to underlying debtors will have (non-exhaustively) the following consequences:

- each underlying debtor is entitled, by virtue of his lack of knowledge of the receivables purchase agreement and the transactions contemplated therein, to continue to make payments to the originator as the party legally entitled to receive the same;
- the originator can grant each underlying debtor a good discharge for payments when it receives the relevant moneys from such debtor;
- any rights of set-off which accrue in an underlying debtor's favour against the originator before notice is given to that underlying debtor of the receivables purchase agreement and the transactions contemplated therein will bind any person(s) equitably entitled to the relevant moneys;
- if the originator were to assign the benefit of the receivables to a third party acting in good faith, and for value and without notice of any person(s) equitably entitled thereto, and such third party gave notice of his interest,

to the relevant underlying debtor before such person(s) so equitably entitled did so, such third party would gain priority over the interests of such person(s) equitably entitled; and
- in order to bring proceedings against an underlying debtor, the SPE would have to join the originator in the proceedings against the underlying debtor as a co-plaintiff and if the originator does not consent to being joined as a co-plaintiff, then as a co-defendant.

True-Sale

Under Singapore law, the courts have recognised that financing transactions may be effected equally in the form of a secured loan or by means of a legal sale. The key in the interpretation of the legal nature of a transaction is the intention of the parties, as inferred from the documentation, rather than the economic consequences of a documented transaction.

This means, for a legal true sale analysis, it is assumed that the transaction is that which is inferred from documents so long as there is no sham or façade and parties do not act inconsistently with the transaction documents. A transaction will only be held to be a sham if the extrinsic evidence shows that the parties concealed the true nature of the transaction or by their conduct replaced it with some other agreement.

Whilst there is generally no one clear touchstone by which a transaction would be treated as a sale rather than a secured loan, generally where the originator retains any equity of redemption of the receivables or retains the risks of losses incurred on the transferred assets in the case of a re-sale by the SPE, this tends to be more indicative of a secured loan transaction instead.

It is generally agreed that any one of the factors below would not in itself be inconsistent with a sale transaction.

- The originator continuing to service and collect the receivables following the transfer of the receivables to the SPE (in fact this is fairly common for securitisation transactions in Singapore).
- Credit enhancement mechanisms such as the entry by the originator into arm's length derivative transactions with the SPE.
- The originator holding a degree of credit risk as first loss position.
- A deferral of part of the purchase price payable by the SPE to the originator.
- The obligation of an originator to repurchase receivables in certain limited circumstances (such as breach of warranty or a "clean-up call", as opposed to a general repurchase right).

It would be usual to request a true sale opinion to be delivered in connection with a Singapore securitisation transaction in Singapore.

6.4 Construction of Bankruptcy-Remote Transactions

Where there are contractual prohibitions or other restrictions against assignments or transfers of the underlying assets, a trust structure can be used in the alternative. This would involve having the originator declare a trust over the underlying assets in favour of the SPE. The SPE obtains an equitable interest in the assets. However, unlike an equitable assignment, this interest cannot be converted to a legal interest by delivery of notice.

6.5 Bankruptcy-Remote SPE

See **6.2 SPEs**.

7. Tax Laws and Issues

7.1 Transfer Taxes

Singapore stamp duty is a documentary tax generally imposed on instruments that effect the transfer of immovable property in Singapore, shares of Singapore incorporated companies and shares of foreign companies that have a share register in Singapore.

A transfer of receivables that do not involve any interest in the aforementioned assets is generally not subject to stamp duty in Singapore. However, it should be noted that any mortgage, agreement for mortgage or debenture of such assets, as well as the transfer or assignment of any mortgage or debenture may be subject to stamp duty if they are executed or received in Singapore.

7.2 Taxes on Profit

Singapore generally adopts a territorial basis of taxation. Any income accrued or derived in Singapore, as well as any income earned from any source outside Singapore (ie, foreign-sourced income) that is received or deemed to be received in Singapore will be taxable. The ascertainment of the source of income is a practical hard matter of fact and the broad guiding principle is to examine what the taxpayer has done to earn the profits in question and to identify the location where those activities that the taxpayer has engaged in took place.

Where the income is considered to be sourced in Singapore, companies are subject to corporate income tax at the prevailing rate of 17%, subject to any applicable tax exemptions.

Please see **1.3 Applicable Laws and Regulations** for tax concessions that apply in the context of a securitisation transaction.

7.3 Withholding Taxes

Withholding tax is applicable in Singapore in respect of certain types of payments such as:

- interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness which are:
  - (a) borne, directly or indirectly, by a person resident in Singapore or a permanent establishment in Singapore (except in respect of any business carried on outside Singapore through a permanent establishment outside Singapore or any immovable property situated outside Singapore); or
  - (b) deductible against any income accruing in, or derived from, Singapore; or
- any income derived from loans where the funds provided by such loans are brought into or used in Singapore.

Such payments, where made to a person not known to the paying party to be a resident in Singapore for tax purposes, are generally subject to withholding tax in Singapore. The rate at which tax is to be withheld for such payments (other than those subject to the final withholding tax rate of 15%) to non-resident persons (other than non-resident individuals) is currently 17%. However, if the payment is derived by a person not resident in Singapore otherwise than from any trade, business, profession or vocation carried on or exercised by such person in Singapore and is not effectively connected with any permanent establishment in Singapore of that person, the payment is subject to a final withholding tax of 15%. The rate of 15% may be reduced by applicable tax treaties.

However, where the above-mentioned payments are made pursuant to securities that are "qualifying debt securities" under the ITA, such payments are not subject to Singapore withholding tax. See **1.3 Applicable Laws and Regulations**.

7.4 Other Taxes

A transfer of receivables is generally exempt from GST under the Fourth Schedule to the Goods and Services Tax Act 1993.

7.5 Obtaining Legal Opinions

Singapore tax opinions are generally sought for securitisation transactions in Singapore. For instance, if the receivables are transferred to a purchaser that is not resident in Singapore at an artificial discounted price, the transaction may be recharacterised in whole or in part as a loan or indebtedness where such discount is considered to be interest that is subject to withholding tax.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Accounting issues relating to securitisation transactions are addressed by accountants, and accountancy firms will render the relevant accounting advice to parties seeking to undertake such securitisation transactions. In particular, originators will typically require advice on whether or not a particular desired accounting treatment under the applicable accounting standards can be achieved.

Key considerations are whether or not a securitisation transaction can receive off-balance sheet treatment from the originator's group.

8.2 Dealing with Legal Issues

One of the key factors that auditors typically consider is whether the assignment of the receivables takes effect as a true sale, that is, whether the assignment of the receivables by the originator to the SPV would constitute a sale of the receivables, rather than a loan secured by the relevant assigned receivables.

Please see **6.3 Transfer of Financial Assets**.

SPAIN

Law and Practice

Contributed by:
Jaime de la Torre, Arnau Pastor and Jaime Juan Rodríguez
Cuatrecasas

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Cuatrecasas has more than 1,700 professionals and is firmly established in Spain, Portugal and Latin America, where it has offices in Chile, Colombia, Mexico and Peru. The Cuatrecasas securitisation team is based in Madrid and Barcelona, and provides legal advice to originators, management companies, rating agencies, placement entities and arrangers on the structuring and execution of securitisation transactions regarding all types of underlying assets, including residential mortgage, commercial mortgage, credit cards, auto loans, leasing, trade receivables, non-performing loans, etc. Cuatrecasas has a strong focus on green securitisation, and especially the application of green labels, including the European Green Bond (EuGB). It recently advised UCI in the first green public securitisation in Spain (RMBS Green Prado XI), the JLMs in a landmark auto loan transaction (Santander Consumer Auto 2023-1), and ING in the biggest Spanish securitisation (Sol Lion II).

Authors

Jaime de la Torre is a partner at Cuatrecasas and advises private and public entities on debt capital markets issuances, public and private placings, domestic and international issuances, and high-yield and direct lending transactions. He regularly advises on acquiring distressed debt and non-performing loans. Jaime is admitted to practise in Spain in the Madrid Bar (Ilustre Colegio de Abogados de Madrid) and in England & Wales. He lectures in postgraduate and specialisation courses at different universities, including ESADE Business & Law School, CUNEF University College of Financial Studies, the Institute of Stock Exchange Studies and Universidad CEU San Pablo.

Arnau Pastor is a principal associate at Cuatrecasas and advises on public and private securitisation transactions across a diverse range of asset classes and other structured financing transactions, such as cross-border factoring programmes backed by commercial and consumer receivables. He specialises in financial derivatives instruments, advising banks and companies on negotiating and drafting the framework agreements based on market standards as well as ad hoc documentation for specific OTC products (deal-contingent swaps, credit default swaps and forward swaps). Arnau is admitted to practise in Spain and is a member of the Barcelona Bar (Ilustre Colegio de Abogados de Barcelona).

Jaime Juan Rodríguez is an associate at Cuatrecasas and provides legal advice on DCM matters with listings in regulated markets or multilateral trading facilities (MTFs) of the European Union. His advice on securitisation transactions extends to residential mortgages, auto loans, balloon loans, consumer loans and credit cards. He also offers expertise in the preparation of interest rate hedges under ISDA and CMOF standards. Jaime Juan is a member of the Madrid Bar (Ilustre Colegio de Abogados de Madrid) and is an adjunct professor in undergraduate law programmes on private law (civil law).

Cuatrecasas

Calle de Almagro, 9
28010 Madrid
Spain

Tel: +34 915 24 71 00
Email: madrid@cuatrecasas.com
Web: www.cuatrecasas.com

CUATRECASAS

1. Specific Financial Asset Types

1.1 Common Financial Assets

The Spanish securitisation market is dynamic and closely linked to the country's economic conditions. Consumer loans and auto loans are the most commonly securitised assets in Spain, based on the number of transactions.

For instance, according to the official register of the Spanish Securities Exchange Commission (CNMV) for 2023, the 17 publicly disclosed securitisation deals in Spain included four auto loans transactions and four consumer loans transactions; the remaining transactions involved trade receivables, corporate loans, residential mortgage loans and non-performing loans. In contrast, in 2022, six out of 20 publicly disclosed transactions involved residential mortgage loans.

1.2 Structures Relating to Financial Assets

There are no significant structure differences for different asset types. Spanish securitisations necessarily pivot on a special-purpose vehicle known as a *fondo de titulización* ("securitisation fund"), as explained in **6.2 SPEs**.

A securitisation transaction in Spain may use one of the following options:

- public SPE or private SPE – depending on whether the notes are listed in a regulated market (eg, AIAF – in which case it will be considered a public fund) or in a multilateral trading facility or without listing (a private fund);
- opt-out from the Securitisation Regulation – since securitisation is regulated at both the EU level and the domestic level, a securitisation transaction may be structured under national law outside the scope of the Securitisation Regulation's definition of securitisation, although several implications should be carefully addressed by a specialist legal team;
- closed-ended or open-ended – Spanish SPEs can be structured with open or closed assets and liabilities, or any combination of both;
- sale documentation – if the underlying assets comprise mortgages and the seller is a credit institution, the sale transaction to the SPE will be documented under a special regulation contained in Royal Decree-Law 24/2021;
- risk retention modality – how the risk retention requirement set forth in Article 6 of the Securitisation Regulation is met (see **4.3 Credit Risk Retention**);
- waterfall – Spanish SPEs should feature at least one ordinary waterfall and a post-enforcement waterfall; additional waterfalls are optional;
- initial costs – the initial costs are typically funded by the originator, either through a specific note tranche or by means of a subordinated loan; and
- meeting of creditors – if a meeting of creditors is considered, the numbers required for majorities and the scope of decisions should be necessarily included.

Changing any of these characteristics once the transaction has been executed is difficult, and could involve in the winding down of the transaction (whenever possible).

1.3 Applicable Laws and Regulations

The main laws and regulations that are relevant for the purposes of structuring a securitisation transaction is Spain are either EU regulations or domestic regulations.

Spanish Regulations

- Law 5/2015 (the "Spanish Securitisation Law") sets out the domestic legal framework for securitisation transactions.
- Law 6/2023 (the "Spanish Securities Markets Law") sets out the domestic legal framework for the issuance of notes in capital markets. It has recently been recast in order to transpose a number of EU directives.
- Royal Decree 724/2023 (the "Spanish Capital Markets Regulation") sets out the domestic legal framework developing the Spanish Securities Markets Law.
- Royal Decree-Law 24/2021 (the "Spanish Mortgage Mobilisation Regulation") sets out the domestic legal framework for mobilising mortgage loans by credit institutions by means of securitisation, covered bonds and collateralised loan obligations.

EU Regulations

- Regulation (EU) 2017/2402 (the "Securitisation Regulation") and delegated regulations – most of the transactions in Spain are covered under the definition of "securitisation" in the Securitisation Regulation, and are therefore subject to its provisions.
- Regulation (EU) 2017/1129 (the "Prospectus Regulation") and delegated regulations are applicable in the case of public transactions when notes will be listed in a regulated market, and therefore a prospectus should be registered with the CNMV.

1.4 Special-Purpose Entity (SPE) Jurisdiction

The most common way to securitise Spanish-governed assets is through a transaction in Spain subject to both the Securitisation Regulation and the Spanish Securitisation Law. There are several advantages for choosing this option, including the lower costs and the regulatory framework, which has proven agile and is especially designed to allocate Spanish assets. Please see **6.2 SPEs** regarding the special type of entity known as a "securitisation fund" (*fondo de titulización*), which is a special type of orphan vehicle.

However, it is possible to structure a cross-border securitisation of Spanish assets by means of foreign SPEs, although the use of this structure is residual. Recently, several transactions pertaining to Spanish assets have been instrumented by means of an Irish designated activity company (DAC) or a Luxembourg company together with a private Spanish SPE. Several complexities arise from this alternative, such as cross-border frictions in terms of listing requirements, tax implications and corporate obligations.

1.5 Material Forms of Credit Enhancement

Of the multiple material forms of credit enhancement used in Spanish securitisation transactions, the following are used most frequently:

- subordination – the tranching of notes is the most usual credit enhancement, but it should be noted that this alternative is expressly omitted when the structure is intended to opt-out from the Securitisation Regulation;
- hedging instruments – this credit enhancement is especially relevant in transactions where the assets and liabilities have different interest profiles;
- reserves – Spanish transactions sometimes embed one or two types of reserves:
  (a) reserves as proper credit enhancements; and/or
  (b) reserves to mitigate other risks (commingling risk, compensation risk, etc); and

- excess spread – this is the most usual credit enhancement in Spain and is closely linked to the financial model of the transaction.

2. Roles and Responsibilities of the Parties

2.1 Issuers

Under the Spanish Securitisation Law, securitisations made in Spain are structured by means of a special type of SPE known as a *fondo de titulización*, the main characteristics of which are discussed in **6.2 SPEs**.

The role of the SPE is ring-fenced as it is administered by a management company (see **2.7 Bond/Note Trustees**) without no possibility of undertaking other business activities outside the scope of the transaction.

2.2 Sponsors

The concept of a sponsor is alien to the Spanish Securitisation Law; unlike other EU jurisdictions, this role is not part of the securitisation tradition of Spain. Therefore, at the Spanish level, the only applicable rules are those established in Article 2 of the Securitisation Regulation, which covers certain credit institutions (located inside or outside the EU) or investment firms (other than the originator).

2.3 Originators/Sellers

The originator and the seller are usually the same party, and their roles are limited to the following.

- Sale and purchase agreement (SPA) – the seller executes the SPA with the SPE (in the case of assets other than mortgage loans). If mortgage loans are transferred, the seller will issue and deliver multiple titles in favour of the SPE, representing the ownership of the mortgage loans (provided that the seller is a financial entity).
- Asset liability – the seller assume liabilities vis-à-vis the SPE under a set of representations and warranties regarding itself and the assets. Such liability subsists for the length of the securitisation transaction.
- Prospectus liability – responsibility is assumed vis-à-vis noteholders for certain sections of the prospectus (or the information memorandum) that are drafted based on the information provided by it.

The most common originators in Spain are:

- major and medium banks, especially in residential mortgage loans and consumer loans;
- specialist car finance companies, which regularly package car loans in traditional or innovative structures;
- consumer loan lenders, which usually securitise consumer loans and credit card loans, in both statis and revolving structures; and
- working capital specialists – asset classes of working capital and invoices have been increasingly active of late.

2.4 Underwriters and Placement Agents

The role of a placement agent is key in Spanish securitisations, but the role of an underwriter is practically non-existent.

The role and responsibilities of placement agents are as follows.

- Regulated activity – the placement activity is regulated under Article 38 of the Spanish Securities Market Law, so those entities acting as placement agents must be registered with the relevant registers of the CNMV or the Bank of Spain.

- Lead manager – the usual title used by placement entities is "lead manager", either as "sole lead manager" or as "joint lead manager". The tasks under this title cover the placement of the notes, controlling the status and evolution of the investors' demand, and executing the pricing of the notes.
- Arranger – at least one of the placement entities acts as arranger of the transaction. This role is related not to the placement of the notes, but to the structuring of the transaction. However, the arranger of a transaction usually holds a key position in the settlement of the notes as billing and delivery agent, although several structures are possible in this regard.
- Prospectus – under Article 38 of the Spanish Securities Markets Law, an arranger assumes responsibility for certain sections of the prospectus (or the information memorandum) that are prepared based on the information provided by the originator.
- Placement agreement – the originator, the SPE, the lead managers and the arrangers execute a placement agreement upon closing, setting the terms of the placement of the notes. This agreement is usually governed by Spanish law.

2.5 Servicers

The servicer's main functions are as follows.

- Contractual delegation – the SPE's management company delegates a number of functions related to the administration of the underlying assets in accordance with the terms of the SPE's deed of incorporation and the servicing agreement.
- Payments and collateral – the servicer is usually bound by some sort of sweep process related to the bank accounts where the debtors pay the underlying assets.
- Reporting – under the servicing obligations, the servicer usually has to deliver periodic reports on the underlying assets' behaviour.
- Enforcement – one of the key functions of the servicer is to manage the defaulted assets. An enforcement policy is usually agreed in the servicing agreement, setting out the scenarios for out-of-court renegotiations or forbearance, and also for court enforcements.

The features of the servicing activities in the context of a securitisation transaction are further discussed in **3.5 Principal Servicing Provisions**.

2.6 Investors

The role of investors is to subscribe the notes issued by SPEs and pay the purchase price of the notes. Depending on the type of transaction, the following responsibilities will apply to investors.

- Subscription agreement – in some transactions, some or all investors execute a subscription agreement in order to allocate subscription tickets.
- Regulatory obligations – some types of investors are subject to special regulatory obligations, due to their legal status. Moreover, investors in securitisation transactions are bound by the due diligence requirements under Article 5 of the Securitisation Regulation.
- Qualified investors – transactions are usually restricted to qualified investors, as defined by Article 2 of the Prospectus Regulation.
- Retail clients – if a securitisation position is to be marketed to any retail client as defined under Article 4(1) of Directive 2014/65/EU (ie, any client that does not constitute a "qualified investor"), certain strong requirements must be met, including the suitability test.

2.7 Bond/Note Trustees

Given the continental nature of Spanish law, the concept of "trust" or "trustee" is alien to the Spanish Securitisation Law. However, as explained in **2.1 Issuers**, as SPEs are devoid of legal personality, they must be administered by a special type of management company that has the following features.

- Strongly regulated entities are the only type of entities that are legally allowed to administer SPEs under the Spanish Securitisation Law (Title III, Chapter II). They must be authorised by the CNMV, which has a list of authorised management companies available on its website.
- Legal duties include handling the incorporation, management and legal representation of an SPE in the interest of the noteholders. In particular, management companies must:
  (a) have staff with expertise;
  (b) conduct a risk assessment of the securitised assets;
  (c) avoid conflicts of interest; and
  (d) comply with reporting obligations.
- Status – entities shall have the suffix "S.G.F.T." in their legal name (as an abbreviation of *sociedad gestora de fondos de titulización*).
- Foreign SPEs – according to Article 25.2 of the Spanish Securitisation Law, Spanish management companies may only incorporate, manage and represent foreign SPEs that are similar to Spanish SPEs, in accordance with the applicable regulations of the relevant jurisdiction.

Apart from the general obligation of the management company to act in the interest of the noteholders, securitisations can be embedded with or without a meeting of creditors; see **1.2 Structures Relating to Financial Assets**.

2.8 Security Trustees/Agents

Due to the specific legal framework in Spain, the role of the security trustee is not necessary. However, there are a number of other agents that are customarily needed, such as the paying agent, the billing and delivery agent and the account bank.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The classic risk for securitisations is the risk of claw-back in the event of the seller's insolvency. Fortunately, the Spanish Securitisation Law contains an exception to the typical claw-back mechanism under the Spanish Insolvency Law.

Securitisations made under the Spanish Securitisation Law by means of an SPE enjoy an "absolute separation right", which means that claw-back is substantially restricted as it can only take place on grounds of fraud. This legal exception is sufficient to comply with Article 20(1) of the EU Securitisation Regulation, which requires that the transfer of receivables to an SPE shall not be subject to severe claw-back provisions in the event of the seller's insolvency.

3.2 Principal Warranties

Types of Warranties

Two sets of representation and warranties (R&W) given by the seller are commonly used in Spanish securitisations.

- Representations on the seller – the standard R&W include:
  (a) the legal form and status of the seller;
  (b) the absence of insolvency or bankruptcy situations;
  (c) authorisations and corporate approvals;

and
(d) audited annual statements for the last two fiscal years.
- Representations on the assets – the standard R&W include that the assets:
  (a) originated in the ordinary course of the seller's business;
  (b) are existing, valid and susceptible of being enforced under the applicable laws; and
  (c) meet all necessary conditions to be transferred to the SPE.

Breach of R&W

Most of the wording of warranties regarding the breach of an asset representation and warranty is usually structured as a breach of the eligibility criteria, and its contractual enforcement is materialised as a three-step obligation process for the seller:

- to remedy the breach;
- to replace the affected receivable; and
- if these are not possible, to repurchase the affected asset.

Enforcement is made primarily by the management company, although judicial enforcement is a possibility since these provisions are a contractual undertaking under the deed of incorporation of the SPE.

3.3 Principal Perfection Provisions

Common Provisions

The transfer of assets from the seller to the SPE is instrumented under Spanish law as follows.

- Assignment transaction – as an assignment (*cesión*) of the receivables derived from the loans.
- Type of asset – the sale is executed by means of an SPA generally or, in the case of mortgage loans, through the issuance of multiple titles if the seller is a financial entity.
- Formalities – the assignment transaction also has to comply with the formalities contained in Article 17 c) of Law 5/2015.
- Revolving formalities – in the context of revolving securitisations, the management company should deliver to the CNMV for each additional purchase a document executed by the seller containing identification of the additional assets and a declaration of compliance with the eligibility criteria.

Notarisation

Considering Articles 1227, 1280 and 1526 of the Civil Code, the documentation usually includes an execution covenant so that the sale agreement is notarised in order to be fully effective vis-à-vis third parties.

Notification to Borrowers

Notification is not a perfection requirement. However, until the borrower is notified of the sale of the loan to the SPE, pursuant to Article 1,198 of the Civil Code, the borrower will be:

- legally discharged of its obligations for payments made to the seller (as original lender); and
- able to set off obligations against the seller (this can be an issue if the seller performs retail banking).

As the seller is usually designated as servicer in Spanish securitisations, no notification is required, except in the following instances.

- If required by law – several regional regulations require notification to borrowers if those borrowers are qualified as consumers and the loans meet certain requirements.

- Upon a servicer event – certain event-specific scenarios normally trigger the servicer succession mechanism, such as the insolvency of the servicer or a breach of obligations. In this scenario, a compulsory notification to all borrowers is usually the best practice to avoid a few operational risks.

3.4 Principal Covenants

There are usually three sets of covenants in any securitisation from a subjective point of view:

- from the seller;
- from the originator; and
- from the management company.

The following key commitments are usually included in the documentation.

- Sale – the seller shall sell the relevant assets meeting the eligibility criteria (the representations and warranties described in **3.2 Principal Warranties**) to the SPE.
- Collection – the servicer shall transfer the amounts collected from the debtors of the underlying assets to the SPE.
- Servicing – the servicer shall manage the underlying assets (see **4.9 Banks Securitising Financial Assets**).
- Risk retention – the seller (as originator) shall retain a material net economic interest of not less than 5% of the nominal value of the securitisation (see **4.3 Credit Risk Retention**).
- Compliance – the applicable regulations shall be complied with.

3.5 Principal Servicing Provisions

Under Article 26 of the Spanish Securitisation Law, the primary rule is that the management company of the SPE is legally responsible for administering the assets pooled in the SPE.

Usual Servicing Provisions

The servicing provisions should be ring-fenced in a servicing agreement to be executed upon closing by the SPE. Those provisions should include at least the following:

- custody of the documentation relating to the underlying assets;
- collections – an undertaking to transfer all collection amounts to the SPE;
- default process – the actions to be implemented in case of defaulted assets;
- notices between the management company and the SPE; and
- termination – servicer termination events and a replacement procedure.

Servicing Differences

Depending on the asset class, the servicing activity can be subject to certain requirements.

- Mortgage loans – in the case of real estate mortgages, the Spanish Mortgage Mobilisation Regulation requires the seller (as original lender) to retain a number of non-delegable tasks. The remaining tasks can be (and usually are) delegated as part of the servicing arrangement. This issue can be particularly important when securitising NPL portfolios.
- Other loans – the management company usually completely delegates the management of the assets to a servicer (usually the seller), but this delegation does not impair the primary liability of the management company under Article 26 of the Spanish Securitisation Law, which shall continue to be liable vis-à-vis the noteholders.

3.6 Principal Defaults

Three different sets of defaults can be differentiated.

- SPE defaults – Spanish transactions do not usually embed SPE defaults. Actually, payment default is usually not observed and, therefore, an interest payment default simply leads to an accumulation in the next payment date (without default interest). At the SPE level, most of the early redemption triggers are linked with ad hoc calls such as the clean-up call, the tax call and the regulatory call. However, it is possible to include tailor-made calls, depending on the needs of the seller (such as a green call or a random repurchase call).
- Management company default – management companies are bound by certain operational defaults established in the Spanish Securitisation Law, related to their legal status and compliance with legal covenants. If the defaults are not cured within a statutory period, the documentation always replicates the replacement procedure established in the Spanish Securitisation Law.
- Seller defaults – as described in **3.2 Principal Warranties**, the seller is bound by certain asset representations, which can have the effect of triggering the seller's liability.
- Servicers' default – the paying agent, the account bank, the hedge provider, the servicer, etc, are bound by certain defaults in their respective documentation. For instance, in the case of the account bank, a rating downgrade event is the most common type of default that triggers a replacement procedure.

3.7 Principal Indemnities

The very concept of "indemnity" is alien to the continental legal systems. However, the placement agreement executed between the seller, the SPE and the placement agents occasionally includes a number of indemnities due to the influence of English law, limited to the compliance of the selling restrictions in the context of the placement activity of the placement agents.

3.8 Bonds/Notes/Securities

As described in **1.2 Structures Relating to Financial Assets**, one of the structural drivers is the difference between a private transaction and a public transaction. The notes are usually represented as book entries in Iberclear, although listing differs as follows.

- Public securitisation – a prospectus must be filed with the CNMV drawn under the Prospectus Regulation, and the notes are usually listed in the Spanish regulated market for fixed income securities (AIAF).
- Private securitisation – no prospectus is needed as the notes are listed in a multilateral trading facility. The most usual venues are the Spanish MARF, the Vienna MTF and Dublin MTF.

On certain occasions, the transaction can be structured without book entries, but with the note represented in a physical security.

3.9 Derivatives

Interest rate derivatives are the most common type of derivative used in Spanish securitisations to match the interest profile of the assets of the SPE (ie, the loans) and the liabilities of the SPE (ie, the notes).

The ISDA standard is the most used documentation package, but in some instances the CMOF standard is also used. Interest derivatives can be governed by Spanish law or foreign law (English law, French law and Irish law are the most usual foreign legislation used in Spain). It should be taken into consideration that using a foreign ISDA will likely involve extra costs for the legal opinion related to the hedging agreement.

3.10 Offering Memoranda

As described in **1.2 Structures Relating to Financial Assets**, one of the structural decisions is choosing between a public and a private transaction.

- Prospectus – a prospectus is necessary in the case of public securitisations (ie, when the notes issued by the SPE are listed on a regulated market). This prospectus has to be drawn up according to the Prospectus Regulation and must be authorised by the Spanish CNMV.
- Information memorandum – no prospectus will be needed if the notes are listed in a multilateral trading facility, but a listing document might be necessary. For instance, in the case of listing the notes in the Spanish MARF, an "information memorandum" should be drawn up in accordance with the minimum requirements and custom formats of this venue set up in MARF Circular 2/2018.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Spanish Level

Disclosure to the CNMV

The assignment of receivables to an SPE is subject to the following requirements (Article 17 of Law 5/2015):

- annual accounts – the assignor must provide its audited annual accounts for the previous two years to the CNMV (unless it has been recently incorporated);
- annual reports – the assignor must detail the transactions involving the transfer of credit rights (whether regarding present or future receivables) in its annual reports;
- revolving nature – if additional assets are assigned to the SPE (beyond the initial ones), a notification must be sent to the CNMV identifying the assets incorporated and their characteristics, together with a representation stating that such new assets meet all the requirements set out in the SPE's deed of incorporation; and
- formalities – transfers of assets to an SPE must be formalised in a written document.

Public information

Management companies shall publish the following information on their websites, for each of the SPEs they manage (Article 34 of Law 5/2015):

- the deed of incorporation and any other subsequent deeds;
- the prospectus and any supplements thereto, if applicable; and
- the annual/quarterly reports (see **4.4 Periodic Reporting**).

European Level

SPEs are generally subject to the disclosure requirements envisaged under the Securitisation Regulation (see **4.2 General Disclosure Laws or Regulations**).

4.2 General Disclosure Laws or Regulations

Disclosure to Investors and National Supervisory Body

According to the Securitisation Regulation, SPEs shall make the following information regarding the securitisation available to the CNMV and investors before pricing (and also to potential investors if they so require):

- all underlying documentation that is essential for the understanding of the transaction;
- where a prospectus has not been drawn up, a transaction summary/overview of the main features of the securitisation; and
- in simple, transparent and standardised (STS) securitisations, the STS notification.

Disclosure to Securitisation Repository

In public deals, according to the Securitisation Regulation, disclosures must be made to a securitisation repository – ie, an entity duly registered with the European Securities and Markets Authority (ESMA) for that purpose. The means of disclosure for private deals, on the other hand, is not prescribed. According to ESMA, "absent any instructions or guidance provided by national competent authorities, reporting entities are free to make use of any arrangements that meet the conditions of the Regulation".

4.3 Credit Risk Retention

Spanish regulations do not contain specific risk retention requirements for securitisation transactions; the applicable legal framework is to be found in Article 6 of the Securitisation Regulation, which establishes the obligation of the originator, sponsor and original lender to retain a material net economic interest of not less than 5% of the nominal value of the securitisation.

Such economic net interest shall be measured at the origination date, maintained throughout the securitisation transaction and determined by the notional value for off-balance sheet items. Furthermore, the net economic interest cannot be sold, divided between different retainers nor subject to any credit-risk mitigation, any short positions or any other hedging.

The Securitisation Regulation sets forth alternative procedures with the retention of the following to comply with requirements:

- no less than 5% of the nominal value of each of the tranches sold;
- the originator's interest of no less than 5% of the nominal value of each of the securitised exposures (in revolving securitisations or securitisations of revolving exposures);
- randomly selected exposures, equivalent to no less than 5% of the nominal value of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation and the number of potentially securitised exposures is not less than 100 at origination;
- the first loss tranche and, where such retention does not amount to 5% of the nominal value of the securitised exposures, 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 is equal in total to an amount equivalent to no less than 5% of the nominal value of the securitised exposures; and
- a first loss exposure of not less than 5% of every securitised exposure.

4.4 Periodic Reporting

Reporting to the CNMV

Management companies of SPEs must submit the following information on each SPE to the CNMV, as the national public supervisory body (Article 35 of Law 5/2015):

- quarterly, within two months of the end of each calendar quarter, certain information including a breakdown of the assets transferred to the SPE, a breakdown of the SPE's

liabilities and the total commitments arising from the derivative instruments in place (when applicable); and
- annually, the relevant SPE's annual financial statements for registration with the CNMV, together with the auditors' report in respect thereof, within four months following the end of the SPE's financial year (ie, prior to 30 April of each year).

Other Relevant Information to Make Publicly Available

Management companies must give immediate notice to the CNMV and to their creditors (Article 36 of Law 5/2015) of any material event that is specifically relevant to the situation or development of the SPE (except in the case of an SPE whose securities are not admitted to trading on an official secondary market). Material facts specifically relevant to the SPE will be those that could have a significant impact on the notes issued and/or on its assets.

4.5 Activities of Rating Agencies

According to Law 5/2015, there is no legal requirement in Spain to grant a credit rating to the securitisation notes in order to incorporate an SPE, but it is common market practice to assign ratings to the notes of public securitisations.

In Spain, the securitisation activities of rating agencies are primarily regulated under:

- Regulation EC 1060/2009 on credit rating agencies (the CRA), which has subsequently been amended by Regulation EU 513/2011 (CRA II), which transferred the responsibility for the registration and supervision of credit agencies to ESMA; and
- Regulation EU 462/2013 (CRA III), which introduced certain items in relation to credit rating agencies (eg, the reliance of firms on external credit ratings, independence, sovereign debt ratings, or the degree of competition in the industry or the liability regime).

4.6 Treatment of Securitisation in Financial Entities

Banks' capital and liquidity requirements are regulated under the so-called "CRDV package" of legislation, which includes:

- Directive 2013/36/EU, regarding prudential supervision, which has been transposed into the Spanish legal framework by Law 10/2014 and Bank of Spain Circulars 2/2014 and 2/2016;
- Regulation EU 575/2013, on prudential requirements;
- Directive EU 2019/878, the transposition of which into the Spanish legal framework has been initiated by Royal Decree-Law 7/2021; and
- Regulation EU 2019/876 (CRR II).

In general terms, the CRDV package establishes the following two main requirements.

- The liquidity coverage requirement (LCR) assesses if the number of high-quality liquid assets (HQLA) owned by banks is sufficient to cover the liquidity needs over a stress period. In this regard, there are three tiers of HQLA (Level 1, Level 2A and 2B), and securitisations can only be eligible as Level 2B when the following requirements are fulfilled:
  - (a) the securitisation qualifies as STS; and
  - (b) an external credit quality assessment has been conducted by an External Credit Assessment Institution meeting some requirements.
- The net stable funding requirement (NSFR) has the main purpose of ensuring that banks

do not suffer from a short-term funding crisis, by establishing the holding of a minimum level of stable funding. In this regard, in the securitisation context, an originator bank is required to establish a certain level of stable funding in relation to the assets held. In addition, a bank that invests in a securitisation will be required to establish a certain amount of stable funding in relation to the securitisation that it is holding.

The legal framework for insurance companies is contained in Law 20/2015 and Royal Decree 1060/2015, regarding the regulation, supervision and solvency of insurance and reinsurance entities.

The requirements in relation to other regulated financial entities (eg, alternative investments fund managers) are established in Law 22/2014, regulating venture capital entities, other closed-ended collective investment entities and management companies of closed-ended collective investment entities.

4.7 Use of Derivatives

Hedging

Derivatives continue to be a common tool to hedge possible risks for SPEs, mainly interest rate risk, which is hedged by means of swaps and caps.

The CNMV is the Spanish supervising body for the derivatives market, as well as the principal regulator of the entities operating in such market. When the relevant entity is a credit institution, the Bank of Spain may also have certain supervisory or control functions.

In any case, the relevant regulation on derivatives is as follows:

- Spanish regulation – with regards to the use of derivatives as hedge instruments, Law 5/2015 (Article 35) lays out that management companies shall submit the annual report to the CNMV for each of the SPEs they manage (as described in **4.4 Periodic Reporting**), which must include, inter alia, the total commitments arising from the derivatives in place (if any); and
- European regulation – the Securitisation Regulation (Article 21) sets forth that SPEs shall not enter into derivative contracts except for the purpose of hedging interest rate or currency risk, and that such derivatives shall be underwritten and documented according to common market standards.

Synthetic Securitisation

In addition to employing derivatives instruments as hedging, in synthetic securitisation transactions a financial derivative instrument is used for risk transfer. Said synthetic securitisation transactions are permitted under both Spanish and European regulations (Law 5/2015 and the Securitisation Regulation), as outlined in **5.1 Synthetic Securitisation Regulation and Structure**.

4.8 Investor Protection

Spanish Supervisory Body

Securitisation in Spain is a regulated activity under Law 5/2015, supervised by the CNMV. For public SPEs, prior authorisation is required from the CNMV, which is the supervisory body responsible for approving and registering the relevant prospectuses. For private securitisations that do not require a prospectus to be published, the CNMV performs an ex-post control, as the deed of incorporation of the SPE must be registered in the CNMV's records. In this regard, note that securitisations can only be carried out in Spain through securitisation funds, as further

discussed in **4.10 SPEs or Other Entities** and **4.11 Activities Avoided by SPEs or Other Securitisation Entities**.

The Meeting of Creditors

Law 5/2015 (Article 37) contains the possibility of setting up the so-called "meeting of creditors" (*Junta de Acreedores*), which is a creditors' committee in the context of a particular securitisation transaction and constitutes an additional protection for investors.

European Regulations

In any case, European regulation is the main legal framework that provides protection for investors by virtue of:

- the Securitisation Regulation, which contains, among others, the disclosure requirements and the compulsory periodic reporting obligations; and
- when applicable, the Prospectus Regulation, which ensures that investors will be provided with all material information regarding a securitisation transaction.

4.9 Banks Securitising Financial Assets

In Spain, the applicable legal provisions for securitising banks are to be found primarily in the Securitisation Regulation, the CRR and Law 5/2015. In addition, the following Spanish legal requirements must be considered.

Mortgage Loans

The applicable legislation establishes that the credit rights arising from mortgage loans can be assigned by means of transferrable securities called mortgage participations (MPs) (*participaciones hipotecarias*). In order to transfer said credit right through an MP, the following general conditions must be met:

- the mortgage loan shall be secured with a first-rank mortgage;
- the LTV does not exceed 60% or 80% regarding commercial or residential properties, respectively;
- the mortgaged property is insured against damages; and
- the assets do not qualify as excluded assets (eg, mortgage loans granted over a right of usufruct, surface rights or administrative concessions).

If any of these requirements are not met, the credit rights may be transferred through different transferrable securities, called mortgage transfer certificates (MTCs) (*certificados de transmission de hipoteca*). However, MTCs can only be held by qualified investors (as defined in **2.6 Investors**).

Consumer Loans

The applicable Spanish legal framework does not establish particularities in relation to the sale and perfection of consumer loans. However, according to Law 16/2011, if a loan is assigned by the original lender and said lender is no longer the servicer, a notification to the customer shall be completed.

In addition, as outlined in **3.3 Principal Perfection Provisions**, certain regional regulations require notification to borrowers if those borrowers are qualified as consumers and the loans meet certain requirements.

4.10 SPEs or Other Entities

Securitisation in Spain is regulated under Law 5/2015, according to which Spanish securitisation transactions can only be carried out specifically through a securitisation fund (*fondo de titulización*) (the SPE).

Please see **2.7 Bond/Note Trustees** regarding the main features of an SPE established under the Spanish Securitisation Law.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

As explained in **4.10 SPEs or Other Entities**, securitisation in Spain is only carried out through SPEs, which are managed by *sociedad gestora de fondos de titulización* (SGFTs), whose sole purpose is to manage such securitisation SPEs in Spain and abroad.

4.12 Participation of Government-Sponsored Entities

In general, government-sponsored entities do not participate in the securitisation market.

4.13 Entities Investing in Securitisation

Securitisations can have a wide variety of investor profiles, including credit institutions, investment funds, insurance companies and other institutional investors.

4.14 Other Principal Laws and Regulations

The following domestic laws have incidental relevance in securitisations carried out in Spain.

- Royal Legislative Decree 1/2020 (the "Spanish Insolvency Law") sets out the domestic legal framework regulating insolvency. On the one hand, the law affects the bankruptcy-remoteness nature of Spanish SPEs, as set forth in **6.1 Insolvency Laws**; on the other hand, depending on the underlying asset, it affects the insolvency regime of the debtors vis-à-vis the SPE.
- Royal Decree of 24 July 1889 (the "Civil Code") establishes the basic private and civil law regulations in Spain, which are relevant in terms of executing documentation and structuring the transfer of assets to the SPE.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

In Spain, synthetic securitisation transactions are permitted under both Law 5/2015 and the Securitisation Regulation. Securitisation transactions are those where the risk is transferred from the originator to the investors by means of derivatives instruments or guarantees, without transferring the exposures being securitised.

In particular, Law 5/2015 (article 19) establishes that:

- SPEs may synthetically securitise loans and other credit rights by contracting credit derivatives with third parties and/or granting financial guarantees to the holders of the loans or credit rights; and
- the assets of the SPE may include deposits in credit institutions and/or fixed income securities traded in official secondary markets.

In addition to the Securitisation Regulation and Law 5/2015, Spanish synthetic securitisations are also regulated at a European level, through CRR II and Regulation EU 2021/557, which establishes the requirements for a synthetic securitisation to achieve an STS label.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Insolvency regulations affect Spanish securitisations in the following ways.

- Transfer – claw-back risk is the classical challenge when transferring assets, in this case from the seller to the SPE. As explained in **3.1 Bankruptcy-Remote Transfer of Financial Assets**, the transfer of receivables to an SPE shall not be subject to severe claw-back provisions in the event of the seller's insolvency.
- Insolvency of the SPE – as described in **6.5 Bankruptcy-Remote SPE**, the Spanish SPE is excluded from insolvency proceedings by legal design. The Spanish Securitisation Law establishes certain procedures for the early liquidation of the SPE in an orderly manner.
- Insolvency of the SPE management company – Article 33 of the Spanish Securitisation Law provides for the compulsory replacement of the management company upon its insolvency. Moreover, money belonging to the SPE would not be deemed part of the bankruptcy assets of the management company. See **6.2 SPEs** for more information on the legal structure of the SPE.

6.2 SPEs

Structural Aspects of the SPE

As described in **4.10 SPEs or Other Entities**, securitisations made in Spain are regulated under the Spanish Securitisation Law, without a wide margin of discretion. A special type of SPE has to be incorporated as an ad hoc special purpose fund, with the following features:

- orphan in nature, with separate estate and zero equity, organised in a single or several compartments (which are independent among them);
- devoid of legal personality, administered by a special type of management company (see **2.7 Bond/Note Trustees**);
- the suffix "*fondo de titulización*" or "F.T." is used, which means "securitisation fund";
- the fund is incorporated at closing of the securitisation transaction by means of the notarisation of a deed of incorporation, which is the equivalent of the by-laws of a company;
- the activities carried out by an SPE are restricted to those described in the prospectus (and the deed of incorporation) – those activities usually cover the issuance of notes and the acquisition of underlaying assets, as well as the ancillary ongoing obligations in terms of disclosure obligations, waterfall administration, etc; and
- ownership and security of assets – the SPE is the owner of the transferred assets, in addition to any ancillary rights, such as the security attached to each asset.

Substantive Consolidation

The general doctrine on substantive consolidation is irrelevant in the context of Spanish securitisation. The bankruptcy-remote nature of the SPE is not affected by this doctrine, given that the Spanish insolvency law is not applicable to SPEs.

6.3 Transfer of Financial Assets

Legal Requirements

The sale of assets to the SPE must comply with the requirements set forth in Article 17 of the Spanish Securitisation Law, which include the following:

- written agreement – the seller and the SPE should execute a written document identifying each loan by at least the following data fields: identification code, execution date, outstanding balance as of cut-off date, interest, amortisation system and maturity date; and
- disclosure – the seller must file the financial statements for the last two fiscal years with

the CNMV, and states any executed securitisation transactions in its financial statement.

True-Sale Opinion

Usually, the drafting counsel includes a declaration in its transaction legal opinion concluding that the assignment of the receivables to the SPE on the incorporation date:

- has been carried out legally, validly and unconditionally for the remaining term until maturity by means of a true sale or assignment or transfer; and
- is enforceable vis-à-vis the seller and any third parties with full recourse to borrowers (and, where applicable, guarantors).

6.4 Construction of Bankruptcy-Remote Transactions

As described in **6.5 Bankruptcy-Remote SPE**, Spanish SPEs are bankruptcy-remote by legal design. However, there is one specific risk related to the collections, which must be mitigated from a structural point of view.

Commingling risk arises in Spanish securitisations when the servicer (usually the seller/originator) collects the loans in its own bank account and transfers the amount to the SPE's bank account within a period of time. In the event of the servicer's insolvency, there is a risk that the claim of the SPE to the moneys deposited in the servicer's bank account may be challenged by other creditors due to the fungible nature of money.

Best practice in Spain to mitigate the commingling risk include the following:

- operational term – reducing the time of transfer from the seller's collection account to the SPE in order to quantitatively reduce the risk amount;
- the seller setting up a commingling reserve in an SPE's locked account amounting for an average of commingling risk; and
- creating a pledge on the seller's collection account in order to have a preferential claim over that account in the event of the seller's insolvency.

6.5 Bankruptcy-Remote SPE

The bankruptcy-remoteness of SPE funds is a feature by legal design. As described in **2.1 Issuers**, the SPE used in Spanish transactions is necessarily a securitisation fund regulated under the Spanish Securitisation Law. The Spanish Insolvency Law is inapplicable to securitisation funds due to their lack of legal personality.

Notwithstanding the above, the following best practices must be observed in connection with the bankruptcy-remote nature of Spanish SPEs.

- Prospectus and deed of incorporation – several legal references shall be included in the prospectus and the deed of incorporation related to:
  - (a) the nature of the SPE as a Spanish securitisation fund incorporated under the Spanish Securitisation Law;
  - (b) the non-applicability of the Spanish Insolvency Law to the SPE; and
  - (c) the application of Article 16.4 of the Spanish Securitisation Law, Article 15 of Law 2/1981 (which is now contained in Article 42.2 of the Spanish Mortgage Mobilisation Regulation) and the First Additional Provision of the Spanish Mortgage Mobilisation Regulation.
- Legal opinion – the drafting counsel customarily prepares a legal opinion covering the

whole transaction, with the following being specifically mentioned:
(a) the absence of severe claw-back provisions for the transfer in the event of the seller's insolvency;
(b) the non-application of the Spanish Insolvency Law to the SPE; and
(c) the consequences of an insolvency of the management company of the SPE (ie, the replacement by another management company pursuant to Article 33 of the Spanish Securitisation Law).

7. Tax Laws and Issues

7.1 Transfer Taxes

Under Spanish value-added tax (VAT) legislation, the transfer of receivables would be a supply of services for VAT purposes, which would be deemed to be located in the place where the recipient of the services is established for VAT purposes. Therefore, as long as the recipient of the services (SPE) is established for VAT purposes within Spanish VAT territory or has a permanent establishment within the Spanish VAT territory to which the service is supplied, the transfer would be subject to VAT in Spain, but exempt.

Note that the services rendered by the seller to the purchaser, consisting of the collection of the payments made by the obligors, would be considered a separate transaction. According to the Spanish general VAT location rules, such collection services would be deemed to be located in the jurisdiction where the purchaser is established for VAT purposes.

In addition, provided the assignment of the receivables is formalised by means of a public deed and meets certain requirements (ie, the receivables have an ascertainable value; the transaction has a document that can be registered in a public registry, regardless of whether it is effectively registered; and the receivables are not subject to transfer tax, capital duty or inheritance gift tax), the assignment shall be subject to stamp duty. Tax rates currently range between 0.5% and 2%, depending on the autonomous region in which the public deed is to be registered. However, a specific exemption from this stamp duty tax applies when the originator assigns mortgage transfer certificates (*certificados de transmission de hipoteca* – MTCs) or mortgage participations (*participaciones hipotecarias* – MPs) over mortgage loans. This exemption is governed by Royal Decree-Law 24/2021 and by transfer tax and stamp duty legislation.

7.2 Taxes on Profit

The SPE is subject to the general provisions of the Corporate Income Tax (CIT) Law. The taxable base is calculated in accordance with the provisions of Section IV of the CIT Law. The current applicable tax rate is 25%.

The SPE's CIT taxable base should be close to nil if its financial income (interest earned from the receivables) offsets its financial expenses (interest paid to the bondholders). However, certain specific CIT features are applicable to the SPE, as follows.

- The tax deductibility of the impairment in the value of debt securities registered as assets in the SPE – in this regard, Rule 13 of CNMV Circular 2/2016 sets forth the criteria for the SPE to carry out value adjustments resulting from the impairment in the value of their registered financial assets. Article 13.1 of the CIT Law states that the CIT regulations (Article 9 and the seventh Transitory Provision) will rule the conditions for the deductibility of value adjustments made on account of the impair-

ment in the value of debt securities valued at amortised cost.
- As of 1 January 2024 and pursuant to Article 16.6 of the CIT Law, the limitation on the tax deductibility of financial expenses shall apply to the SPE.
- The yield of credit rights that constitute the income of the SPE shall not be subject to any withholding tax on account of the CIT liability payable by the SPE.

The SPE can be considered an entrepreneur for VAT purposes. However, as SPEs carry out VAT-exempt activity, they are not entitled to deduct any input VAT.

7.3 Withholding Taxes

Whether the payments on the receivables made to a non-Spanish tax resident purchaser by Spanish obligors would be subject to withholding taxes in Spain depends on the characterisation, for tax purposes, of the income received by the purchaser, and on the jurisdiction where the purchaser resides for tax purposes.

Although the tax characterisation of the income obtained by the non-Spanish tax resident purchaser is not clearly defined under Spanish law, it is likely to be deemed to be either interest income or capital gains.

According to the Spanish Non-Resident Income Tax Law, regardless of whether it is characterised as interest or capital gains, such income would be tax-exempt in Spain to the extent the purchaser meets the following requirements:

- it is resident for tax purposes in an EU member state or in a state within the European Economic Area (EEA), other than a tax haven territory, provided that the purchaser is also the "beneficial owner" of such income; and
- it does not act, in regards to the purchase of the receivables, through a permanent establishment located in Spain or outside the EU or EEA.

Residency for tax purposes in an EU member state or in a state within the EEA must be accredited through a certificate of tax residency issued by the relevant tax authorities. Tax residency certificates are valid for a one-year period.

If the purchaser is resident for tax purposes in a state that is neither an EU member state nor a state within the EEA, it may be subject to withholding tax in Spain in accordance with the provisions set forth in the relevant convention for the avoidance of double taxation.

Residency in a particular jurisdiction for the purposes of the application of a reduced rate of withholding tax in accordance with a specific convention must be accredited through a certificate of tax residency, issued by the relevant tax authorities. These certificates are valid for a one-year period.

If the purchaser is not accredited to be tax resident in an EU member state or a state within the EEA, nor in a jurisdiction with which Spain has a convention for the avoidance of double taxation in force, the purchaser would be subject to tax on the income derived from the transaction at the general current tax rate of 19%.

7.4 Other Taxes

The incorporation of the SPE is subject to but exempt from "Capital Duty" (*Operaciones Societarias*) (Article 45.I.B.20.4 of the Revised Text of the Law on Transfer Tax and Stamp Duty). The incorporation and winding-up of the SPE is not subject to Stamp Duty Tax (Article 31.2 of

the Revised Text of the Law on Transfer Tax and Stamp Duty).

7.5 Obtaining Legal Opinions

Legal opinions usually cover taxation matters, such as the taxation of the transaction (including stamp taxes and VAT on the transfer of the receivables and on the collection services provided to the SPE) and the taxation of the investors on the income deriving from the notes issued by the SPE.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

There are three accounting issues related to securitisation:

- a review of the status of the receivables in the assignor's balance sheet prior to the securitisation – the receivables must be recorded as existing credit rights;
- SPEs have a legal obligation to audit the yearly financial accounts; and
- credit entities transferring mortgage loans according to the regime envisaged under Royal Decree-Law 24/2021 (further described in **4.9 Banks Securitising Financial Assets**) have to create and update a special accounting registry to keep track of the following, among other matters:
  (a) the total mortgage pool;
  (b) the MPs and MTCs issued (as defined in **4.9 Banks Securitising Financial Assets**);
  (c) the *cédulas hipotecarias* and *bonos hipotecarios* issued; and
  (d) the final balance of the eligible collateral available versus the already issued transfer titles.

8.2 Dealing with Legal Issues

Accounting rules do not usually trigger legal issues.

There is one special case where the review of the status of the receivables in the assignor's balance sheet prior to the securitisation is key: when the transaction involves the transfer of balloon instalments, it is necessary to confirm that, unlike leasing instalments, the balloon loan instalments are actually recorded as existing receivables.

SWEDEN

Law and Practice

Contributed by:
Albert Wållgren, Henrik Ossborn and Lionardo Ojeda
Advokatfirman Vinge KB

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Advokatfirman Vinge KB is one of Sweden's true full-service firms, with offices in Stockholm, Gothenburg, Malmö, Helsingborg and Brussels. It is consistently involved in a broad range of banking and finance matters, representing both lenders and borrowers in all types of financing deals. The firm handles the entire spectrum of banking and finance work that is central to the Swedish economy, from complex international transactions to smaller, local mandates, including acquisition financing, asset finance, structured finance, securitisations, project finance, real estate finance, aviation finance, shipping finance, export credit finance, derivatives and financial reconstruction. The Vinge banking and finance team also advises on the full range of regulatory and compliance matters, including UCITS, Swedish special funds, exchange-traded funds, hedge funds and AIFMD-related issues. The practice also covers prime brokerage, custodian and distribution arrangements.

Authors

Albert Wållgren is a partner in Vinge's banking and finance practice. He advises lenders and borrowers on various types of financing arrangements, including corporate credits, leveraged finance, project finance and bonds, and has a particular focus on securitisations and other structured finance transactions. Albert has extensive experience both in domestic and in international deals from working for Vinge in Stockholm, as well as for the European Investment Bank (EIB) in Luxemburg and a leading US law firm in New York and London.

Henrik Ossborn is a partner in the banking and finance group at Vinge. He advises on a broad range of finance transactions, with a particular focus on securitisations, supply chain financings, project finance and other asset-based financings. He is a leading practitioner in this field with extensive experience, having worked on these types of transactions for more than 20 years. Henrik has acted for banks, investors and originators across Europe.

Lionardo Ojeda is a senior associate in the banking and finance group in Vinge's Stockholm office, and is a member of the Swedish Bar Association. He has extensive experience in national and international banking and finance transactions, including investment grade finance, leveraged finance, securitisations and other asset-backed financing. Lionardo also advises issuers, arrangers and underwriters on a broad range of debt capital markets transactions, including high-yield, investment-grade and hybrid bond and regulatory capital issuances.

Advokatfirman Vinge KB

Advokatfirman Vinge KB
Smålandsgatan 20
Box 1703
111 87
Stockholm
Sweden

Tel: +46 0 106 143 000
Email: contact@vinge.se
Web: www.vinge.se

VINGE

1. Specific Financial Asset Types

1.1 Common Financial Assets

The most common types of financial assets securitised in Sweden are:

- loan receivables (eg, consumer, SME, mortgage or auto loans);
- lease receivables (eg, auto leases); and
- trade receivables.

1.2 Structures Relating to Financial Assets

The usual transaction structure in a Swedish securitisation, for each of the financial asset types set out in **1.1 Common Financial Assets**, involves:

- an originator;
- a servicer;
- an issuer;
- one or several investors (lenders); and
- certain specified third parties (including a cash manager, a back-up servicer and an account bank).

The originator, which is normally also the servicer of the receivables post-transfer to the issuer, transfers the underlying assets to the issuer. As outlined in **6.1 Insolvency Laws**, **6.2 SPEs** and **6.4 Construction of Bankruptcy-Remote Transactions**, the issuer is a newly established bankruptcy-remote SPE. The transfer and the servicing agreement are structured to ensure a true sale of and security over the underlying assets.

The purchase of assets in accordance with the RPA, as further outlined in **3.1 Bankruptcy-Remote Transfer of Financial Assets**, is made based on certain eligibility criteria and financed by the investors pursuant to a facilities agreement. The investors are usually major national or international banks, asset managers, debt funds or other credit institutions. In addition to the senior and junior investors, the originator retains a material net economic interest in the securitisation of at least 5%, in accordance with the Securitisation Regulation, by making a subordinated facility available to the issuer.

In order to maintain the independence of the securitisation structure in relation to the potential bankruptcy of the originator, a back-up servicer is engaged. In the event of the originator's bankruptcy or the issuer's termination of the appointment of the servicer, for example, such back-up servicer can step in and continue the servicing of the transferred assets on substantially similar terms.

1.3 Applicable Laws and Regulations

The applicable laws and regulations are as follows:

- the EU Securitisation Regulation;
- the Bankruptcy Act (1987:672);
- the Instruments of Debt Act (1936:81);
- the Companies Act (2005:551);
- the Consumer Credit Act (2010:1846); and
- the Banking and Financing Business Act (2004:297).

1.4 Special-Purpose Entity (SPE) Jurisdiction

The most common jurisdiction of incorporation for SPEs today is Sweden, but it is not uncommon (especially not historically) to use an orphan SPE set up in Luxembourg or Ireland for tax and/or regulatory reasons and purposes.

1.5 Material Forms of Credit Enhancement

A number of different forms of credit enhancement have been used in the Swedish market over the last couple of years, including:

- subordination;
- over-collateralisation;
- cash reserves;
- deposits;
- guarantees;
- letters of credit;
- credit default swaps; and
- other forms of insurances.

Furthermore, and as addressed in **4.12 Participation of Government-Sponsored Entities**, the European Investment Fund has in certain cases provided guarantees to investors as part of its credit enhancement programme.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The role of the issuer is to own the securitised assets and to act as pledgor and borrower in relation to the securitisation investors. The issuer is typically a bankruptcy-remote SPE in the form of a limited liability company, usually established for the sole purpose of the securitisation transaction.

2.2 Sponsors

In most Swedish securitisations, the sponsor is also the originator and seller (see **2.3 Originators/Sellers**). In global or European trade receivables securitisation programmes for industrial companies, the sponsor is sometimes a parent company located outside Sweden, while the originator/seller is a Swedish subsidiary which originates the Swedish receivables as part of the programme.

2.3 Originators/Sellers

The role of the originator/seller is to originate, and subsequently to sell to the issuer, the underlying assets by adhering to certain established and agreed-upon eligibility criteria in connection with the origination of such assets. An originator is usually a retail lender, SME lender, bank or industrial company with portfolios of trade receivables.

2.4 Underwriters and Placement Agents

Underwriters and placement agents, sometimes referred to as managers and/or arrangers, are usually not engaged or involved in Swedish law-governed securitisation transactions. Instead, transactions are usually managed directly between the originator, issuer and lender, with the latter often being a financial institution (eg, a major bank or asset manager). Consequently, book-building processes and similar steps are uncommon on the Swedish market.

2.5 Servicers

The role of the servicer is to service the transferred receivables and thus to function as the main point of contact for the debtors under the securitised receivables. The servicer is usually the originator/seller of the receivables.

2.6 Investors

Investors are usually:

- major national or international banks;
- asset managers;
- debt funds; or
- other credit institutions.

2.7 Bond/Note Trustees

Bond/note trustees are not required, but is common for the bondholders/noteholders to appoint an agent which represents them in relation to the issuer, and which acts as a middleman for facilitating dealings and information between the issuer and the bondholders/noteholders. If bond/note trustees are not used, this is typically because there is only one bondholder/noteholder of each class; though in rare instances where there are only a few bondholders/noteholders, such holders can also choose to act and exercise rights through unilateral or majority decisions.

2.8 Security Trustees/Agents

Swedish law does not recognise the concept of a trust or trustees. However, it is common for a third party or, for example, an affiliate of a bank to act as "security agent" in relation to the security granted for the benefit of the secured parties. The role of the security agent is to hold and administrate the security.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

In order to achieve bankruptcy-remote transfers under a Swedish securitisation, two agreements are usually used:

- a receivables-purchase agreement (RPA), sometimes referred to as a loan-purchase agreement, which is entered into between the originator as seller, the issuer as purchaser and the security agent; and
- a servicing agreement, which is entered into between the originator as servicer, the issuer and the security agent.

Core Provisions of the RPA

The RPA sets out the details for the sale and purchase of the receivables to be securitised. For example, it contains provisions about:

- the purchase price;
- the actions to perfect the transfer;
- lack of recourse; and
- if applicable, terms for the repurchase of transferred receivables by the originator.

The RPA usually also contains certain originator warranties and asset warranties made by the originator. The originator warranties are similar to standardised representations made by an obligor under an LMA-form facilities agreement, including representations about status, power, capacity and authority, licences and corporate approvals. The asset warranties are more specific for a securitisation transaction, and include representations that:

- the loans comply with the agreed eligibility criteria;
- the loans are not subject to any security or encumbrance;
- the loans have been originated and, up until the transfer, administered in compliance with the applicable laws – eg, the Swedish Consumer Credit Act (*Konsumentkreditlag* (2010:1846)) in the case of consumer loans;
- records have been kept about all transactions, receipts, proceedings and notices in relation to the loans;
- adequate know-your-customer (KYC) checks have been conducted prior to origination of the loans; and
- the borrower has made no claims, by way of set-off or counterclaim, for example, against the originator that would render the whole or part of the transferred loan unenforceable.

Core Provisions of the Servicing Agreement

Under the servicing agreement, the issuer appoints the originator as its servicer to administer and to collect amounts due under the transferred loans in accordance with the originator's credit and collection policy. Loan proceeds are often collected on an account held by the servicer, where such proceeds are held as escrow funds, and are then swept, by daily transfers, to an assigned account of the issuer.

Typically, the servicing agreement contains an indemnification provision whereby the servicer undertakes to indemnify the issuer against any cost, claim, loss and liability that has arisen in connection with a breach by the servicer of its liabilities and undertakings under the servicing agreement.

As outlined in **6.3 Transfer of Financial Assets**, it is an established principle under Swedish law that, in order to achieve a true sale where the transferor shall continue to service the sold assets, the transferee of the receivables (ie, the issuer) must be able to terminate the appointment of the transferor (ie, the originator) as servicer for the transferred loans, at any time and at its sole discretion. Thus, the servicing agreement usually contains such discretionary provisions alongside customary provisions regarding the resignation or termination of the servicer.

In addition to the servicing agreement, the servicer, the issuer and the security agent often enter into a back-up servicing agreement with a third-party service provider. This agreement, together with the servicing agreement, forms the basis for the replacement of the servicer in the case of a termination or resignation, pursuant to the servicing agreement.

3.2 Principal Warranties

As outlined in **3.1 Bankruptcy-Remote Transfers**, asset-related warranties are the principal warranties used in securitisation documentation governed by Swedish law, besides standard corporate warranties relating to the originator and the SPE. Such asset-related warranties are mainly focused on compliance with agreed eligibility criteria, agreed concentration limits, and applicable laws and regulations.

Any breach of warranty would typically constitute an event of default and/or an early amortisation trigger event under the securitisation documentation, but any breach of asset-related warranties could usually be cured by a repurchase of the affected receivables by the originator within a certain period of time (and sometimes, a breach of asset-related warranties would only result in the affected loans falling out of the borrowing base without triggering an event of default if the borrowing base ratio is still being complied with).

3.3 Principal Perfection Provisions

As outlined in **6.3 Transfer of Financial Assets**, the necessary perfection provisions depend on whether the receivables are non-negotiable promissory notes (*enkla skuldebrev*) or negotiable promissory notes (*löpande skuldebrev*). Generally, the necessary steps include:

- notifying the debtor of the transfer; and
- in the case of negotiable promissory notes, transferring the physical promissory note to the SPE.

In most cases, the secured parties will obtain a pledge over the transferred receivables, under which the security agent, acting on behalf of the secured parties, will obtain a power of attorney authorising it to do all such acts and take any steps necessary to establish, maintain and pre-

serve the pledge. There is normally a high level of focus on ensuring that all relevant perfection steps are taken, and such perfection steps are typically conditions precedent to funding (both on the initial utilisation date and on future utilisation dates).

3.4 Principal Covenants

In addition to customary positive and negative covenants relating to the ring-fencing of the SPE and the assets and liabilities forming part of the securitisation, Swedish securitisation documentation usually includes certain covenants specific to the securitisation and the Swedish regulatory environment. For example, a company that intends to participate in financing by acquiring receivables and raising financing from financially regulated entities (eg, an issuer in a securitisation) does not need a licence from the Swedish Financial Supervisory Authority to conduct such activities. It does, however, need to register with the Swedish Financial Supervisory Authority pursuant to the Currency Exchange and Other Financial Operations (Reporting Duty) Act.

Once registered, the Company will be a so-called financial institution (*finansiellt institut*), which, in accordance with the mentioned act, will be subject to certain anti-money laundering and KYC obligations, for example. Although the company can initiate its business as soon as the registration application has been submitted to the Swedish Financial Supervisory Authority, the securitisation documentation usually contains a covenant to promptly complete such registration and a covenant restricting the company from raising financing from non-regulated entities.

In addition, depending on the applicable credit enhancement structure and the applicability of the Securitisation Regulation, the securitisation documentation usually contains a covenant to maintain risk retention in order to ensure compliance with the Securitisation Regulation.

Any breach of covenants would constitute an event of default and/or an early amortisation trigger event.

3.5 Principal Servicing Provisions

As outlined in **3.1 Bankruptcy-Remote Transfers**, the servicer is often the parent company of the issuer and is also the original originator of the receivables. Due to the close corporate relationship between the issuer and the servicer, the servicing agreement contains strict provisions about the services provided, including but not limited to:

- administration of the loans;
- record-keeping;
- the collection of loan receipts;
- reporting requirements (including requirements under the Securitisation Regulation); and
- related information undertakings.

A common Swedish law-governed structure (as further outlined in **1.2 Structures Relating to Financial Assets**) entails that, following the transfer of receivables from the originator to the issuer, the debtor will continue to make payments of principal and interest into an account held by the originator, which will then make daily sweeps of collected monies to an account of the issuer. Given this typical structure, the servicing agreement usually contains provisions regulating that such loan receipts shall be held as escrow funds by the servicer on behalf of the issuer in order to avoid commingling with the servicer's other assets.

Furthermore, as a result of the established true sale principles mentioned in **6.3 Transfer of**

Financial Assets and **3.1 Bankruptcy-Remote Transfers**, it is fundamental for the issuer to be able to terminate the appointment of the servicer, at any time and at its sole discretion. Consequently, the servicing agreement usually contains such arbitrary termination provisions.

3.6 Principal Defaults

Principal defaults used in Swedish securitisation documentation are similar to customary defaults in an LMA-form facilities agreement – ie, the following are common default triggers:

- non-payment;
- misrepresentation;
- breach of obligations;
- change of control; and
- a material adverse change.

Other securitisation-specific defaults commonly used include:

- the failure by the originator to comply with the risk-retention requirements of the Securitisation Regulation; and
- the failure to complete the registration as a financial institution pursuant to the Currency Exchange and Other Financial Operations (Reporting Duty) Act, as outlined in **3.4 Principal Covenants**.

If the RPA contains a repurchase mechanism, under which the originator is obliged to repurchase transferred loans in certain situations, the failure to repurchase transferred receivables in order to cure an asset performance failure (for example) is a default.

3.7 Principal Indemnities

Principal indemnities used in a Swedish securitisation are very broad and in line with international standards, including:

- indemnities for losses resulting from defaults;
- any finance party acting on requests or instructions by the issuer;
- currency indemnities; and
- tax indemnities.

Indemnities are usually subject to the applicable priority of payments, and exclude any situation where the otherwise indemnified party has acted with:

- gross negligence;
- fraud; or
- wilful misconduct.

3.8 Bonds/Notes/Securities

The terms and conditions of the bonds/notes/securities are normally documented in a Note Facilities Agreement (either one combined for all tranches, or one separate for each tranche), which is based on standard LMA format but with adjustments to fit the securitisation structure.

3.9 Derivatives

The type of derivate used depends on the type of underlying asset, and on whether there is any mismatch as regards currencies (FX) or type of interest (fixed versus floating); however, typically the securitisation would be designed to match the underlying asset so that no hedging is required (other than in the form of credit enhancement to address credit risk).

3.10 Offering Memoranda

In Sweden, an Offering Memorandum would take the form of a prospectus approved by the Swedish Financial Supervisory Authority and be prepared in accordance with Regulation (EU) 2017/1129 of the European Parliament and of the Council (the "Prospectus Regulation"), the adhering delegated regulations, and certain supplementary local laws and regulations.

The relevant requirements for (and exemptions to) preparing a prospectus follow directly from the Prospectus Regulation and are the same for securitisations as for other "regular" debt instruments. Generally speaking, a prospectus is required in relation to instruments that are offered to the public or that are otherwise admitted to trading on a regulated market.

As the vast majority of securitisations in Sweden take the form of unlisted and unrated private placements which are marketed and sold to either only qualified investors or to fewer than 150 investors (or both), a prospectus is rarely needed for purely Swedish securitisations.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

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 (the "Securitisation Regulation"), has been directly applicable and enforceable in Sweden since its adoption. Therefore, the transparency requirements under Article 7 of the Securitisation Regulation are applicable in relation to a Swedish securitisation.

4.2 General Disclosure Laws or Regulations

In addition to the transparency requirements under the Securitisation Regulation, Swedish limited liability companies are subject to mandatory disclosure rules in accordance with:

- the Companies Act;
- the Accounting Act (*bokföringslag* (1999:1078)); and
- the Annual Reports Act (*årsredovisningslag* (1995:1554)).

Such disclosure rules include obligations to disclose annual reports and the company's articles of association (for example), and to keep available an updated shareholders' register.

In addition, publicly listed companies are subject to certain disclosure rules in accordance with:

- the Swedish Securities Act (*Lag* (2007:528) *om värdepappersmarknaden*);
- Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (the "Market Abuse Regulation") and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC; and
- the rules and regulations of the relevant regulated market where their shares are traded, as applicable.

Furthermore, financial institutions such as banks are subject to applicable disclosure provisions pursuant to the EU's capital adequacy and liquidity regulation (CRR/CRD), which is directly applicable in Sweden.

4.3 Credit Risk Retention

There are currently no specific Swedish laws or regulations regarding credit-risk retention, other than the rules pursuant to the Securitisation Regulation. However, in accordance with Article 30.1 of the Securitisation Regulation, certain

supplementary legislation has been adopted in order to ensure that the relevant competent authority – ie, Sweden's Financial Supervisory Authority (*Finansinspektionen*) – has the necessary supervisory, investigatory and sanctioning powers to fulfil its duties under the Securitisation Regulation.

On 1 February 2020, the Supplementary Act to the Securitisation Regulation (*Lag* (2019:1215) *med kompletterande bestämmelser till EU: sförordning om värdepapperisering*) entered into force in Sweden. The act gives the Financial Supervisory Authority certain investigative and supervisory powers, and establishes interventions and sanctions for violations of the Securitisation Regulation.

4.4 Periodic Reporting

As outlined in **4.1 Specific Disclosure Laws or Regulations** and **4.2 General Disclosure Laws or Regulations**, Swedish companies are subject to the transparency requirements of the Securitisation Regulation and to local law requirements pursuant to the Companies Act, the Accounting Act and the Annual Reports Act.

In addition, regulated entities such as financial institutions are subject to the regulatory regimen under which they operate. Such requirements can include, but are not limited to, reporting regarding capital adequacy and liquidity, and anti-money laundering.

4.5 Activities of Rating Agencies

Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies is directly applicable in Sweden. Swedish national law does not contain any other material provisions regarding rating agencies.

4.6 Treatment of Securitisation in Financial Entities

As Sweden is part of the EU, the Swedish legal framework is based on the single rule book for the EU.

The Swedish legal framework regarding capital adequacy and liquidity is based on the EU's capital adequacy and liquidity regulation (CRR/CRD), and is valid for banks and other regulated financial entities (*Kreditmarknadsbolag*).

For insurance companies, the Swedish legal framework is based on the Solvency II Regulation.

4.7 Use of Derivatives

There are no specific national laws or regulations that apply to the use of derivatives in securitisations. However, Swedish companies are subject to the applicable EU regulations and directives.

4.8 Investor Protection

There are no investor protection laws or regulations that apply specifically to Swedish securitisations, though the general Swedish and EU laws and regulations would come into play depending on the extent to which a Swedish securitisation is a public issuance. In addition, the Securitisation Regulation provides the following protective measures:

- due diligence requirements pursuant to Article 5;
- risk-retention requirements pursuant to Article 6; and
- transparency requirements pursuant to Article 7.

4.9 Banks Securitising Financial Assets

Swedish banks that securitise any of their financial assets or invest in positions in securitisa-

tions are regulated by the Securitisation Regulation and by the applicable capital adequacy and liquidity regulation (CRR/CRD).

4.10 SPEs or Other Entities

As outlined in **6.2 SPEs**, a Swedish SPE is usually set up as a limited liability company in accordance with the Companies Act. Swedish law does not provide for any specific regulation regarding SPEs; instead, an SPE will be subject to the rules and regulations generally applicable to Swedish limited liability companies.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Pursuant to the Swedish Banking and Financing Business Act (*Lag* (2004:297) *om bank- och finansieringsrörelse*), a company must have a licence in order to carry out financing business (*finansieringsrörelse*) in Sweden. The term “financing business” includes any commercial operations where the purpose is to:

- accept repayable funds from the public; or
- grant loans, provide guarantees for loans or, for financing purposes, acquire claims or grant rights of use in personal property.

In an opinion issued on 18 February 2021 (*Ställningstagande: Obligationsfinansierad kreditgivning*), the Swedish Financial Supervisory Authority established its view that the issuing of debt instruments, including bonds, would not be subject to the licence requirements under the Banking and Financing Business Act, unless such instruments are issued to a financial institution (as the term is used in the CRR) and the issuing company can ensure that the issued instrument cannot be transferred to a non-financial institution.

As a result of the above, for a Swedish company that is not a bank or a financial institution, it is crucial that any debt issued pursuant to a securitisation transaction not be held by or transferred to a private person or a company that is not a financial institution. Therefore, Swedish securitisation documents contain strict provisions regarding the transfer and assignment of debt, limiting such transfers and/or assignments to so-called eligible institutions.

It should be noted, however, that although an issuer can avoid being subject to the licence requirements under the Banking and Financing Business Act, in most situations it will (as outlined in **3.4 Principal Covenants**) be subject to the registration requirements under the Currency Exchange and Other Financial Operations (Reporting Duty) Act (*Lag* (1996:1006) *om valutaväxling och annan finansiell verksamhet*).

4.12 Participation of Government-Sponsored Entities

There are no Swedish government-sponsored entities that specifically target Swedish securitisations, though Swedish pension funds and other managers of public funds are occasionally seen as investors in Swedish securitisations. However, European institutions such as the European Investment Fund have been involved in Swedish securitisation transactions by providing guarantees through their credit enhancement operations in order to facilitate and enhance access to finance for small and medium-sized enterprises.

4.13 Entities Investing in Securitisation

Investors are usually:

- major national or international banks;
- asset managers such as funds and pension funds; or

- other credit institutions.

All these entities are subject to the regulatory landscape under which they operate.

4.14 Other Principal Laws and Regulations

No further information is available.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Swedish law does not explicitly regulate synthetic securitisations – ie, securitisations where the transfer of risk is achieved through the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator.

However, synthetic securitisations are admissible in Sweden subject to the EU legal regime – in this case, the Securitisation Regulation and the applicable capital adequacy and liquidity regulation (CRR/CRD), which are directly applicable in Sweden.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

Swedish securitisations are structured to ensure that the issuer is bankruptcy-remote from the originator and its creditors, and that the investors in the securitisations are exposed only to the assets and liabilities that form part of the securitisation. Navigating Swedish insolvency laws is central to achieving this, with key focus areas including:

- limiting the number of potential creditors of the issuer;
- avoiding any bankruptcy proceedings relating to the originator affecting the issuer or its assets; and
- ensuring that the securitised assets will not be included in the originator's bankruptcy estate.

Assets of the Bankruptcy Estate

Under Swedish law, the bankruptcy estate shall include the property of the debtor at the time the bankruptcy order was issued, including property that may be subject to claw-back.

Transferred Assets and True Sales

Assets that have been transferred by the originator to the issuer in connection with a securitisation transaction may be included in the bankruptcy estate of the originator, unless the transfer has been duly perfected and a valid right in rem (*sakrättsligt skydd*) has been established. The steps required to create a perfected transfer of assets depend on the asset, but will in most cases include:

- the actual physical transfer of the asset from the transferor to the transferee; and/or
- notification to the underlying debtor in connection with, for example, the transfer of a receivable under a non-negotiable promissory note (*enkelt skuldebrev*).

Although Swedish law does not recognise a true sale as an independent legal concept, the Swedish Supreme Court (*Högsta Domstolen*) has established a number of prerequisites (as further outlined in **6.3 Transfer of Financial Assets**) that ought to be satisfied in a situation where an originator transfers receivables to another company, while at the same time maintaining the role as servicer towards the debtors under the

receivables, in order to avoid the reclassification of the actual sale transaction.

Claw-Back

In bankruptcy, under certain circumstances and subject to applicable time limits, transactions can be reversed. The relevant assets shall then be returned to and included in the bankruptcy estate. Broadly, these transactions include situations where:

- the debtor has conveyed property fraudulently or preferentially to one creditor to the detriment of its other creditors before the initiation of the relevant insolvency proceedings;
- the debtor has created a new security interest, or has repaid a debt that is not due or that is considerable compared to the value of the debtor's assets; or
- the payment is made through an unusual means of payment.

In most situations, a claim for recovery can be made in respect of actions that were made during the three months preceding the commencement of the bankruptcy proceedings. In certain situations, longer time limits apply, and, in other situations, there are no time limits. These include situations where the other party in a transaction is closely related to the debtor, such as a subsidiary or a parent company.

It should be noted that, under Swedish law, a perfected sale or security interest can also be subject to claw-back in accordance with the above-mentioned rules.

6.2 SPEs

A Typical SPE Structure

An SPE is usually set up for the sole purpose of the securitisation, and certain measures are taken to avoid liabilities relating to historic operations or to operations other than the securitisation. In most cases, an SPE is a newly established off-the-shelf company directly owned and controlled by the originator. Its business operations will be limited by its by-laws, which will typically contain restrictive language about the SPE's business object.

Although a typical Swedish securitisation structure (as further outlined in **1.2 Common Structures** and **1.4 Special-Purpose Entity (SPE) Jurisdiction**) involves the establishment of a Swedish limited liability company directly owned by the Swedish originator, it is not uncommon for Swedish securitisations to involve an orphan SPE set up in Luxembourg or Ireland, for example, for tax and/or regulatory reasons and purposes.

Consolidation in Bankruptcy

Under Swedish law, bankruptcy proceedings are conducted on a "company-by-company" level – ie, a subsidiary will not be declared bankrupt solely by reason of its parent company's bankruptcy, and the creditors of one company being declared bankrupt would not individually lead to there being recourse against any other company in the same group.

Under normal circumstances, the concept of "substantive consolidation" does not exist under Swedish law. Consequently, in a typical securitisation structure – if done correctly – the bankruptcy of the originator would not have a direct legal impact on the SPE's financial situation or operations.

Exceptions

However, it should be noted that there are certain exceptions to the above general principle. For example, if the SPE and the originator are organised as a group for VAT purposes (*moms-*

grupp), each member of the group for VAT purposes is jointly and severally liable for the principal group entity's (*huvudmannens*) VAT liabilities.

Consequently, any claim for taxes directed towards the principal group entity (eg, the originator), in or outside bankruptcy, could also be directed towards any other entity within the group for VAT purposes. Although this is not a bankruptcy issue per se, the implication could be viewed as an exception to the principle that each company is independently liable for its own debt.

Furthermore, it is a well-established principle under Swedish law that a Swedish limited liability company is a separate legal entity from its owners. Thus, as a main rule, the shareholders of a limited liability company cannot be held responsible for actions carried out by a subsidiary, nor can they become liable for a subsidiary's obligations and liabilities. However, general principles of piercing the corporate veil (*ansvarsgenombrott*) have been developed in case law from the Swedish Supreme Court, where shareholders have, under exceptional circumstances (disloyal purpose, under-capitalisation of the company and lack of independence), become liable for the obligations of a subsidiary.

6.3 Transfer of Financial Assets

Perfection of Transfer

Swedish law distinguishes between non-negotiable promissory notes (*enkla skuldebrev*) and negotiable promissory notes (*löpande skuldebrev*). As a general principle, both non-negotiable promissory and negotiable promissory notes (and receivables thereunder) are freely transferable by the creditor without the prior consent of the debtor, and a transfer is effective between the transferor and the transferee upon the execution of the transfer agreement.

However, while the new creditor who has acquired a negotiable promissory note will be protected against third-party claims by being in physical possession of the actual promissory note, a new creditor under a non-negotiable promissory note will obtain such protection first after the debtor has been notified of the transfer. Although there are no formal legal requirements regarding the form of such notice, it is usually made by the originator (ie, the transferor) in writing to the debtor.

True Sales

A true sale is not an independently recognised concept under Swedish law – ie, it is not regulated as a specific type of sale transaction. This means that there are no formal requirements that must be fulfilled in order for a sale to be characterised as a true sale. Instead, a court would evaluate a transaction on the characteristics of that specific transaction.

Generally, under Swedish law, the parties' intention when entering into an agreement is an important factor when interpreting the agreement. A court would take such intention into account, but would also take into account the economic characteristics of the transaction (substance over form) when evaluating whether an intended sale of assets (a true sale) could instead be recharacterised as a security assignment. Factors that could affect such assessment include the extent to which the seller retains the following:

- any credit risk;
- the right to collect receipts on the receivables; and
- the right to repurchase the sold receivables.

Although there is some uncertainty as to how a court would characterise a sale of assets under

a securitisation structure, the situation whereby an originator transfers a non-negotiable promissory note to another company but maintains the role as servicer towards the debtors has been subject to the scrutiny of the Swedish Supreme Court. The starting point under Swedish law in connection with a transfer of assets is that the physical possession and right to access and operate the assets shall pass from the transferor to the transferee, in order for the transfer to be fully perfected.

A case from the Supreme Court (NJA 1995 Section 367) established a number of prerequisites that must be fulfilled in order to create a perfected transfer and a valid right in rem (*sakrättsligt skydd*), where assets that have been transferred to another party continue to be serviced by the transferor. The general view of the Swedish market is that those prerequisites are as follows:

- the debtors are duly notified of the transfer;
- the notification to each debtor states that the transferor should continue to receive payments under the transferred contract for and on behalf of the transferee (and not on its own behalf) and in accordance with the transferee's instructions; and
- the notification states that the transferee (or its agent) could at any time revoke the transferor's servicing assignment (and the terms of the servicing assignment shall include such right of revocation).

Although these prerequisites are widely accepted and recognised in the Swedish market, it should be noted that they have been based on the facts and circumstances set out in one specific case tried by the Supreme Court, and it cannot be ruled out that a Swedish court would apply other principles in a similar but not identical case.

In addition to the above-mentioned principles and as briefly outlined in the preceding paragraphs, it is crucial that the substantial risks associated with the underlying assets are being transferred to the transferee (ie, the SPE) in order to achieve a true sale that would survive the scrutiny of a court. This means that any credit risk associated with the underlying assets must be assumed by the SPE, and that the SPE or any of its creditors would not have a recourse claim against the transferor (ie, the originator) if an underlying debtor fails to meet its payment obligations.

It should be noted that the legal treatment of a transfer of assets (whether it is characterised as a true sale or not, as further outlined in **8.1 Legal Issues With Securitisation Accounting Rules**) is independent from the accounting analysis and treatment of such transaction – ie, the above-mentioned principles established by the Supreme Court do not necessarily have an impact on the accounting true sale analysis.

As outlined in **6.4 Construction of Bankruptcy-Remote Transactions**, the legal counsel of the securitisation investors will usually issue one legal opinion addressing the true sale, among other things.

6.4 Construction of Bankruptcy-Remote Transactions

As outlined in **6.2 SPEs**, it is a well-established principle under Swedish law that a Swedish limited liability company is a separate legal entity from its owners, and that assets of a subsidiary (the SPE) would be part of its parent company's (the originator's) insolvency estate, assuming that any transfer of assets between the originator and the SPE has been duly perfected and falls within the applicable boundaries for any

claw-back risks, as outlined in **6.1 Insolvency Laws**.

In addition, as most securitisation transactions in the Swedish market are structured in such a way that the originator will continue to service the transferred underlying assets (in most cases receivables) and collect interest and principal receipt on such assets, it is crucial that such receipts are held as escrow funds by the servicer on behalf of the issuer in order to avoid being assets of the servicer/originator in the bankruptcy of the servicer/originator. Therefore, the servicing agreement, as further outlined in **3.5 Principal Servicing Provisions**, usually contains provisions addressing this issue.

Other means for achieving a bankruptcy-remote structure include:

- incorporating restrictive language in the by-laws of the SPE regarding its business objective; and
- ensuring that the SPE is not part of a group for VAT purposes (see **6.2 SPEs**).

It is not market standard in Sweden to obtain separate insolvency opinions in connection with a securitisation transaction. Instead, insolvency matters will be addressed in the general legal opinion, which will normally cover:

- capacity and authority;
- validity and enforceability;
- authorisations and registrations;
- choice of law and jurisdiction;
- true sale;
- bankruptcy-remoteness; and
- tax.

6.5 Bankruptcy-Remote SPE

In addition to that previously discussed in **6. Structurally Embedded Laws of General Application**, the securitisation documentation would typically include limited recourse provisions and non-petition undertakings from all parties involved.

7. Tax Laws and Issues

7.1 Transfer Taxes

There is no specific transfer tax for the SPE; however, if the SPE makes a gain on its assets, this could result in profit being taxable in accordance with that set out in **7.2 Taxes on Profit**.

7.2 Taxes on Profit

A Swedish SPE is taxed on its taxable net profits at the corporate tax rate of 20.6%. The basis for the taxable net profits is the accounting net profits, adjusted for items that are not taxable or tax-deductible. Tax deductions for net interest expenses are generally restricted to 30% of tax-adjusted EBITDA. Practitioners typically attempt to mitigate such taxes by designing the operations, income and expenses (notably the waterfall) of the SPE such that it makes no or little accounting net profit.

7.3 Withholding Taxes

There is no Swedish withholding tax on cross-border payments, nor on interest payments. Dividends (if any) paid by the SPE to a non-resident shareholder may be subject to withholding tax.

7.4 Other Taxes

Swedish VAT may apply in respect of services performed for an SPE. Such VAT risk is normally ascribed to the servicer (ie, if VAT is applied, the service fee will decrease and the servicer will receive its fee post-deduction of VAT); however,

if such risk is not acceptable to the originator as servicer, the services can sometimes be performed for no consideration in order to mitigate the risk (in which case, the funds will flow through the waterfall).

7.5 Obtaining Legal Opinions

As outlined in **6.4 Construction of Bankruptcy-Remote Transactions**, one opinion that addresses several issues, including tax, is obtained in connection with a Swedish securitisation transaction. The tax section of such opinion generally includes that:

- any non-Swedish SPE (as applicable) will not be taxable in Sweden;
- no stamp (or similar) taxes in respect of the transaction documents will apply;
- there will be no withholding of tax on payments made by a Swedish SPE; and
- there will be no VAT on the sale of receivables/loans or services provided to the SPE.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

In general, the legal analysis and treatment of a securitisation is independent from the accounting analysis and treatment, and vice versa. Consequently, a legal true sale of the securitised asset may not necessarily entail a derecognition of assets from an accounting perspective. However, the accounting analysis and treatment are often affected by the legal treatment, meaning that a legal true sale is necessary, accounting-wise, to achieve a derecognition, though it is not necessarily sufficient to reach such conclusion.

On the contrary, the legal treatment is not affected by the accounting treatment, although the relevant transaction is often structured in a legal manner to achieve a certain accounting treatment.

8.2 Dealing with Legal Issues

A legal opinion addressing a true sale, among other things, is usually obtained in order to support a derecognition of the underlying financial assets in the originator's balance sheet.

As previously mentioned, the accounting analysis of a transfer of assets will be separate from the legal analysis; however, in most cases a legal opinion will be necessary to achieve a derecognition from an accounting perspective.

Trends and Developments

Contributed by:
Albert Wållgren, Henrik Ossborn and Lionardo Ojeda
Advokatfirman Vinge KB

Advokatfirman Vinge KB is one of Sweden's true full-service firms, with offices in Stockholm, Gothenburg, Malmö, Helsingborg and Brussels. It is consistently involved in a broad range of banking and finance matters, representing both lenders and borrowers in all types of financing deals. The firm handles the entire spectrum of banking and finance work that is central to the Swedish economy, from complex international transactions to smaller, local mandates, including acquisition financing, asset finance, structured finance, securitisations, project finance, real estate finance, aviation finance, shipping finance, export credit finance, derivatives and financial reconstruction. The Vinge banking and finance team also advises on the full range of regulatory and compliance matters, including UCITS, Swedish special funds, exchange-traded funds, hedge funds and AIFMD-related issues. The practice also covers prime brokerage, custodian and distribution arrangements.

Authors

Albert Wållgren is a partner in Vinge's banking and finance practice. He advises lenders and borrowers on various types of financing arrangements, including corporate credits, leveraged finance, project finance and bonds, and has a particular focus on securitisations and other structured finance transactions. Albert has extensive experience both in domestic and in international deals from working for Vinge in Stockholm, as well as for the European Investment Bank (EIB) in Luxemburg and a leading US law firm in New York and London.

Henrik Ossborn is a partner in the banking and finance group at Vinge. He advises on a broad range of finance transactions, with a particular focus on securitisations, supply chain financings, project finance and other asset-based financings. He is a leading practitioner in this field with extensive experience, having worked on these types of transactions for more than 20 years. Henrik has acted for banks, investors and originators across Europe.

Lionardo Ojeda is a senior associate in the banking and finance group in Vinge's Stockholm office, and is a member of the Swedish Bar Association. He has extensive experience in national and international banking and finance transactions, including investment grade finance, leveraged finance, securitisations and other asset-backed financing. Lionardo also advises issuers, arrangers and underwriters on a broad range of debt capital markets transactions, including high-yield, investment-grade and hybrid bond and regulatory capital issuances.

Advokatfirman Vinge KB

Advokatfirman Vinge KB
Smålandsgatan 20
Box 1703
111 87
Stockholm
Sweden

Tel: +46 0 106 143 000
Email: contact@vinge.se
Web: www.vinge.se

VINGE

Contributed by: Albert Wållgren, Henrik Ossborn and Lionardo Ojeda, **Advokatfirman Vinge KB**

The European securitisation market commenced some time after the concept was well established in the USA. The Swedish market was even slower in the early stages, in particular due to legislation resulting in an SPV being required to hold a licence and being subject to capital adequacy rules. These rules, together with tax benefits and international investors being more familiar and comfortable with the laws of other jurisdictions, meant that the SPV would typically benefit from being established outside Sweden, thus creating a cost and complexity threshold. The major Swedish banks could also effectively use covered bonds for the financing of residential mortgages.

New players in the residential mortgage market, however, saw the opportunity to establish offshore SPVs and refinance existing mortgage portfolios through securitisations. Since then, accounting rules, internationalisation, unfavourable view of offshore jurisdictions, technical developments and regulatory changes have meant that securitisations have picked up in the Swedish market, and this has also led to the use of Swedish SPVs. This development has also been fuelled by the growth of the Swedish consumer debt and specialist SME lender markets.

This trends and developments article sets out certain key developments that have formed the Swedish securitisation market in recent years, and highlights certain trends that are currently being seen.

Offshore to Onshore

In the early days of the Swedish securitisation market, SPVs were typically incorporated in Luxembourg, Ireland or Jersey (for the reasons mentioned above); however, as the Swedish securitisation market developed (including by way of regulatory changes), and as part of the general trend within the Swedish financing market of moving funds and SPVs onshore to promote transparency and trust in the domestic market, most securitisations by Swedish originators or sponsors today use an SPV incorporated in Sweden.

Access to Public Funding for Non-banks

The acquisition of receivables for financing purposes constitutes financial services subject to a licensing requirement under Swedish law, *if* the purchaser (the SPV) finances itself using *repayable funds from the public*. Therefore, in order for the SPV to not be subject to licensing and thus capital adequacy requirements, the SPV needs to use private funding only. Repayable funds from the public are first and foremost deposits, but under Swedish law also include bonds and similar capital markets instruments that are publicly listed on any exchange or regulated market. At the outset, there was some uncertainty as to whether privately placed bonds could also constitute such funds from the public, if the bonds were freely transferable.

Securitisation Exemption

Relevant Swedish banking regulation includes an exemption from the licensing requirement if the activity of the SPV is limited to acquiring receivables on a few occasions, and if the SPV is not financing itself with repayable funds from the public *on an ongoing basis* – the so-called securitisation exemption (*värdepapperiseringsundantaget*). In the years leading up to the SFSA investigations and clarification described below, such exemption was frequently used by unlicensed issuers wishing to tap the Swedish securitisation market. It was widely believed that, as long as the SPV was limited to acquisitions and debt issuances on a few occasions, it would be exempt from the licensing requirement.

SFSA Investigations (2017–2019) and Clarification (February 2021): Private Placements

Around 2016–17, the Swedish regulator and competent authority, the Swedish Financial Supervisory Authority (SFSA), initiated investigations and proceedings against certain SPV issuers in Swedish securitisations, and ultimately forced them to restructure their financing on the basis that it was, in the view of the SFSA, subject to a licencing requirement where the originator and the SPV was part of the same corporate group and the originator did not itself hold a licence. The SFSA further argued that, while the securitisation exemption was sufficient to exclude the SPV from a licensing requirement, it was not sufficient to exclude the originator and owner from being required to hold a licence.

Instead, the fact that origination and funding was separated into two legal entities within the same corporate group should not mean that the originator/issuer could avoid a licence altogether, according to the SFSA. The SFSA argued that the two should be viewed as a whole (*genomlysning*). Since this was based on the SFSA's interpretation of the regulations (which contrasted with parts of the market and which were never tried by a Swedish court), and since it was enforced through the SFSA's supervisory functions rather than its explicit regulations, for a number of years there was some uncertainty regarding what the regulatory status and requirements for Swedish securitisation SPVs really were.

However, the securitisation market adapted and developed new standards; and in February 2021, the SFSA clarified in a written communication that a company which finances its lending activities with repayable funds from the public is subject to a licensing requirement. In the same communication, it was established by the SFSA that as long as the relevant financing instruments (including, for example, bonds) are only issued to financially regulated entities (so-called eligible institutions) and include contractual transfer restrictions (whereby they are transferable to eligible institutions only in the secondary market), such financing instruments would not constitute repayable funds from the public in the view of the SFSA.

Growth of Fintech and Alternative Lenders

Despite being a relatively small market, Sweden has a strong start-up scene, and this is certainly also true within the space of fintech and of alternative lenders (in particular consumer and SME lenders). To be able to challenge the more traditional banks, digital challenger banks and other alternative lenders have strived to develop not only digital platforms, user-friendly software and cost- and time-efficient infrastructure, but also innovative and tailored financing solutions such as P2P (peer-to-peer lending), forward-flow transactions and securitisations. Access to affordable funding is one of the key challenges for these alternative lenders, and if they do not hold a banking licence or licence as a credit market company, they will generally have difficulties obtaining deposits or accessing the public debt capital markets (for the regulatory reasons described above). As a result, these new players have increasingly turned to the private securitisation market, which has contributed to a stable growth of the Swedish securitisation market for non-banks in recent years.

Key Asset Types

Trade receivables and supply-chain financing

For large corporates, securitisation transactions have traditionally focused on trade receivables, and that continues to be the case. However, an increasing number of more bespoke structures is

also being seen, such as more complex supply-chain financing securitisation transactions and handset financing for telecommunications in the form of securitisations. Structured supply-chain financing involving platform providers such as Prime Revenue and Demica is also observed.

Unsecured consumer debt

The bread and butter of the Swedish securitisation market in more recent years, especially for non-banks, has been unsecured consumer loans. This development has, to a large extent, been driven by new players, including niche banks and fintech start-ups focused on tech (as described above and similar to mortgage loans and SMEs, as described below). Such players include, for example:

- P2P lending platforms;
- credit card debt providers;
- niche banks engaged in *blanco* lending; and
- alternative consumer lenders that finance or refinance short-term unsecured consumer debt arising in day-to-day purchases and other transactions made by consumers.

Residential mortgages

In relative terms, Sweden has a very large market for residential mortgages. Historically, it has been dominated by the major Swedish banks; however, in recent years the residential mortgage market has seen the growth of new players, and the market is becoming more diversified on the lender side (although the Swedish banks continue to be dominant).

Initially, it was niche banks and similar entities that focused on specific types of mortgage loans (typically those with higher risk). Then, more recently, the non-bank alternative lenders have focused on tech-driven and more efficient operations. In both cases, they have shown significant interest in the securitisation market and the market for residential mortgage-backed securities (RMBS); although so far, the non-bank alternative mortgage lenders that have turned to the market for alternative investment funds (AIFs) for funding – rather than to the RMBS/securitisation market – have been more successful, at least in terms of lending volumes.

SME loans

In the most recent years, there has been a significant increase in securitisations of SME loans by Swedish originators. The originators are predominantly alternative lenders and traditional bank challengers who originate SME loans based on digital infrastructure (including automated processes for credit approvals, such as algorithms and artificial intelligence (AI)), and who identified a gap in the market due to SMEs' limited access to the regular banking market. They do not currently face the same regulatory hurdles as the alternative (non-bank) consumer lenders, but access to public funding is still subject to significant restrictions and securitisations may still be an attractive route to financing.

The authors believe that this growth is partly tech-driven, but to a large extent was also boosted by the EU (in particular the EIF/EIB) and the Swedish government in connection with the COVID-19 pandemic, since it was believed that SMEs were particularly vulnerable to disrupted markets (with limited access to begin with), and rapid and extreme changes in consumer behaviour and rescue programmes targeted at SMEs were launched as a response to this, which benefited the securitisation market for SME loans.

The EU Securitisation Regulation

The EU Securitisation Regulation that came into force on 1 January 2019 is directly applicable in Sweden and has significantly reformed the

securitisation market. Prior to its introduction, there was very little regulation directly focusing on securitisations; and initially, this increase in regulation created entry barriers for new issuers and introduced new requirements that, up to that point, had been free for transaction parties to agree upon. However, as the dust settled, this increase in regulation has led to the development of a more sophisticated and coherent market, especially within the areas of reporting, transparency, standardisation, risk retention, etc. While things still remain to be seen, it is possible that the EU Securitisation Regulation will help create a more stable domestic securitisation market that is more attractive to international players, due to its predictability and reliability.

Other Recent Trends

Other notable trends in the Swedish securitisation market over the most recent years include the following.

- Due to the general market downturn in 2022, the Swedish securitisation market has tightened, and conditions are becoming more difficult for issuers. As a result, a "flight to quality" can be seen, as can an increased focus on credit protection measures, such as back-up servicing, various forms of credit enhancement, and protection against increased interest rates (including excess spread and hedging) and credit losses.
- The change in market conditions has also affected access to mezzanine financing. In the authors' experience, senior investors are often willing to finance up to 80–90% of the pool of assets (depending on the asset type), which usually creates a funding gap between that senior advance rate and the 5% level of risk retention required by the EU Securitisation Regulation. As such, the ability to find a mezzanine investor can be crucial to the prospects of setting up a viable securitisation structure; and, in the authors' view, this has often been a bottleneck for issuers as of late.
- Another development that adversely affects the financial stability of the SPV and the protection against credit losses is the decrease in pricing and general tightening of terms in the market for arrears loan sales. Prices available from arrears loan buyers have dropped rapidly, and it can now be difficult to find pricing and general terms that are attractive to the SPV and its investors.
- The introduction of the General Data Protection Regulation (GDPR) in 2018 has led to a significant increase in focus on data processing and the handling of personal data. In order to safeguard GDPR compliance, and especially where the underlying asset is consumer loans, nowadays the loan files and personal data are usually encrypted. Decryption keys are often held by a newly introduced party, the data trustee, and will only be made available to the security trustee or agent in connection with an enforcement scenario.

Looking Ahead: Banks to Offload Balance Sheets and STS

The Swedish securitisation market has been relatively quiet when it comes to significant risk transfer (SRT) securitisations (including synthetics), NPL securitisations and other securitisations designed to offload the balance sheets of banks. The Swedish banks have been well capitalised, but new regulation in capital adequacy and accounting standards, as well as the EU Securitisation Regulation, have created a new environment where it may become more beneficial for banks to turn to securitisations to improve their capital base, balance sheets and returns on equity. This area has, to some extent, been hindered by the SFSA's view on so-called flowback risk; however, if such risk can

be mitigated, the authors see this as an area of potential growth in Swedish securitisations and an area where increased activity will be seen in the next couple of years.

Thus far, interest in achieving STS designation in accordance with the EU Securitisation Regulation has been rather limited in the Swedish market. As the market matures and the processes and documentation become increasingly more standardised, the authors believe that the threshold for the additional feature of STS designation will be lower; and thus interest is likely to grow.

SWITZERLAND

Law and Practice

Contributed by:
Johannes Bürgi, Roger Ammann, Lukas Wyss and Maurus Winzap
Walder Wyss Ltd

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Walder Wyss Ltd is a leading law firm in Switzerland with around 250 legal experts across offices in Zurich, Basel, Berne, Geneva, Lausanne and Lugano, including a team of six partners and 12 associates for Swiss securitisation transactions. The firm has been involved in almost all Swiss first-time transactions (first Swiss RMBS transaction for Zürcher Kantonalbank 2001, first covered bond transaction for UBS AG 2009, first insurance-linked synthetic transaction for FIFA 2006, etc) and continues to be involved in most public and private ABS transactions, synthetic transactions, covered bond transactions and other securitisations, in particular in auto lease ABS (and consumer lending more generally) and mortgage loan transactions. Walder Wyss is regularly retained by market participants, including Swisscard, Cembra Money Bank, AMAG Leasing, Multilease, Ford Credit, PSA, BMW Schweiz, Credit Suisse, UBS and Goldman Sachs. The firm is also active in relation to various regulatory initiatives in the structured finance area and is part of a larger working group led by the Swiss Bankers Association.

Authors

Johannes Bürgi is a partner at Walder Wyss Ltd, where he advises clients on matters involving real estate, finance, structured finance/securitisation, covered bonds, restructuring, capital markets, banking, securities and corporate law, and has acted as lead counsel on virtually all Swiss securitisation transactions across a variety of asset classes. He was educated at Lausanne and Bern Universities (Dr iur, summa cum laude) and at Stanford Law School (LLM in corporate governance and practice). Johannes is fluent in German, English and French, and regularly publishes in his areas of practice.

Roger Ammann is a partner in the banking and finance team at Walder Wyss Ltd. He regularly advises Swiss and international financial institutions and corporations on all aspects of secured lending and structured financings, including project finance and securitisation transactions (such as ABS, RMBS and covered bonds). Roger obtained his degrees from the University of St Gallen (HSG) in law and economics in 2008 and in accounting and finance in 2009. He was admitted to the Zurich Bar in 2011 and is a member of both the Zurich Bar Association and the Swiss Bar Association.

Lukas Wyss is a partner in the Walder Wyss banking and finance team. His practice focuses on debt financing transactions, including asset finance, structured finance, such as ABS, covered bonds and securitisation more generally. During the last three years, he has been involved in all public Swiss ABS transactions involving Swiss underlying assets. He has worked as an attorney at major law firms in Zurich and New York.

Maurus Winzap is a partner and heads the tax team at Walder Wyss. He acts for a broad range of corporate and financial clients and has developed significant expertise in planning and advising on structured financings and securitisation transactions (including ABS, RMBS and covered bonds). He was admitted to the Zurich Bar in 1999 and became a Swiss Certified Tax Expert in 2004.

Walder Wyss Ltd

Seefeldstrasse 123
PO Box
8034 Zurich
Switzerland

Tel: +41 58 658 58 58
Fax: +41 58 658 59 59
Email: reception@walderwyss.com
Web: www.walderwyss.com

walderwyss attorneys at law

1. Specific Financial Asset Types

1.1 Common Financial Assets

Securitisation transactions in Switzerland have in the past primarily been based on trade receivables, auto leases and loans, credit card receivables, residential mortgage loans, commercial real estate loans and loans to small and medium-sized businesses.

More recently, the market has seen a large number of public securitisation transactions involving auto lease receivables and credit card receivables. In addition, privately placed securitisation transactions are regularly implemented in Switzerland. Whilst in principle any type of asset can be securitised, general considerations around suitability of assets for securitisations transactions also apply in Switzerland.

Covered bond transactions in Switzerland have been traditionally based on Swiss residential and commercial mortgage loans and, more recently, also on auto lease assets. Due to the increasing volume of residential and commercial mortgage loans in Switzerland, the number of covered bond transactions and securitisation transactions in Switzerland involving residential and commercial mortgage loans is expected to continue to grow in the future.

1.2 Structures Relating to Financial Assets

Securitisation transactions in Switzerland are usually structured as (legal) true sale transactions in which a (domestic or foreign) bankruptcy remote special-purpose entity (SPE) purchases a pool of income-generating assets and issues the notes. The notes are either publicly placed and listed or privately placed. The proceeds from the issuance of the notes are used by the SPE to acquire the initial pool of assets from the originator upon the issuance of the notes. The securitisation structures then typically provide for a revolving period during which the SPE acquires additional assets from the originator fulfilling predefined eligibility criteria and thereby replenishing the asset pool on a regular basis. The replenishment period is followed by an amortisation phase, during which the notes are amortised over time using the proceeds from the asset pool, unless the originator repurchases the asset pool at the end of the revolving period and the notes are repaid in full using the proceeds from the repurchase by the originator at that time. Transaction parties involved in Swiss securitisation transactions regularly include asset and corporate servicers for the SPE, security and note trustees, cash managers, account banks and further third-party service providers, in addition to the arrangers and managers who are usually involved in structuring the securitisation transaction.

1.3 Applicable Laws and Regulations

Switzerland has not enacted any specific primary legislation covering securitisation (or covered bond) transactions. Instead, securitisation and covered bond transactions in Switzerland have been developed and are structured under the general legal and regulatory framework relevant as for any other financing transaction, such as the Swiss Code of Obligations (eg, relating to the formation of the SPE and the transfer of receivables and assets), the Swiss Civil Code (eg, relating to security interests), general capital market regulations and regulatory and tax laws.

1.4 Special-Purpose Entity (SPE) Jurisdiction

Securitisation transactions in Switzerland can be structured using either Swiss or foreign SPEs. However, various considerations typically need to be made when deciding whether a Swiss or

foreign SPE is used, which depend in particular on the underlying assets that are being securitised.

In particular, in a transaction where the underlying asset relates to real estate located in Switzerland, special care must be given when using non-Swiss SPEs due to restrictions under the Federal Act on the Acquisition of Real Estate by Persons Abroad (known as the "Lex Koller") and also owing to the fact that special cantonal withholding taxes may be incurred on any interest payment secured by Swiss real estate.

In addition, interest payments on debt instruments issued by a Swiss SPE (or a Swiss originator in the case of a covered bond) are typically subject to Swiss withholding tax at a rate of 35%. Structuring a transaction using non-Swiss SPEs in view of the Swiss withholding tax is in principle possible but adds much complexity to the structuring process and care must be given in view of a strong focus on the true sale analysis from a tax perspective.

Furthermore, Swiss originators that do not have any presence abroad typically prefer the use of a Swiss SPE for cost-efficiency and organisational purposes.

1.5 Material Forms of Credit Enhancement

Swiss securitisation transactions can benefit from various forms of credit enhancement, including subordination, over-collateralisation and cash reserves, subject to structuring considerations on a case-by-case basis.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer in securitisation transactions is a (Swiss or foreign) SPE that is structured in a bankruptcy remote way, acquires the assets to be securitised from the originator and issues debt financial instruments.

In contrast, in Swiss covered bond transactions, the issuers are operating entities that originate the assets serving as cover pool (such as banks as originators of residential and commercial mortgage loans) and transfer such cover pool assets to the guarantor for security purposes.

2.2 Sponsors

As Switzerland has not adopted any securitisation legislation, there are no specific responsibilities or roles that would be assigned to a sponsor in Swiss securitisation transactions. The term "sponsor" is thus commonly referring to the originator as the entity that originates the underlying assets and initiates the securitisation transaction.

2.3 Originators/Sellers

Originators in Swiss securitisation transactions are typically operating entities that generate the underlying assets to be securitised. In the course of the securitisation transaction, they transfer the assets to be securitised to an SPE against payment of the considerations. Typically, also the servicing of the assets is delegated by the SPE to the originator as the initial servicer.

Recently, the main originators of public ABS have been active in the auto leasing business and credit card business. In addition, there have been an increasing number of private ABS transactions with originators being active in a vari-

ety of businesses and including various asset classes.

2.4 Underwriters and Placement Agents

The underwriters or managers, which are often investment banks, typically enter into a subscription agreement with the issuer, under which they agree to purchase the debt instruments issued by the issuer against payment of the issue price and then place them with the investors. The underwriters thereby act as an intermediary between the issuer and the investors in an offering.

2.5 Servicers

The servicer is appointed by the SPE to collect and enforce the transferred receivables and to service the other underlying assets. The role of the servicer is typically assigned to the originator, subject to certain trigger events occurring, after which it will be replaced by a substitute servicer.

Given that there is no specific securitisation legislation in Switzerland, there is no licensing requirement for servicers as such, but the generally applicable regulatory and licensing requirements will need to be carefully analysed on a case-by-case basis, in particular in light of the specific underlying assets and the business conducted by the originator.

2.6 Investors

The investors acquire the financial instruments that are issued by the SPE.

2.7 Bond/Note Trustees

Swiss public securitisation transactions typically provide for the appointment of a note trustee that normally also acts as sole representative of each class of notes for the purposes of the Swiss law bondholder provisions. The form of the appointment of the note trustee and the scope of its rights and obligations are determined in the securitisation documentation, which is commonly subject to foreign law.

2.8 Security Trustees/Agents

The security trustee is appointed by the noteholders (and other secured parties) to hold and enforce the security interests in favour of such secured parties. The scope of the security trustee's rights and obligations and the form of its appointment (agency relationship or trust) is typically governed by a security trust deed that is subject to foreign law.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The transfer of Swiss law governed underlying assets is documented in Swiss law governed transfer documents, such as an asset sale agreement and transfer deeds. Such transfer documents lay out the mechanics of the transfer of title and perfection of such transfer, which depend on the asset class to be securitised and typically also include customary representations and undertakings regarding the originator, the assets and the underlying debtors.

3.2 Principal Warranties

The principal warranties provided by the originator and issuer in a Swiss securitisation transaction will depend on the assets to be securitised and the securitisation structure, but would typically include warranties regarding the status of the originator and issuer, the underlying assets (including the underlying agreements) and further warranties customarily provided in financing transactions.

3.3 Principal Perfection Provisions

The perfection steps for the transfer of the underlying assets to the SPE depend on the assets to be transferred. Under Swiss law, for the transfer and assignment of rights and receivables governed by Swiss law, an agreement and a written assignment declaration is required. Notification of the underlying debtor is not required. However, prior to notification of the obligors, the obligors may validly discharge their obligations by paying the originator or the SPE, and in the event of bankruptcy over the SPE, such payments would form part of the bankrupt estate of the SPE, until the obligors are notified.

In relation to the creation of security interests over receivables and bank accounts, the execution of a written security assignment agreement by the parties is sufficient to perfect the security interest in the receivables and the bank accounts. No notification is required, even though it is standard to notify the account bank, which is normally involved in the transaction in any event.

3.4 Principal Covenants

The principal covenants of the originator and issuer in a Swiss securitisation transaction will depend on the assets to be securitised and the securitisation structure, but would typically cover those items that are also subject to principal representations.

3.5 Principal Servicing Provisions

The servicer is appointed by the issuer under a servicing agreement which typically provides, among others, for the following services:

- the collection of payments and recovery from the obligors and the transfer of such collections to the issuer;
- the enforcement of the underlying receivables;
- record keeping in relation to the securitised assets;
- overall administering of the securitised assets in line with the credit and collection policies of the originator; and
- the provision of servicer reports.

Upon the occurrence of pre-defined servicer termination events, the servicer will be replaced by a replacement servicer.

3.6 Principal Defaults

Typical events of defaults under the notes may include:

- the occurrence of an insolvency event with respect to the issuer;
- a payment default of the issuer on interest or principal of the most senior class of notes outstanding; and
- non-compliance with other obligations under the transaction documents.

Upon the occurrence of a default under the notes, the most senior class of noteholders typically have the right to instruct the note trustee to declare all outstanding amounts under the notes due and payable and to have the security provided enforced.

3.7 Principal Indemnities

The scope of indemnities provided to the issuer depends on the specific transaction but typically includes indemnities from the originator for losses and liabilities in connection with the securitised assets sold and of the servicer for losses and liabilities arising in connection with the servicing of the securitised assets.

3.8 Bonds/Notes/Securities

The terms and conditions of the notes are typically included in the note trust deed and normally include provisions relating to:

- the form and denomination of the notes
- the status and priority of the notes;
- limited recourse and non-petition;
- covenants of the issuer;
- payments on the notes of interest and principal;
- redemption of the notes;
- priority of payments;
- bondholder provisions; and
- governing law and jurisdiction.

3.9 Derivatives

Depending on the underlying assets, the notes and the particularities of a transaction, Swiss securitisation structures may provide for the use of derivatives (such as swaps) to account for and mitigate, in particular, interest rate and foreign exchange risks.

3.10 Offering Memoranda

The prospectus regulations contained in the Swiss Financial Services Act (FinSA) and the Swiss Financial Services Ordinance (FinSO) provide that any person offering securities for sale or subscription in a public offering in Switzerland or any person seeking the admission of securities for trading in a trading venue as defined in the Financial Market Infrastructure Act (FinMIA) must first publish a prospectus. There are various exemptions available from the prospectus requirement (eg, based on the type of offering) and the prospectus requirements need to be analysed on a case-by-case basis. If a prospectus is required, it will need to be approved by a prospectus review body appointed by the Swiss Financial Market Supervisory Authority (FINMA). Whilst the approval will generally need to be obtained in advance of the public offering, such approval may also be obtained after the public offering has started for certain debt instruments and under certain conditions. The approved prospectus will need to be published in accordance with FinSA.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

There is no specific securitisation legislation in Switzerland, but the FinSO contains limited disclosure requirements specifically relating to ABS. These rules provide for the disclosure in the prospectus (in addition to the general disclosure requirements) of (i) a transaction summary, covering the general characteristics of the structure and a structure overview, risks related to an investment in the ABS, cross-references to the specific sections in the prospectus dealing with such risks, and (ii) a transaction overview, covering key elements of the transaction (ie, structure, parties involved and their role, cash flows and credit enhancement), a description of the assets that back the transaction and related risks, historical key date (three years) relating to the relevant assets, structural risks, legal risks and other significant risks.

The limited disclosure requirements outlined above will need to be complied with (in addition to the general prospectus and listing requirements) when issuing securities to the public capital market in Switzerland. To the extent that Swiss securitisation transactions are placed outside of Switzerland or become otherwise subject to the EU Securitisation Regulation, the transactions must be structured to ensure compliance

with Regulation (EU) 2017/2402 (the "Securitisation Regulation") or other non-Swiss regulations that might apply.

4.2 General Disclosure Laws or Regulations

The general disclosure regulations of the FinSO for debt instruments apply, which provide for the minimum disclosure content in the prospectus, including regarding the issuer, the securities, risks and admission to trading.

4.3 Credit Risk Retention

Swiss law does not provide for risk retention rules. In particular, Article 6(1) of the Securitisation Regulation has not been adopted by Switzerland and implemented into Swiss law.

However, in view of not negatively affecting distribution, transactions frequently impose covenants on the originator to retain, on an ongoing basis, a material net economic interest in the transaction in an amount equal to at least 5% (or a higher percentage as may be required from time to time in accordance with the applicable EU risk retention rules).

4.4 Periodic Reporting

Switzerland has not adopted specific securitisation legislation. Also, neither FinSO nor the listing rules of the SIX Swiss Exchange provide for specific public disclosure requirements that relate, as such, only to issuances in the framework of securitisation transactions. Like with any other issuer, issuing SPEs listed on the SIX Swiss Exchange will need to comply with general Swiss capital market regulations, including the ad hoc publicity under the listing rules of the SIX Swiss Exchange. However, similar to other jurisdictions, it is market standard that servicer reports and investors' reports are provided on a monthly basis. Furthermore, to the extent that any non-Swiss regulation would be applicable (such as the Securitisation Regulation), such regulations will need to be complied with.

4.5 Activities of Rating Agencies

It is market practice that credit ratings are obtained for notes issued in public ABS transactions in Switzerland from at least one internationally recognised rating agency. However, rating agencies are not regulated under Swiss law for securitisation activities.

4.6 Treatment of Securitisation in Financial Entities

The capital holding requirements for banks and account-holding securities firms in Switzerland are governed by, among others, the Capital Adequacy Ordinance (CAO) and the relating technical implementation provisions issued by the FINMA, in particular FINMA Circular 2017/07 (Credit Risks – Banks). These provide, among others, for technical rules in connection with the calculation of the minimum capital that applies for transaction in connection with the securitisation of credit risk and the applicable Basel minimum standards.

The rules for the investment of insurance companies of their assets in general and the tied assets (ie, assets required in order to cover claims arising from insurance contracts) are governed by, among others the Insurance Supervisory Act, the relating ordinances and implementation provisions issued by the FINMA (in particular FINMA Circular 2016/05 (Investment Rules – Insurance Companies). These provide, among others, for technical rules in connection with the investment of insurance companies in securitised claims (such as ABS, MBS and CDO).

4.7 Use of Derivatives

There are no special laws or regulations that solely apply to the use of derivatives in securitisation transactions in Switzerland, but the general legal framework in particular, the FinMIA) applies with respect to the use of derivatives in securitisation transactions.

4.8 Investor Protection

As Switzerland has not adopted specific securitisation legislation, the general legal framework also applies with respect to investor protection. This includes the prospectus regulation under the FinSO and FinSA, which aims at protecting the investors by, among others, providing for prospectus disclosure requirements in order to allow investors to make informed decisions when investing in public securitisation transactions and for the requirement to have the prospectus approved by a prospectus approval office.

4.9 Banks Securitising Financial Assets

Switzerland has not adopted specific legislation on the securitisation of banks, but the general legal and regulatory framework applies, in particular the Swiss Banking Act and the relating ordinances.

4.10 SPEs or Other Entities

SPEs in Switzerland may take the form of a limited liability stock corporation (AG) or a limited liability company (GmbH). As there is no specific legislation in Switzerland on securitisations, the general legal framework also applies to SPEs and other entities.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

There is no specific securitisation legislation or legislation on covered bonds in Switzerland, and therefore there are no licensing requirements per se for SPEs, originators, servicers or other securitisation entities. However, every transaction needs to be analysed and structured carefully on a case-by-case basis in view of the general regulatory and licensing requirements under applicable financial market regulations, including the Swiss Federal Banking Act, the Swiss Federal Collective Investment Schemes Act and Swiss anti-money laundering regulations. Further, depending on the receivables and assets being securities or used as collateral for a covered bond and the regulatory status of the originator, additional regulations may be of relevance, including (but not limited to) the Consumer Credit Act (eg, credit card receivables or retail auto lease receivables being securitised), the Federal Law of 16 December 1983 on the Acquisition of Real Estate by Persons Abroad (Lex Koller) (eg, residential mortgage loans being securitised or used as collateral for a covered bond) or the Insurance Supervisory Act (in the case of licensed insurance companies acting as transaction parties).

4.12 Participation of Government-Sponsored Entities

There have been no public transactions in which government-sponsored entities participated in the Swiss securitisation market.

4.13 Entities Investing in Securitisation

Securitisation transactions that are offered to the Swiss public capital market can in principle be offered to any investor, including retail investors. However, the financial intermediaries who are involved in the placement of the notes will need to comply with their duties under financial market laws (such as the FinSA), including in relation to the assessment of appropriateness and suitability of such products for the investors, as applicable. Furthermore, certain lead managers might apply (internal) guidelines in the distribu-

tion process. Additional restrictions may apply under relevant foreign capital market regulations that would have to be complied with in connection with any placement of securitisation transactions outside of Switzerland.

4.14 Other Principal Laws and Regulations

See **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

As Switzerland has not adopted specific securitisation legislation, the general legal and regulatory framework also applies to synthetic securitisations, which have to be analysed and structured on a case-by-case basis.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

As Switzerland has not adopted specific securitisation regulation, the general insolvency regime and regulation (in particular the Swiss Debt Enforcement and Bankruptcy Act (DEBA)) apply in Switzerland also to Swiss entities (such as issuers, originators and servicers) in securitisation transactions. Similar to other jurisdictions, the bankruptcy remoteness of the SPE is a key consideration when structuring a domestic securitisation transaction.

6.2 SPEs

Swiss SPEs are either held and controlled by shareholders unaffiliated with, and independent from, the originator and the other transaction parties (ie, orphan SPEs) or structured as (direct or indirect) subsidiaries of the originator; in each case depending on the specific needs and goals of the originator and corresponding requirements from an accounting perspective in view of potential derecognition and deconsolidation. In the majority of the public transactions, the Swiss SPE is held by the respective originator, sometimes also providing for golden shareholder structures that provide the (independent) golden shareholder or shareholders with some control (veto rights) at the level of the shareholders' meeting. Essentially, all transactions involving Swiss SPEs provide for an independent director structure giving the independent director some control (veto rights) at board level.

As a matter of Swiss corporate law, the bankruptcy of a shareholder of the SPE will not automatically lead to the bankruptcy or liquidation of the SPE itself. Rather, a shareholder bankruptcy would result in the SPE's shares falling into the bankruptcy estate of the shareholder, which would be sold in the course of such liquidation or bankruptcy. Any such transfer of shares in the SPE would not legally affect the contractual obligations of the SPE under the transaction documents. Also, there is no concept of substantive consolidation under Swiss law (subject to extraordinary cases, such as fraud and abuse of rights), and a bankruptcy of an SPE shareholder would, as a matter of Swiss law, not result in a consolidation of its assets and liabilities with those of the SPE.

6.3 Transfer of Financial Assets

For the perfection steps required for a transfer, see **3.3 Principal Perfection Provisions**.

6.4 Construction of Bankruptcy-Remote Transactions

Bankruptcy remoteness in Swiss securitisation transaction is generally achieved by the lim-

ited corporate purpose of the SPE and limited recourse and non-petition provisions to which counterparties to the SPE are asked to sign up to. In addition, all parties contracting with the SPE are asked to sign up to waiver set-off provisions.

6.5 Bankruptcy-Remote SPE

See **6.4 Construction of Bankruptcy-Remote Transactions.**

7. Tax Laws and Issues

7.1 Transfer Taxes

The transfer of underlying assets that are frequently securitised in the Swiss market (such as auto lease receivables, credit card receivables and trade receivables) from the originator to the issuer is not subject to any transfer tax in Switzerland. However, it will need to be analysed on a case-by case-basis and typically advance tax ruling confirmations are obtained to confirm the tax treatment of the securitisation transactions.

7.2 Taxes on Profit

Swiss domestic SPEs are generally subject to corporate income and capital tax. If the transaction involves a Swiss SPE, it is therefore, among other things, required that the additional entity-level corporate income and net equity taxes, which cannot be structured away completely, are kept at a (negligible) minimum. Due to a lack of specific tax legislation or tax guidelines, or both, securitisation transactions need to be presented and signed off by the relevant tax authorities by way of advance tax rulings.

7.3 Withholding Taxes

Interest payments on debt instruments issued by a Swiss vehicle directly to multiple investors attract Swiss withholding tax at a rate of 35%. While Swiss withholding tax is generally recoverable, the process for doing so might be burdensome for non-Swiss investors and even a Swiss investor would suffer a delay in recovering the withholding tax. If an investor is located in a jurisdiction that does not benefit from favourable double tax treaties or does not otherwise benefit from treaty protection (such as tax-transparent funds), Swiss withholding tax might not be fully recoverable, if at all. Swiss withholding tax can be structured away if a non-Swiss vehicle is used. However, this adds much complexity to the structuring process because there will also be a strong focus on the true sale analysis from a tax perspective.

7.4 Other Taxes

Swiss VAT should be analysed carefully in connection with securitisation transactions. For example, asset servicing may trigger Swiss VAT and, if the Swiss SPE holding the securitised assets is not registered for VAT purposes (and is not part of the VAT group of the originator), such VAT charge will constitute a leakage for the transaction. Furthermore, if VAT-charged receivables are transferred to an SPE, such transfer may trigger an acceleration of the tax point for VAT purposes. In addition, the originator may be denied bad debt relief for non-performing receivables transferred. If future receivables are transferred at a time when the tax point for VAT purposes has not yet been reached, a potential secondary joint liability of the acquiring SPE with the transferring originator may arise. Subject to careful structuring, these issues can be addressed and comfort can be obtained by advance tax ruling confirmations from the tax administration.

7.5 Obtaining Legal Opinions

It is market practice in Swiss securitisation transactions that legal opinions are being provided,

including in relation to selected tax aspects of the transaction.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Typical accounting topics in Swiss securitisation transactions frequently include the derecognition of the assets to be securitised from the balance sheet of the issuer and the non-consolidation of SPEs.

8.2 Dealing with Legal Issues

The accounting analysis and treatment of a securitisation transaction is performed separately from the legal analysis and accounting matters are not addressed in legal opinions in the Swiss market. However, transactions can usually be structured legally in a way that supports the accounting analysis on a case-by-case basis.

Trends and Developments

Contributed by:
Johannes Bürgi, Roger Ammann, Lukas Wyss and Maurus Winzap
Walder Wyss Ltd

Walder Wyss Ltd is a leading law firm in Switzerland with around 250 legal experts across offices in Zurich, Basel, Berne, Geneva, Lausanne and Lugano, including a team of six partners and 12 associates for Swiss securitisation transactions. The firm has been involved in almost all Swiss first-time transactions (first Swiss RMBS transaction for Zürcher Kantonalbank 2001, first covered bond transaction for UBS AG 2009, first insurance-linked synthetic transaction for FIFA 2006, etc) and continues to be involved in most public and private ABS transactions, synthetic transactions, covered bond transactions and other securitisations, in particular in auto lease ABS (and consumer lending more generally) and mortgage loan transactions. Walder Wyss is regularly retained by market participants, including Swisscard, Cembra Money Bank, AMAG Leasing, Multilease, Ford Credit, PSA, BMW Schweiz, Credit Suisse, UBS and Goldman Sachs. The firm is also active in relation to various regulatory initiatives in the structured finance area and is part of a larger working group led by the Swiss Bankers Association.

Authors

Johannes Bürgi is a partner at Walder Wyss Ltd, where he advises clients on matters involving real estate, finance, structured finance/securitisation, covered bonds, restructuring, capital markets, banking, securities and corporate law, and has acted as lead counsel on virtually all Swiss securitisation transactions across a variety of asset classes. He was educated at Lausanne and Bern Universities (Dr iur, summa cum laude) and at Stanford Law School (LLM in corporate governance and practice). Johannes is fluent in German, English and French, and regularly publishes in his areas of practice.

Roger Ammann is a partner in the banking and finance team at Walder Wyss Ltd. He regularly advises Swiss and international financial institutions and corporations on all aspects of secured lending and structured financings, including project finance and securitisation transactions (such as ABS, RMBS and covered bonds). Roger obtained his degrees from the University of St Gallen (HSG) in law and economics in 2008 and in accounting and finance in 2009. He was admitted to the Zurich Bar in 2011 and is a member of both the Zurich Bar Association and the Swiss Bar Association.

Lukas Wyss is a partner in the Walder Wyss banking and finance team. His practice focuses on debt financing transactions, including asset finance, structured finance, such as ABS, covered bonds and securitisation more generally. During the last three years, he has been involved in all public Swiss ABS transactions involving Swiss underlying assets. He has worked as an attorney at major law firms in Zurich and New York.

Maurus Winzap is a partner and heads the tax team at Walder Wyss. He acts for a broad range of corporate and financial clients and has developed significant expertise in planning and advising on structured financings and securitisation transactions (including ABS, RMBS and covered bonds). He was admitted to the Zurich Bar in 1999 and became a Swiss Certified Tax Expert in 2004.

Walder Wyss Ltd

Seefeldstrasse 123
PO Box
8034 Zurich
Switzerland

Tel: +41 58 658 58 58
Fax: +41 58 658 59 59
Email: reception@walderwyss.com
Web: www.walderwyss.com

walderwyss attorneys at law

Contributed by: Johannes Bürgi, Roger Ammann, Lukas Wyss and Maurus Winzap, **Walder Wyss Ltd**

Overview

In 2023, the Swiss securitisation and covered bond market has again been very robust with numerous new Swiss ABS being issued, with a trend to more private placements compared to previous years and securitisations of trade receivables continuing to be a reliable source of funding for domestic originators. In addition, there have been several public issuances of domestic covered bonds under existing and new programmes. In particular, a global Swiss bank set up a new CHF20 billion covered bond programme and performed inaugural issuances thereunder in 2023.

Receivable Securitisations

In recent times, the securitisation of trade receivables and other claims (such as claims from the purchase or rental of mobile devices) has been frequently implemented by Swiss companies from various industries and has also been an important funding tool for CFOs in 2023.

Similar to other jurisdictions, receivable securitisation transactions in Switzerland are typically structured as true sale transactions, whereby the Swiss sellers sell, transfer and assign eligible receivables to a special-purpose entity (SPE) usually located outside of Switzerland against payment of the purchase price. The SPE is financed by either issuing notes or other debt instruments to investors or warehousing loans or a combination of both. These transactions frequently involve multiple sellers of the operating group, which are located in multiple jurisdictions and are set up by using existing platforms of banks and other arrangers.

When implementing these transactions, there are a number of particularities that need to be considered from a Swiss law perspective, including (but not limited to) in relation to the assignment of underlying receivables governed by Swiss law and tax considerations.

Under Swiss conflict-of-law rules, the transfer and assignment of a right or a receivable can generally be governed by the law chosen by the parties concerned. However, Article 145 of the Swiss Private International Law Act provides that the choice of a law to govern the assignment that is different from the law that is governing the underlying right or receivable may not be asserted against the underlying obligor under the assigned receivable, unless the obligor has agreed to the choice of law. As a consequence, consent being absent, the general approach is to have the assignment and transfer governed by the law of the underlying right or receivable.

Under Swiss substantive laws, the assignment and transfer of a Swiss-law-governed right or claim requires an agreement among the parties (such as a receivable purchase agreement) and a written assignment from the assignor to the assignee, which requires a wet ink signature (or a specific qualified electronic signature in the sense of Article 14, paragraph 2bis of the Swiss Code of Obligations).

Under Swiss substantive laws, a claim is freely assignable unless such assignment is prohibited by law, contractual arrangement or the nature of the claim. Thus, special consideration must typically be given, in particular as to whether there are contractual restrictions on assignment.

Typical tax considerations in receivable securitisation transactions involving Swiss entities include Swiss federal withholding tax and Swiss VAT, which should be analysed on a case-by-case basis.

Given the relatively low costs, short time to implement and overall versatility of receivable securitisation transactions making use of existing platforms (compared to, for example, standalone public ABS transactions), it is expected that Swiss companies will continue to participate in and make use of such programmes in the future.

Covered Bonds

Introduction

During the low interest rate period of the past several years, the overall prices for real estate and the volume of residential and commercial mortgage loans has grown considerably in Switzerland. While few securitisations of mortgage loans have been implemented in the past in Switzerland, mortgage loans have historically served as collateral for financings of banks under Pfandbriefe and under contractual covered bonds.

Owing to the flexibility that contractual covered bonds provide over Pfandbriefe, the number of covered bond transactions in Switzerland involving residential and commercial mortgage loans has increased considerably during the past couple of years, with first-time issuers setting up new programmes in 2020, 2022 and 2023, with the last one being set up with a volume of up to CHF20 billion by a global Swiss bank.

Covered bond transactions in Switzerland are typically structured with one bankruptcy remote SPE, which is incorporated by the issuer and acts as guarantor of the payment obligations of the issuer under the covered bonds. The collateral to cover the guarantee is provided by the issuer, which in recent transactions in the Swiss market consisted mainly of residential and commercial mortgage loans, but also auto lease assets. The transaction structure will typically require a certain level of over-collateralisation to be maintained by the issuer during the lifetime of the covered bond. Different from (true sale) securitisation transactions, the collateral is not sold but rather transferred for security purposes to the guarantor. The covered bonds are usually issued under a programme and publicly placed and listed or privately placed, whereby the proceeds from the issuance of the covered bonds are typically used for the general business purposes of the issuer. The arrangers and managers are normally involved in the structuring, whereby additional transaction parties include servicers for the guarantor, the note trustees, the bondholder's representative, account banks, asset monitors and further third-party service providers.

Unlike contractual covered bond structures that were implemented in Switzerland during the early 2010s, which regularly provided for certain elements of the structure to be governed by laws other than Swiss law (eg, English law), the recently implemented public covered bond programmes all provided for an entirely or predominantly Swiss law governed structure, which has been well perceived by the market. In addition to residential and commercial mortgage loans, there have also been issuances of covered bonds relying on other assets serving as collateral to secure the claims of the covered bondholders, such as auto lease receivables.

Certain Elements of the Typical Covered Bond Structure in Switzerland

Guarantor

The guarantor is set up as an SPE, which is incorporated in the form of a limited liability stock corporation (*Aktiengesellschaft*) in Switzerland. The shares of the guarantor are held by the issuer and two independent shareholders. The governing corporate documentation provides

for the two independent shareholders to have a joint veto right for most of the resolutions of the general shareholders meeting. The guarantor typically has up to four board members, two of which need to be independent board members (including the chair and the vice-chair). In view of the bankruptcy remoteness of SPEs, the purpose of the guarantor is very narrow and in principle limited to entering into certain transactions that are related to the covered bond programme.

Guarantee and security interests

A guarantee is issued by the guarantor in favour of the covered bondholders on the basis of a guarantee mandate. The guarantee essentially covers all obligations of the issuer towards the covered bondholders under the covered bonds and may be drawn by the trustee subject to the certain guarantee activation events occurring. Any amounts that become due and payable under the guarantee will need to be fully reimbursed by the issuer, which will also be under an obligation to pre-fund these reimbursement obligations.

These obligations of the issuer towards the guarantor to reimburse the guarantor for payments under the guarantee and the pre-funding obligations of the issuer towards the guarantor are secured by the issuer providing security over the cover asset pool in favour of the guarantor.

Cover pool assets

The cover pool assets that secure the obligations of the issuer towards the guarantor typically consists of mortgage loans (residential and/or commercial) or, in the recent past, auto lease receivables made available by the issuer to its clients. In the case of mortgage loans, entitlement to the mortgage notes securing a relevant mortgage loan is also transferred for security purposes by the issuer to the guarantor. In addition, certain substitute assets (such as cash or other assets satisfying certain criteria) may be part of the cover pool. There are certain tests (such as an asset cover test and an interest cover test) that the cover pool must fulfil and the cover pool will have to provide for over-collateralisation (ie, exceed the aggregate amount of all covered bonds issued at the relevant point). Changes to the cover pool during the lifetime of the covered bonds are possible (eg, by adding or replacing certain assets), subject to specific requirements being fulfilled.

Outlook

With the latest public covered bond programme set up in Switzerland in 2023 with a volume of up to CHF20 billion by a global Swiss bank and the very successful first issuances thereunder, the Swiss covered bond structure has again proven to be a reliable and robust funding tool, which is very well perceived by the market. Given this continued success of covered bonds, other banks or owners of other suitable assets might follow in setting up similar covered bond programmes in the future.

Interest Rate Environment

Due to inflationary pressure in Switzerland, the Swiss National Bank (SNB) increased its policy rate from minus 75 basis points to minus 25 basis points in June 2022, from minus 25 basis points to positive 50 basis points in September 2022, and from 50 basis points to 100 basis points in December 2022, thereby ending a period of over seven years of negative interest rates in Switzerland. This trend of increasing interest rates has continued in 2023 with two consecutive interest rate increases of 50 basis points in March and 25 basis points to 175 basis points in June. Given that inflation in Switzerland has recently been relatively moderate at 1.7% in October 2023 and thus within the target band

set by SNB of 0-2%, it is assumed that the pressure to further increase interest rates to combat inflationary pressure has eased. However, depending on the ongoing assessment of the overall economic and inflationary outlook, further interest rate increases remain possible.

As a consequence of rising interest rates, yields on corporate and government bonds have generally increased and coupons on new issuances have tended to be higher compared to issuances performed during the negative or low interest environment. This holds true not only for corporate bonds, but also for securitisation transactions and ABS. As a result of the demand for higher coupons, the financial modelling and structuring of new securitisations and ABS issuances have become more challenging, in particular for securitisations of income generating assets that originated in the low interest rate environment, with such pools of assets providing for relatively low yields compared to the increased funding costs under new issuances.

Under the negative interest rate environment that prevailed in recent years, corporate bonds provided for very low yields and proved to be an extremely efficient funding source for corporate issuers (even in the case of a relatively low rating of the issuer). Also, for asset managers, unsecured bonds are typically simple instruments and internal processes for getting to an investment decision are very efficient as opposed to structured transactions and ABS, which are slightly more complex. The process for asset managers to get to an investment decision for such structured instruments is normally more burdensome and, as a result, the interest levels for securitisation transactions and ABS were relatively high compared to straight bonds, considering the significantly lower risk profile and the much higher rating. However, now that the interest rates have increased, the advantages of securitisations compared to straight bonds might well again be reflected in the interest rate spreads between securitisations and straight bonds.

Therefore, in this market of rising interest rates, it is important for issuers under securitisation transactions and ABS to continue to be present in the market and to continue to be diverse. The COVID-19 pandemic and other disruptive events in the past have shown that securitisation transactions and ABS are a stable and reliable source of funding.

UAE

Trends and Developments

Contributed by:
Victoria Mesquita
Addleshaw Goddard

Addleshaw Goddard is an international law firm that can trace its roots back almost 250 years. The firm is trusted by over 3,000 major organisations, including 51 FTSE 100 companies, to solve problems, deliver deals, defend rights, comply with regulations and mitigate risk. Its work spans more than 50 areas of business law, paving the way to deliver the best possible outcomes for clients across multiple industries, helping them do business, operate and grow – effectively and safely – in over 100 countries worldwide.

Author

Victoria Mesquita is a partner at Addleshaw Goddard (Middle East) LLP. Victoria has 20 years' experience advising clients on commercial transactions, 15 of which she has spent in the Middle East advising on banking, finance, investments and the debt capital markets, with a particular focus on Sharia-compliant financings and investments. Victoria counsels both financiers and issuers/borrowers on a wide range of complex, cross-border financing and debt capital markets transactions and restructurings, including syndicated facilities, projects, mezzanine, leveraged acquisitions, private debt, asset-based finance, structured notes, securitisations. She is ranked by Chambers as an Islamic finance specialist.

Addleshaw Goddard (Middle East) LLP

Level 6, Burj Daman Tower
Al Mustaqbal St
DIFC
Dubai

Tel: 971506570233
Email: v.mesquita@aglaw.com
Web: www.addleshawgoddard.com

Contributed by: Victoria Mesquita, **Addleshaw Goddard**

The Growing Need for Securitisation in the UAE

Securitisation has emerged as a vital instrument in modern financial markets, playing a key role in capital allocation, risk management and liquidity enhancement. Modern securitisations find their origin in the 1970s with the first US mortgage-backed securities, and since then the market for securitisations has grown exponentially across continents, in particular the US and Europe. In fact, the term securitisation is often used loosely to refer to all asset backed securities (ABS), including repackagings, collateral debt obligations and "true" securitisations. ABS transactions play a pivotal role in mature financial markets as they allow borrowers and originators to raise finance from sources outside the more traditional bank finance and the public capital markets.

Despite its many advantages, the securitisations market in the UAE remains relatively undeveloped. A growing securitisation market would benefit the UAE financial markets in several ways:

- A vibrant securitisation market would create additional sources of financing which would benefit SMEs in particular – bank finance in the UAE is generally hard to come by for companies which are not government-related entities or investment grade, and of course the conventional public bond markets are generally inaccessible to businesses that are not mature companies with large creditworthy balance sheets that can also handle large amounts of disclosure.
- Securitisations may provide for a cheaper source of finance than would otherwise be available to the borrower/originator – this cheaper cost is achieved through an arbitrage between the yield paid under the underlying receivables and that paid by the issuer under the securitisation.
- Securitisations give originators the ability to remove receivables from their balance sheets – this is of particular importance to banks and financial institutions, as removing receivables from their balance sheets will result in lower capital ratio requirements.

Securitisations can have a transformative effect, in that they are generally used to transform an asset which is not a debt security (such as loans, credit card receivables and other receivables, rentals or mortgages) into a marketable debt security. It is this transformative feature that makes securitisations so incredibly useful at allocating capital and matching the risk-return profiles of investors with originators seeking finance. This gives companies access to a pool of investors who would otherwise be unreachable, in particular at a time where investment funds, pension funds, insurance companies and family offices have become key investors in public and private placement issuances.

Securitisations in UAE

As mentioned above, historically the UAE has not been an active market for securitisations. Some of the securitisations that stand out include the Tamweel ABS Sukuk (2005 and 2007) and Sun Finance Sukuk (2009). Both issuances were public and were issued prior to the global financial crisis and since then securitisations have been predominantly privately placed. However, the securitisation market in the UAE remains relatively small. There are legal and tax reasons for caution. This article will examine some of the legal obstacles to securitisation structures in the UAE.

True sale

True sale under the Securitisation Law

True sale is one of the most important factors in a securitisation. However, the true sale of receivables has not, until now, been recognised under UAE law (and for this reason many of the UAE securitisations have been undertaken under a secured loan structure). Recently, the UAE Securities and Commodities Authority (SCA) issued Chairman of the Board of Director's Resolution No (22/RM) of 2023 regulating securitisation and all parties to securitisation transactions or operations in the UAE (the "Securitisation Law"). Article 5 of the Securitisation Law expressly recognises the principle of true sale of securitised assets, differentiating a sale of receivables from a financing transaction. This is a very welcomed development in UAE law which should provide a more certain environment for UAE-based securitisations. However, under Article 4 of the Securitisation Law, the sale of receivables must be notified to the receivables' debtor – failure to notify entails that the receivables' debtor may discharge the debt by payment to the originator.

The scope of the Securitisation Law is limited: it applies to public and private joint stock companies the shares of which are listed on the market exchanges, or where the securitised notes are to be listed in the UAE, or where the securitisation transaction is conducted through a securitisation entity regulated by the SCA. The Securitisation Law does not apply to internal securitisation transactions conducted by banks or financial institutions, which are regulated by the UAE Central Bank when the securitised notes are issued on a private placement basis, or securitisation transactions conducted by government entities and fully government-owned companies.

In addition, the Securitisation Law requires registration with the SCA, which is time consuming and requires lengthy disclosure. Thus privately placed securitisations will fall outside the application of the Securitisation Law and the concept of true sale advanced thereunder.

True sale under the Factoring Law

Outside of the Securitisation Law, future receivables are generally recognised to be subject to a true sale under UAE Federal Law No 16 of 2021 in relation to factoring and the assignment of receivables (the "Factoring Law"). However, whilst the Factoring Law does not require registration of the sale of the receivables in the Emirates International Collateral Registry (EICR), there are obvious advantages to doing so:

- Article 7 (Enforceability vis-à-vis third parties by registration and priority of assignee's rights) of the Factoring Law states that the enforceability of assignments against third parties is as set out in the UAE Movables Security Law; and
- Article 8 (Priority among competing claimants) of the Factoring Law provides that the provisions of the UAE Movables Security Law relating to priority of claims over the receivables applies to the priority of claims under a sale of receivables.

There are also advantages to notifying the relevant counterparties of the sale of the receivables to the issuer – where a notice of assignment is sent to the receivable's debtor, that receivable's debtor may only effect a good discharge of the receivable if it settles such receivable in accordance with the notice of assignment. Thus the notice of assignment serves to ensure that the assignee receives the proceeds from the receivable's debtor directly, even without an acknowledgement of assignment which may be operationally cumbersome to obtain, in particular in securitisation structures with a reinvest-

ment or accumulation period for the purchase of new assets. As a consequence, the true sale of receivables under the Factoring Law remains rather cumbersome insofar as both the registration of the sale in the EICR and a notice of assignment are preferable.

Special purpose vehicles

UAE securitisations are typically structured using a special purpose vehicle (SPV) incorporated in the Cayman Islands, and more recently in the UAE's special economic zones: the Abu Dhabi Global Market (ADGM) and the Dubai International Financial Centre (DIFC). The New Commercial Companies Law No 32 of 2021 introduces the concept of an onshore SPV, but issues such as non-consolidation and the absence of the concept of the "trust" under UAE law will have to be considered. There is still no concept of an incorporated cell company or similar, which is a key feature of many common law jurisdictions for multi-issuances, under onshore UAE law.

Regulated activities

One of the reasons why secured loan securitisations structures are often used in lieu of true sale structures is the UAE regulatory environment which typically requires specific licensing for the conduct of activities onshore. As a consequence, foreign SPVs would typically be barred from performing commercial activities in the UAE, such as leasing of equipment or vehicles or holding loans and credit card debt. In particular, financial activities, including finance leases, are heavily regulated.

Bankruptcy remoteness

One of the main features of securitisations is bankruptcy remoteness – that is reducing as much as possible any leakage of cashflows thus reducing the risk of insolvency of the securitisation vehicle. Such bankruptcy remoteness is typically achieved through a number of structural techniques, including the establishment of the SPV in a zero tax jurisdiction, restricting the activities of the SPV to the securitisation transaction and generally restricting the incurrence of any liabilities other than those required for the purposes of the transaction, restricting the SPV's ability to hire employees (the SPV must use third-party service providers instead) and incorporating limited recourse and non-petition language into the relevant transaction documents. The use of Cayman Islands SPVs for UAE securitisations (and to lesser extent DIFC and ADGM SPVs) is primarily driven by bankruptcy remoteness concerns.

Trusts

Historically, the concept of trust was not recognised under UAE law. This had several ramifications from an international finance perspective, including the validity of standard turnover trusts in the context of subordination provisions and security documents, and in particular in three important ways in the context of securitisations:

- For loan structure securitisations, security would typically be held by a security agent rather than a security trustee. Because an agent is unlikely to be able to prove a claim against the originator in an insolvency, parallel debt provisions are used to create a debt between the originator and the agent, such that the agent can prove such debt in insolvency proceedings, with such parallel debt being deemed to be reduced upon payment of the underlying debt.
- For tax reasons, securitisation transactions are often structured as a receivables trust with receivables being sold to a trust, with the beneficial ownership of the receivables split between the SPV (up to the amount required

for servicing payments due under securities issued by it), with any surplus held on trust for the originator. This structure was not available to securitisation vehicles and originators incorporated onshore.
- In Sharia-compliant securitisations a trust must be created over the underlying Sharia assets used for the purposes of the issuance of trust certificates, which again was not viable until now for onshore UAE vehicles.

Federal Decree Law No 31/2023 Concerning Trusts (the “Trust Law”) was passed in 2023. It stipulates that the trust assets to be transferred to the trust must be owned by the trust founder. The trust shall have legal personality from the date of registration in a specialised register set up in each emirate. If the trustee is a corporate entity, then it must be licensed to undertake trustee activities. The Trust Law is very recent, and although the concept of a UAE trust was first introduced by Federal Decree Law No 19/2020 (which the Trust Law abrogates), the market has not yet widely adopted onshore trust structures, which remain largely untested. In particular, the fact that the trust is a common law concept, adds uncertainty as how to local courts in a civil law jurisdiction such as the UAE will apply the new Trust Law.

It is worth noting that the Securitisation Law does not incorporate the concept of trust. However, assets transferred to the securitisation vehicle are to be segregated from the assets of the originator and the relevant custodian. Article 10.1 of the Securitisation Law provides that amounts collected from the securitisation portfolio must be credited by the originator into a separate account and the creditors of the originator “shall have no right to attach on such account”. Article 10.4 goes on to say that in the event of the insolvency of the originator (or the custodian if applicable), none of the creditors of the originator or the custodian may claim any amounts collected by them in respect of the dues of the securitisation portfolio. It is yet to be seen whether the UAE onshore courts would uphold the right to ownership of the noteholders of the underlying assets in an onshore UAE securitisation, in particular in the context of an insolvency. This is of particular importance where there are several issuances by the same SPV.

Sharia structures

Securitisations also lend themselves well to Sharia compliant financings, in particular sukuk (or Islamic notes), which are a major source of funding in the UAE. In fact, one could say that all sukuk are in essence securitisations – they share some key structural features, including the sale of an asset or assets to a bankruptcy remote special purpose vehicle which are purchased using the proceeds of the issuance of certificates. However, Sharia-compliant securitisations must be carefully structured in order to avoid a direct sale of receivables, which under Sharia rules can only be traded at par, as Sharia prohibits the sale of a debt (*Bay al Dayn*) at a price other than par. In particular, since the creation of the Shair’ah Higher Authority (HSA) first by a UAE cabinet decision, as reaffirmed by Decretal Federal Law No (14) of 2018, regarding The Central Bank of the UAE and the organisation of financial institutions and amendments, the HSA, which is mandated with the supervision of Islamic financial institutions, mandated the adoption of Accounting and Auditing Organization for Islamic Financial Institutions standards in the UAE, and therefore the Sharia rules regarding debt trading will apply to onshore securitisations originated or otherwise sold to UAE Islamic financial institutions.

Tranching

A key feature of many securitisations is the tranching of liabilities of the issuer: by issuing various classes of securities with different levels of priority and return, investors who own the top tranches are senior in right of payment and insolvency to the more junior tranches at the bottom. The holders of lower tranches are compensated in turn for the increased risk with a higher return, thus slicing up the risk and allocating it to different sets of investors depending on their risk appetite. Tranching is also useful as a credit enhancement tool for the senior tranches, as the junior tranches are structured to absorb losses first thus providing a "cushion" to the senior tranches in the same way as equity provides a loss absorbing "cushion" to debt claims. However, the effectiveness of tranching depends on the recognition of subordination provisions. In the UAE, the effectiveness of subordination arrangements in insolvency remain largely untested. There has been a recent helpful decision from the Dubai Court of Cassation, upholding the validity of a subordination agreement. The court also held that the subordinated creditor bears the burden of proof to show that the higher ranking debt has been paid. In the context of an insolvency, however, the liquidator may decide to ignore any subordination agreement on the basis that the mandatory insolvency rules in the UAE require that all unsecured creditors be treated equally.

UK

Law and Practice

Contributed by:
Guy O'Keefe, Richard Jones, Oliver Wicker and David Thomas
Slaughter and May

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Slaughter and May has a securitisation and structured finance team that advises on public and private securitisations of every major asset class, and advises both originators and arrangers. It has a core team of 33 securitisation-focused lawyers in its London office, and the broader multi-specialist financing team is also brought in on matters as needed. The firm works with the best local law firms on cross-border matters. Clients include specialist lenders setting up their first funding transactions, the most prolific ABS issuers in Europe, as well as the largest global banks, which come to Slaughter and May for their highest value, most structured transactions. The team regularly works on STS securitisations in the UK and EU, and also on deals marketed to US and other global investors.

Authors

Guy O'Keefe has a wide-ranging financing practice that covers securitisation and structured finance, as well as banking and capital markets. He advises issuers, borrowers, lenders and counterparties of all types. He also advises governments and financial institutions, funds and lending platforms on various matters, including restructuring and asset sales.

Richard Jones is the head of the securitisation practice at Slaughter and May and has over 20 years' experience in advising on securitisations and other structured finance transactions, covering credit card, store card, point-of-sale, personal loan, auto loan and mortgage receivables. He also advises on whole-business securitisations and regulatory capital-driven internal securitisations. Richard frequently works on master trust and standalone public transactions, as well as private and bilateral transactions, and related structures such as whole loan and forward flow arrangements. He regularly speaks at industry events (including the annual Global ABS conference) and is one of the firm's key points of contact with AFME.

Oliver Wicker advises on a wide range of securitisations, derivatives and structured products matters. His clients include financial institutions, investment funds, insurers and non-bank originators. Recent work has included advising on a number of RMBS and related financings for originators, inter-bank credit protection and bank funding structured through CDS, total return swaps, risk participations and repo arrangements, loans through or involving options and collars and assisting clients with MiFID II and clearing compliance. Oliver is also head of the derivatives practice at Slaughter and May.

David Thomas is a securitisation and asset-backed finance specialist, and advises a range of originator and bank clients on public and private deals, forward flows and more unusual structures. He is knowledgeable about regulatory requirements and market norms, and has worked on a number of STS deals. David has experience of acting as drafting and transaction counsel on public securitisations, and of acting for both bank and non-bank originators. He also advises on securitisation swaps and similar hedging arrangements. David is one of the Slaughter and May's key points of contact with AFME, ICMA and ISDA.

Slaughter and May

One Bunhill Row
London
EC1Y 8YY
United Kingdom

Tel: +44 20 7090 3817
Fax: +44 20 7090 5000
Email: david.thomas@slaughterandmay.com
Web: www.slaughterandmay.com

SLAUGHTER AND MAY/

1. Specific Financial Asset Types

1.1 Common Financial Assets

Common asset classes securitised in the UK include:

- residential and commercial mortgages;
- credit cards;
- personal loans and auto loans;
- commercial/trade receivables; and
- corporate loan portfolios.

Other less common asset classes that have been securitised in the UK include:

- lease and rental receivables;
- IP royalty receivables;
- insurance premiums;
- healthcare receivables;
- ticket receivables;
- receivables from public utilities;
- mobile handset loan receivables; and
- student loan receivables.

1.2 Structures Relating to Financial Assets

The transactional structures used in securitisations are designed to isolate financial assets, to transfer risk and to create securities that can be sold to investors.

- Residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) often use a special purpose entity (SPE) to hold the mortgage loans, which are then used to back the issued securities. The cash flows from the mortgage payments (interest and principal) are passed through to investors in prescribed amounts after administrative costs and fees are covered.
- Asset-backed securities (ABS) involving consumer debt are similar to RMBS and CMBS, and also use an SPE structure. Credit card receivables, auto loans and personal loans are transferred to the SPE, which then issues notes to investors.
- Collateralised loan obligations (CLOs) involve pooling commercial loans and are organised by a manager who selects and actively manages the corporate debt. They differ from other structures as they are managed over their life, with the potential for trading and substitution within the portfolio. The CLO issues tranches of debt with varying seniority and risk profiles to investors.
- Trade receivables securitisations typically operate by the sale of customer invoices by an ordinary operating corporate to a structure set up by a financing bank. Structures are typically designed such that the corporate is not considered to be the originator of a securitisation (thereby avoiding the corporate becoming subject to securitisation-specific regulatory requirements).

Securitisation structures are typically constructed to be bankruptcy-remote, meaning the SPE's assets remain beyond the reach of the originator's creditors in the event of bankruptcy. In addition, credit enhancement techniques are used to achieve desired credit ratings and to attract investors.

In a standard securitisation, it is common for the originator to continue to administer the receivables on the SPV's behalf under a servicing agreement in return for a servicing fee. The originator will typically maintain the original contact with the underlying debtors. To mitigate the risk of non-performance by the originator of the servicing and collection role, back-up servicers may also be appointed during the lifetime of the

transaction, such that an alternative and suitably experienced and creditworthy entity is in a position to take over the servicing of the receivables in the event of a default by the originator/servicer.

Payments are made according to a priority order of payments specified in the transaction documents (often referred to as the cash flow waterfall or priority of payments).

Any money left over after all such payments have been made is extracted from the SPV and either retained by the holders of the most subordinated tranche of securities or passed back to the originator using various profit extraction techniques. These profit extraction techniques may include:

- the originator taking fees for administering the receivables contracts and collecting the receivables, arranging or managing the portfolio of receivables and/or acting as a swap counterparty;
- the SPV paying the originator deferred consideration on the receivables purchased;
- the SPV making loan payments to the originator in respect of any subordinated loans granted by the originator; and
- the originator holding equity securities/the most subordinated tranche of securities in the SPV.

1.3 Applicable Laws and Regulations

Securitisation transactions are governed by a complex framework of laws and regulations that encompass corporate law, contract law, insolvency law, regulatory requirements and, where applicable, specific securitisation regulations. Historically, an important piece of legislation was Regulation (EU) 2017/2402 (the EU Securitisation Regulation), which was onshored post-Brexit. However, the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) have released new draft rules that will replace the EU Securitisation Regulation. These rules will regulate not only authorised firms that are involved in securitisation, but also entities that are not authorised but act as the original lender, originator or securitisation special purpose entity (SSPE) of a securitisation.

Since the end of the Brexit transition period, the retained EU Securitisation Regulation has continued to apply in Britain, with some modifications (the UK Securitisation Regulation). The UK Securitisation Regulation sets out the following:

- standards for simple, transparent and standardised (STS) securitisations;
- risk retention rules where originators are required to maintain a material economic interest in the risk of the assets; and
- disclosure and reporting requirements to ensure investors have sufficient information.

When brought into force, the new FCA and PRA rules are expected to largely replicate the UK Securitisation Regulation, albeit with some technical improvements. It is likely, however, that further changes will be made over time (and, indeed, the new rules have been constructed in a manner that facilitates future changes).

In addition, there are current FCA and PRA rules that include regulations on the capital treatment for banks and investment firms, and the Financial Services and Markets Act 2000 (FSMA) provides the overarching framework for financial regulation.

For securitisations involving residential mortgages, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 requires

specific authorisations for mortgage lending and administration.

Consumer credit laws will also apply in securitisations involving consumer loans, governing the conduct of the servicer. In particular, a wide-ranging consumer duty applies in the UK, which includes a requirement for consumer lenders to provide good customer outcomes. Investor due diligence will typically involve assessing the extent to which the originator and servicer have complied with applicable consumer legislation when originating and servicing loans, the risk being that non-compliance could reduce the amounts recoverable and ultimately reduce the amounts available to pay and repay investors.

Lastly, international standards like Basel III (implemented in the UK) impact the securitisation market by setting out risk-based capital requirements for banking institutions that may hold securitised assets.

1.4 Special-Purpose Entity (SPE) Jurisdiction

SPEs can be incorporated in a variety of jurisdictions, depending on the goals of the securitisation, the originator's location, tax considerations, regulatory concerns and investor preferences.

United Kingdom (England and Wales)

SPEs incorporated in the UK are frequently seen. The UK has a clear legal framework, including for corporate establishment and tax. Using an SPE established in the UK is often the simplest choice where a securitisation relates to UK assets.

European Union

Where a transaction involves assets relating to a jurisdiction in the EU, or where the securitisation transaction is intended to constitute a "simple, transparent and standardised" securitisation for the purposes of the EU Securitisation Regulation, an SPE is typically established in the EU, with the following jurisdictions being the most popular:

- Luxembourg is a particularly favoured jurisdiction due to its flexibility in corporate structuring, and its favourable tax regime; and
- Ireland is frequently chosen for its favourable tax treaties and English-speaking environment.

Other Jurisdictions

SPEs are occasionally established in Jersey, Guernsey or the Cayman Islands, albeit less frequently (although these jurisdictions remain popular as listing venues).

1.5 Material Forms of Credit Enhancement

Four primary forms of credit enhancement are commonly used to improve the creditworthiness of the debt issued.

- Over-collateralisation involves holding a larger pool of assets than the securities issued, which provides a buffer against asset defaults.
- Subordination uses a tiered structure where junior tranches absorb losses before senior tranches, thereby protecting senior investors. It is common for the junior tranches to be held by the originator (or affiliates) to both retain risk and provide confidence to investors.
- Reserve accounts, such as cash reserves or liquidity facilities, are set up to cover potential shortfalls in the cash flow from the asset pool.
- Although this is less common after the financial crisis, guarantees and similar external credit enhancement can be provided by a highly rated entity, offering additional assur-

ance of payment to investors in case the underlying assets fail to generate expected cash flows.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer typically takes the form of a bankruptcy-remote SPE, which is a legally distinct entity created solely to carry out the securitisation transaction. The role of the issuer is typically to acquire or hold an economic interest in the pool of assets to be securitised and issue the securitised debt to investors. The issuer's key obligations are to make payments of principal and interest as required by the transaction documents, to the extent that cash – derived from collections on the receivables – is available for it to do so.

2.2 Sponsors

Securitisation transactions sometimes, but not always, have a "sponsor". This is a financial institution that establishes the transaction and plays a role in its ongoing operation. The sponsor is often involved in structuring the transaction and selecting the portfolio of assets, and may handle or oversee the servicing of the assets post-securitisation. Sponsors can also provide credit enhancement or liquidity facilities to the transaction, or retain risk in the transaction.

An entity that acts as sponsor is subject to regulatory requirements under the UK Securitisation Regulation (or the EU Securitisation Regulation, as applicable).

2.3 Originators/Sellers

An originator is the entity that originally creates or originates the assets being securitised, or that has purchased such assets before they are securitised. In a typical securitisation transaction, the originator sells or transfers a portfolio of financial assets, such as loans, credit card receivables or mortgages, to an SPE. The originator is sometimes a financial institution such as a bank, but non-bank originators are a growing feature of the securitisation market. An originator will typically have an ongoing interest in the securitisation. Often, this is by way of an entitlement to the cash generated by the sold receivables to the extent it is not needed to pay third-party investors.

An entity that acts as sponsor is subject to regulatory requirements under the UK Securitisation Regulation (or the EU Securitisation Regulation, as applicable).

2.4 Underwriters and Placement Agents

Underwriters – often investment banks – serve to facilitate the issuing and distribution of the securitised instruments to investors. Their role encompasses structuring the transaction, pricing the securities, ensuring compliance with relevant legal and regulatory frameworks relating to the marketing of securities and often providing a commitment to purchase any unsold securities. Public securitisations, where the securities are to be widely distributed, will typically have multiple banks that act as underwriters.

In private placements or direct issuances where the securities are sold to a smaller number of sophisticated investors, underwriters are less frequently seen. In such cases, a bank may be appointed to market the deal but not provide an underwriting commitment. A bank fulfilling this function could be described as a placement agent (although that description/title is not frequently used in a securitisation context).

2.5 Servicers

The servicer is responsible for managing the day-to-day operations of the securitised assets, such as collecting payments from borrowers, handling customer enquiries, managing delinquencies and undertaking enforcement and repossession procedures, if necessary.

Servicers thus play a critical role in maintaining the performance and cash flow stability of the securitised asset pool and will generally receive a fee for their role that is sufficient to attract a replacement servicer if the original servicer ceases to be able to perform its role.

The entity that acts as servicer is often the same entity or part of the same group as the originator, but transaction documents typically contemplate that the servicer may be replaced in the future (for example, if the original servicer ceases to be able to perform its role). Specialist servicers are frequently appointed at the outset of transactions to act as a back-up servicer, the intention being that such an entity would be able to quickly assume the role of servicer, if necessary.

2.6 Investors

Investors provide the capital necessary for funding the purchase of assets by buying the securities issued by the SPE. They are typically institutions such as banks, pension funds, insurance companies and asset managers, seeking to deploy capital and earn a yield. Investors will perform due diligence to assess the risk profiles, credit quality and potential returns of the securitisation. Their investment decisions are guided by their own analysis of the underlying assets, the structure of the deal, the protections afforded by credit enhancements and the ratings provided by credit rating agencies.

2.7 Bond/Note Trustees

A note trustee is typically appointed on behalf of the investors in the securitisation. The note trustee will typically be party to the key transaction documents and give the investors, indirectly, the benefit of the representations, warranties and undertakings of the other parties to such documentation.

In practice, the note trustee will typically play an active role in two circumstances:

- during the ordinary life of the deal, when it is proposed that transaction documents are to be modified, in which case the trustee will either exercise discretion to allow the amendment to be made or oversee the process of approaching noteholders for consent; and
- in the case of a default, whereupon the note trustee may be directed by noteholders to declare a default and accelerate obligations under the notes.

In Europe, trustees will typically otherwise play a passive role and not, for example, seek to monitor compliance.

Trustees are usually trust corporations or financial institutions with dedicated trustee departments. While trustees are common in securitisation structures, some transactions might utilise alternative mechanisms like an owner trust or a fiscal agent arrangement, which provides a different level of oversight and control over the adherence to the structure's terms but may offer less comprehensive protection for noteholders than a traditional trustee.

2.8 Security Trustees/Agents

A security trustee (or, less frequently, a security agent) is appointed to hold and manage the security interests on behalf of the secured

parties (most notably, the investors). Typically the same firm as the note trustee, the security trustee takes, directly, the benefit of the security and holds it on behalf of the secured parties. Its responsibilities include managing the security according to the terms of the security documentation, handling enforcement proceedings in the event of default (as directed by noteholders) and distributing proceeds from any enforcement. Although focused on security, the role of the security trustee overlaps with that of a note trustee, and both the note trustee and the security trustee will have a role to play where consents are required (for example, in relation to amendments) or in the case of a default.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

Customary documentation effecting bankruptcy-remote transfers to an SPE typically comprises a receivables purchase agreement and a declaration of trust over amounts standing to the credit of collection accounts. Key terms include:

- the assets to be transferred to the issuer by the originator;
- the purchase price;
- conditions precedents for the transaction to occur;
- conditions for perfection of the transfer, such as notifications or registrations (where necessary);
- comprehensive seller warranties on the quality and status of the assets; and
- covenants restricting the seller's actions to protect the asset pool's integrity.

The declaration of trust over the collection accounts is intended to avoid collections forming part of the originator's (or servicer's) insolvent estate, and is typically formally notified to and acknowledged by the collection account bank, so as to reduce the risk that such bank may set off amounts standing to the credit of such accounts against other liabilities of the originator or servicer.

3.2 Principal Warranties

The originator, servicer, SSPE and, to a more limited extent, other transaction parties will each give warranties relating to certain fundamental matters, such as their capacity, power, authority and solvency.

In addition, the originator will give asset warranties. Most fundamentally, the originator will confirm that the assets are free from encumbrances and that it has the right and ability to sell them. It will also represent that the sold assets comply with a set of carefully drafted eligibility criteria. If the asset warranties are breached, the originator will typically be required to repurchase the affected assets or make a compensatory payment equal to the face value of the relevant assets.

3.3 Principal Perfection Provisions

In a securitisation where there is a transfer by assignment, the transfer documentation will normally provide for perfection on (and only on) specified perfection events. Perfection turns the equitable assignment of receivables into a legal assignment, and is important in ensuring the priority of claims and the ability of the securitisation structure to enforce rights under the receivables in circumstances in which the servicer/originator is not able to do so.

Perfection will typically entail the notification of underlying borrowers and, in certain cases, the registration of the securitisation's interest in

related assets (for example, at the Land Registry).

3.4 Principal Covenants

Key covenants include:

- covenants of the issuer to make payments of principal and interest to noteholders in the amount and times required;
- covenants of the originator to maintain records of the ownership of the securitisation of receivables and not to do anything that could impair the title of the securitisation to such receivables;
- covenants of the servicer to service the receivables in accordance with any applicable legal requirements and the applicable servicing standards; and
- covenants of any cash manager (or, in the absence of such, the issuer) to apply cash strictly in accordance with prescribed cash waterfalls.

Covenants are enforceable by the trustee on behalf of noteholders. Of the above, failure to pay by the issuer will be an event of default under the notes. Breach of fundamental covenants by the originator may result in a perfection event. Breach by a servicer or cash manager of its duties is likely to entitle the trustee to terminate the appointment and appoint a replacement servicer or cash manager.

3.5 Principal Servicing Provisions

Key obligations of the servicer include:

- the servicing of receivables in a manner that is consistent with and no less favourable than receivables which the servicer and originator have not securitised (and that is compatible with the prescribed servicing standards);
- compliance with laws, including those regarding consumer protection and data protection;
- maintaining the necessary regulatory permissions;
- enforcing the obligations of the underlying obligors;
- the preservation of records; and
- maintaining segregated collection accounts, taking steps to ensure that underlying obligors make payment into such accounts and transferring amounts from such accounts to the securitisation.

Breaches of servicing obligations can trigger the replacement of the servicer.

3.6 Principal Defaults

Key events of default include:

- non-payment by the issuer when due;
- breach by the issuer of other obligations under the transaction documents;
- misrepresentation; and
- insolvency.

The occurrence of an event of default, subject to grace periods, would typically entitle noteholders to direct the trustee to accelerate payment obligations under the notes and to direct the security trustee to enforce security.

3.7 Principal Indemnities

Indemnities are carefully negotiated and vary from deal to deal. In some deals, indemnities are given by the originator in respect of losses caused by the sale of ineligible assets.

3.8 Bonds/Notes/Securities

The notes are typically constituted by a deed of covenant, with terms and conditions set out in a trust deed.

The terms and conditions set out the issuer's payment obligations, interest provisions, maturity dates and redemption rights, and can sometimes also set out other provisions, such as covenants, representations and warranties, events of default, cash flow waterfalls and provisions regarding ranking and security (although these provisions can equally be found in other related documentation). Either the conditions or the trust deed will set out provisions governing voting and decision making by noteholders. In the case of a public securitisation, the terms and conditions are typically set out in full in the prospectus.

3.9 Derivatives

Derivatives are often, but not always, used in order to hedge interest rate basis risk and currency risk; where present, they are usually entered into by the SPE.

Commonly encountered derivatives include rate swaps, caps or floors. These derivatives are employed to hedge various risks:

- interest rate swaps mitigate the risk of fluctuating interest rates affecting cash flows;
- currency swaps are used when the securitised assets and the notes issued are in different currencies, thus protecting against foreign exchange risk; and
- caps or floors limit the exposure to interest rate volatility by setting maximum or minimum rates.

Aside from the hedging of risk, currency swaps enable the issuance of notes in a currency other than that of the underlying assets, thereby allowing securitisations to issue notes targeted at investors in different jurisdictions.

3.10 Offering Memoranda

A prospectus is typically required when securities are offered to the public or admitted to trading on a regulated market. A prospectus will set out detailed information on the offer and the issuer in a manner that is consistent with the applicable legal requirements (in the UK, Prospectus Regulation (EU) 2017/1129 as retained and amended by UK law post-Brexit). For private placements or transactions not involving public offerings or regulated markets, the issuer will instead publish a transaction summary, with less extensive/detailed content.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

In addition to the disclosure requirements relating to the offer of securities to the public (see **3.10 Offering Memoranda**), there are also specific disclosure regulations under Article 7 of the UK Securitisation Regulation. The originator, SPE and any sponsor are jointly responsible for providing the required information, although one of them must be designated as the entity that fulfils the requirements in practice. Information required to be made available includes loan level performance data (on the basis of prescribed templates), as well as the transaction documents and investor reports. In the case of a public securitisation (determined by reference to whether or not there is a prospectus), information must be made available by way of an authorised securitisation repository.

4.2 General Disclosure Laws or Regulations

See **4.1 Specific Disclosure Laws or Regulations**.

4.3 Credit Risk Retention

The UK Securitisation Regulation mandates credit-risk retention to ensure that originators or sponsors have "skin in the game", requiring a minimum retention of 5% of the credit risk of the securitised exposures. This can be done by way of (one of) a number of permitted methods, including by retention of a vertical slice of exposures, a first loss tranche and the maintaining of exposure to a random selection of assets that would otherwise be securitised. The regulation is overseen by the FCA and (in the case of banks) the PRA, which enforce compliance through supervision, auditing and sanctions. Penalties for non-compliance can include fines and other regulatory penalties. It is essential that the risk is retained for the life of the transaction. Hedging or transferring of the retained exposure is not permitted.

4.4 Periodic Reporting

The UK Securitisation Regulation sets out periodic reporting requirements, as described in **4.1 Specific Disclosure Laws or Regulations**. Originators, sponsors and issuers are required to provide regular reports on the performance and underlying exposures of the securitised assets. These reports include data on the credit quality and cash flows of the assets, which must be made available to investors, potential investors and the relevant authorities. The reports are typically required on a quarterly basis, but the frequency can vary depending on the asset type and the transaction's structure. Non-compliance with these reporting obligations can lead to enforcement action by regulatory authorities, including fines or other penalties.

The reports described above must be made available on standardised, prescribed templates. The reporting requirements and these templates are currently subject to review by regulators and are likely to change in the medium term.

UK Market Abuse Regulation (MAR) reporting obligations can also apply in relation to inside information.

4.5 Activities of Rating Agencies

The activities of credit rating agencies (CRAs) are regulated, with the key regulation being the Credit Rating Agencies Regulation (CRA Regulation), which is retained EU law, with CRAs supervised by the FCA. The FCA ensures CRAs adhere to standards of integrity, transparency and analytical rigour by requiring they are registered, disclose and manage conflicts of interest and apply appropriate rating methodologies. The enforcement of rules can lead to sanctions, fines or the suspension of the CRA's registration.

4.6 Treatment of Securitisation in Financial Entities

In the UK, capital and liquidity rules apply for banks, insurers and regulated financial entities, and are broadly aligned with international standards. For banks, such holdings are governed by the Capital Requirements Regulation (CRR), which incorporates Basel III and dictates the risk weighting applied to securitisation positions to determine regulatory capital requirements. Under Solvency II, insurers (and reinsurers) must also hold capital against securitisation investments, on a similar basis. However, the Edinburgh Reforms are intended to bring in changes to, among other things, the Solvency II regulations. All these institutions must also adhere to liquidity requirements, ensuring sufficient high-quality liquid assets to cover short-term liabilities. These rules aim to mitigate systemic risk

and ensure financial stability. Non-compliance with capital and liquidity requirements can result in penalties, increased capital charges or other regulatory actions.

4.7 Use of Derivatives

Derivatives used in securitisations are regulated under the European Market Infrastructure Regulation (EMIR), which is EU law onshored post-Brexit (UK EMIR). These regulations mandate risk mitigation techniques for non-centrally cleared derivatives and the reporting of all derivative contracts to trade repositories. The FCA is the primary enforcer of these rules, with the Bank of England also playing a role. In practice, securitisation SPEs are treated as non-financial counterparties; this means that derivatives regulation applicable to securitisations is much lighter than, for example, that applicable in transactions between banks or other financial counterparties.

4.8 Investor Protection

The UK Securitisation Regulation and FSMA protect investors, along with UK MAR, the CRR and Solvency II. The regulations aim to encourage due diligence and monitoring, whilst also avoiding insider trading, market manipulation and instability. The FCA and PRA enforce these rules, focusing on transparency, risk retention and due diligence. Breaches can result in sanctions, fines and restrictions being imposed on the relevant entities.

4.9 Banks Securitising Financial Assets

Please see **4.8 Investor Protection**.

4.10 SPEs or Other Entities

SPEs established in the UK are registered as companies under the Companies Act 2006 with limited liability. Where it is proposed that securities are issued to the public, the SPE is registered as a public company. Limited liability companies are often preferred as the form of entity used as SPEs in UK securitisations for several reasons.

- Limited liability – shareholders of a limited company have limited liability, which means that they are only responsible for the debts of the company up to the amount of unpaid share capital (if any).
- Separate legal personality – a limited company is a separate legal entity from its owners and from any other person/entity, and can enter into binding contractual arrangements in its own name. This allows for the assets and liabilities associated with the securitisation to be segregated from the originator, enhancing bankruptcy remoteness.
- Ring-fencing of assets – as a separate entity, a limited company's assets are inherently ring-fenced from the assets/broader business of the originator and servicer. This assists in the structure being bankruptcy-remote.

To enhance the above, it is usual for an SPE's shares to be held on trust, with the trust being in favour of a purpose rather than any individual beneficiaries. The lack of any individuals/entities that can be said to beneficially own or control the SPE enhances its bankruptcy-remoteness and separation from the originator's group.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

It is important for an SPE to avoid engaging in activities that would classify it as conducting a "regulated activity" under FSMA, such as deposit-taking, providing investment advice or undertaking insurance business. This is to maintain the SPE's status as a bankruptcy-remote entity and to circumvent the need for authorisation by the FCA or the PRA. The activities performed by the SPE are determined by its directors, but

these are strictly outlined in the transaction documents to ensure compliance with regulations.

Similarly, servicing activities facing customers are typically regulated and require regulatory permission. It is therefore a servicer – with the appropriate permissions – that performs this role, rather than the SPE.

If an SPE performs regulated activities, it could face enforcement actions, including fines or sanctions, and may be required to cease activities or obtain the appropriate authorisations, which could impact the securitisation structure. In practice, this is a fairly minimal risk, unlikely to arise with proper drafting of the transaction documents and transaction structuring.

4.12 Participation of Government-Sponsored Entities

The UK government has an established history of participating in the securitisation market, albeit to a much more limited extent than US agencies. Examples include the securitisation by UK Asset Resolution of receivables acquired from rescued banks in the financial crisis, and the use by the British Business Bank of securitisation funding tools to fund SME lenders via its ENABLE programme.

4.13 Entities Investing in Securitisation

A wide variety of investors invest in securitisations, including banks, pension funds and their asset managers, insurance companies and – primarily in respect of mezzanine tranches – private credit funds.

Investors are required to conduct due diligence on securitisations before they invest, with prescribed rules for this set out in Article 5 of the UK Securitisation Regulation. This includes a requirement to ensure that securitisations themselves comply with a number of provisions of the UK Securitisation Regulation (to the extent applicable), such as reporting requirements. The extent to which this restricts UK investors from investing in third country securitisations has been subject to some debate, and is subject to review and potential reform by the FCA and PRA.

4.14 Other Principal Laws and Regulations

UK GDPR (the onshored version of the EU's General Data Protection Regulation) and the Data Protection Act 2018 govern the handling of personal data, which must be considered carefully in every transaction; it is a fundamental principle of securitisations that the securitisation structure can outlast the business of the servicer, but for this to occur, a large volume of personal data relating to underlying customers must be made available to a replacement servicer. It is important to ensure that arrangements in this regard are lawful and operate on an appropriate basis. For so long as the original servicer remains responsible for servicing the assets, the transfer, holding and processing of personal data by the SPE and any investors is minimised.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are common in the UK and, whilst this was a relatively quiet market in the immediate aftermath of the financial crisis, it has grown significantly in recent years. Synthetic securitisation is a form of structured finance where credit risks are transferred to investors using credit derivatives or guarantees rather than through the transfer of actual assets. The focus is on the transfer of risk rather than the transfer of the underlying assets themselves, as found in

traditional securitisations. Synthetic securitisations, like true sale securitisations, operate by virtue of general principles of English contract and property law, although the UK Securitisation Regulation does apply.

In terms of structure, a synthetic securitisation typically involves the following elements.

- CDS or credit-linked notes (CLN) – the originator (usually a bank) enters into a credit default swap with an SPE or directly with investors. Alternatively, an SPE may issue credit-linked notes to investors, where the payments on the notes depend on the performance of the reference assets.
- Reference portfolio – this comprises the assets whose risks are being transferred. The originator still holds the actual assets, and only the credit risk is shifted to the investors.
- Tranching – like traditional securitisations, synthetic transactions are structured with different levels of risk, creating tranches that allow for varying degrees of protection for investors and different levels of return.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

The purpose of a securitisation is to give the investor exposure to the credit risk of underlying obligors, not the originator. Structural protections and contractual provisions are designed not only to insulate the SPE's assets from creditors of the originator in the event of insolvency, but also to ensure that investors are exposed only to the obligors. In particular, steps are taken to reduce the possibility of an insolvency practitioner, in the insolvency of the originator, successfully unwinding the transfer of assets to the SPE (for example, by alleging that the sale amounted to a preference or a transaction at an undervalue). This is primarily achieved by ensuring that the transfer of assets is by way of a sale (and that it cannot readily be recharacterised as security) that occurs (other than in the case of NPL securitisations) at the face value of the receivables. In addition, confirmations of the solvency of the originator at the time of sale, by way of directors' certificates, are almost always sought.

6.2 SPEs

The key consideration for an SPE is ensuring that it is bankruptcy-remote and separate from the corporate group of the originator. This is typically ensured by incorporating an SPE that has no prior history and no contractual relationships other than as part of the securitisation, and that is part of an orphan structure (rather than the corporate group of the originator). The directors of an SPE are typically provided by a corporate services provider that is appointed as part of the securitisation and are not employees of the originator.

English courts do not recognise a doctrine of substantive consolidation.

6.3 Transfer of Financial Assets

The transfer of receivables by way of equitable assignment (see **3.3 Principal Perfection Provisions**) results in the SPE acquiring an equitable interest in such receivables and a right to the benefit of collections relating to such receivables.

In the ordinary course, the transfer of receivables will not be notified to the underlying customers – instead, the originator will maintain its customer relationships and the servicer will collect amounts in the name of the originator.

The servicer will typically hold any collections received on trust for the securitisation structure before paying such amounts to the securitisation. Such a trust is intended to put such amounts beyond the reach of the servicer or originator's other creditors. It is important to ensure that trust funds are not comingled with funds not held on trust, and to ensure that any collection account bank is notified that amounts held in the relevant account are held on trust.

Under certain circumstances, such as the insolvency of the originator, it is usual that the equitable assignment of receivables will be perfected into a legal assignment by notifying the underlying obligors of the sale of receivables – see **3.3 Principal Perfection Provisions** for the description of perfection.

It is common for legal analysis to be undertaken to confirm that the transfer of receivables operates by way of a sale and is not readily recharacterisable as security. It is customary for counsel for the banks/investors to deliver a formal, reasoned legal opinion to this effect. Counsel will typically look to ensure that:

- receivables are transferred in exchange for a price that is calculated by reference to the face value of the receivables;
- the SPE has a right to both interest and principal receipts relating to the receivables; and
- the originator has only limited rights to repurchase receivables from the SPE.

6.4 Construction of Bankruptcy-Remote Transactions

It is also possible to use a trust instead of a "true sale" of assets. In this less common structure, the originator would declare a trust over its rights under the assets, with the SPE as the beneficiary. Whilst this achieves bankruptcy-remoteness, it is uncommon in practice.

In addition, it is inherent in a synthetic securitisation that investors' liability is tied to the performance of the portfolio of reference assets, rather than the originator.

6.5 Bankruptcy-Remote SPE

Securitisation documents will always include specific provisions to protect the SPE from insolvency. One key measure is the "limited recourse" provision, which ensures that the investors can only claim against the secured assets of the SPE, and not beyond that for any shortfall.

Another safeguard is the "non-petition" clause, where the investors agree not to petition for the insolvency of the SPE. This prevents the investors from forcing the SPE into insolvency proceedings, thereby allowing the securitisation structure to remain intact and cash flows to be distributed by way of the prescribed cash flow waterfalls, even in circumstances in which payments to noteholders are delayed or not made in full due to a shortfall in cash generated by the securitised assets.

In addition, the SPE is typically structured so as not to form part of the corporate group of the originator, and the transfer of assets to the SPE is structured as a sale.

7. Tax Laws and Issues

7.1 Transfer Taxes

Generally, there are no taxes payable by the SPE on the transfer to it of the financial assets from the originator. There may be potential stamp taxes on the transfer of certain interests in real

estate or equity-like securities to the SPE, but this is usually not an issue for securitisations.

7.2 Taxes on Profit

Provided that the SPE satisfies the conditions imposed by the Taxation of Securitisation Companies Regulations 2006, the SPE will be chargeable to corporation tax only on the retained profit after it has paid its expenses in accordance with the transaction waterfall. Practitioners will therefore generally structure the SPE so that it benefits from this tax regime by ensuring that:

- the SPE falls within certain categories of company as defined by the regulations;
- payments (other than the retained profit and any amounts reasonably required to cover losses or expenses and support creditworthiness) flow through to investors within 18 months of the end of the accounting period;
- the SPE is not party to any transactions for which UK tax avoidance was one of the main purposes; and
- the SPE is generally not involved in business activities other than those that are incidental to its role as an SPE in the securitisation.

7.3 Withholding Taxes

Withholding Taxes and Cross-Border Payments Received by SPE

The financial assets securitised in UK SPEs are typically UK financial assets, so UK withholding taxes are not usually an issue. Where cross-border payments are received by a UK resident SPE, withholding taxes may be relevant, depending on the jurisdiction, but treaty or other reliefs may be available to minimise these taxes.

Withholding Taxes and Cross-Border Payments Made by SPE

The SPE is subject to UK withholding tax at the basic rate of income tax (20%) on interest paid on the securitisation notes it issues, unless an exemption applies. A commonly used exemption is the "quoted Eurobond" exemption, where the notes are listed on a "recognised stock exchange" such as the London Stock Exchange or admitted to trading on a "multilateral trading facility" operated by a "regulated recognised stock exchange", being a recognised stock exchange that is regulated in the UK, EEA or Gibraltar. The "qualifying private placement" exemption may also be available if the SPE issues notes to investors resident in jurisdictions that are party to a double tax treaty with the UK that includes a "non-discrimination" article. In some securitisations with a more limited number of counterparties, a normal claim for treaty relief may also be possible.

7.4 Other Taxes

UK VAT on servicing fees incurred by the SPE may be relevant, depending on the nature of the services. Where possible, the servicer will usually look to provide the services in a way that falls within a VAT exemption (such as the exemptions for financing transactions). Where this is not possible, the VAT incurred is likely to be an additional cost of the securitisation.

7.5 Obtaining Legal Opinions

The tax lawyers acting for the SPE/arrangers are commonly required to give a tax opinion addressed to the SPE, the trustee acting for the noteholders, and the arrangers. The material conclusions will generally be that:

- the SPE should be chargeable to corporation tax only on the retained profit;
- there should be no requirement to withhold UK income tax from payments of interest on the securitised assets and the securities issued by the SPE; and

- no VAT or stamp duty should be chargeable on the acquisition of the securitised assets by the SPE, nor on the issue or transfer of notes by the SPE.

The tax opinion(s) will make a number of factual assumptions based on the transaction documentation.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Originators will typically obtain accounting advice to ensure the desired accounting treatment of the securitisation is achieved. The accounting treatment that is desired and is achievable varies from transaction to transaction, but key considerations include:

- whether the assets sold should be derecognised from the originator's balance sheet; and
- whether the SPE should be consolidated as part of the originator's group accounts.

As to derecognition, a key consideration is typically whether the originator has sufficiently relinquished control over the sold assets. This requires particular care in the case of whole loan/forward flow funding transactions (which, although not strictly securitisations, provide analogous asset backed funding), where accountants will often require that the purchaser is able to trigger perfection of legal title to the receivables, sell the receivables on and appoint an alternative servicer. Care is required to assess the impact of the exercise of any such rights on, for example, any originators' entitlement to deferred consideration.

8.2 Dealing with Legal Issues

Legal opinions as to a "true sale", the SPE's independence and bankruptcy-remote status and the legal enforceability of transaction documents are the principal interaction between lawyers and these accounting issues. Accountants are likely to use such opinions when drawing conclusions and advising the originator, but it is uncommon for lawyers to directly opine on the accounting treatment of a given transaction.

USA

Law and Practice

Contributed by:
Bjorn Bjerke and Corey Reis
Shearman & Sterling LLP

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Authors

Bjorn Bjerke is a partner in the finance practice at Shearman & Sterling in the New York office. He represents lenders, borrowers, managers and investors in a range of complex financing arrangements across a wide spectrum of asset classes, including securitisations and other structured financings, various shared collateral and second lien structures, repo facilities, commodity, equity, credit and fund-linked derivatives, subscription lines, and a variety of funding arrangements. He also has extensive experience representing investors, creditors and managers in complex restructurings, workouts and acquisitions of distressed and non-performing assets. He is involved in all aspects of deal structuring, negotiation and documentation.

Corey Reis is a senior associate in the finance practice at Shearman & Sterling in the New York office. He focuses his practice on advising financial institutions and corporate borrowers in a broad range of leveraged and structured finance transactions, including securitisations and structured financings, asset-based lending and warehouse facilities, direct lending, acquisition financings and refinancings, restructurings and private banking transactions and high-yield debt issuances.

Shearman & Sterling LLP

599 Lexington Avenue
New York
NY 10022-6069
USA

SHEARMAN & STERLING

Tel: +1 212 848 4000
Fax: +1 646 848 4607
Email: bjorn.bjerke@shearman.com
Web: www.shearman.com

1. Specific Financial Asset Types

1.1 Common Financial Assets

According to data provided by the Securities Industry and Financial Markets Association (SIFMA), the most commonly securitised financial assets are:

- agency MBSs;
- auto;
- commercial loans;
- non-agency residential mortgages;
- commercial mortgage loans;
- equipment leases;
- credit cards; and
- student loans.

1.2 Structures Relating to Financial Assets

Common structures used for the various types of securities previously outlined (see **1.1 Common Financial Assets**) include the following.

Pass-Through Securitisations

These are used in agency-guaranteed securitisation and are described in more detail in **4.12 Participation of Government-Sponsored Entities.**

Double Special Purpose Entity (SPE) Structures

In this structure, one SPE acts as the depositor (typically structured as a limited liability company – LLC) and the other SPE is the issuer (typically structured as a trust). It is typically used for retail auto loans, equipment leases, student loans, consumer loans and a number of other asset classes. The issuer trust will typically issue notes to investors and trust certificate(s) to the depositor.

To the extent that such securitisations are registered, they must comply with the Reg AB II requirements described in **4.1 Specific Disclosure Laws or Regulations**, and otherwise the general disclosure requirements described in **4.2 General Disclosure Laws or Regulations** apply.

Student loans originated under the Federal Family Education Loan Program (FFELP) benefit from a government guarantee and securitisations of such loans will therefore have a reduced risk retention requirement of between 0% and 3%, depending on the level of the guarantee.

Titling Trust Structures

This structure is typically used in auto lease securitisations and other lease transactions relating to titled goods. A titling trust is established to originate the lease and hold title to the leased assets. Instead of selling the assets and leases to be securitised to a particular issuer, the titling trust segregates such leases and assets, and issues special units of beneficial interests (SUBIs) that represent the interest in such segregated pool. The structure is otherwise typically similar to the two-tier structure previously described. The issues and regulations are similar to the general securitisation structure in double SPE structure securitisations, but the titling trust may require additional analysis compared to the other entities in the structure, for the purposes of the Investment Company Act exemption.

Master Trust Structures

These are typically used in dealer floor plan securitisations and credit card securitisations. The credit from the master trust is revolving in the sense that as the dealer inventory is sold or the credit card customer repays their balance, as applicable, funds are paid to the master trust. These funds are used to service interest and principal on the issued securitisation notes and are otherwise available to acquire new receivables or loans, as applicable.

The structure allows for multiple series of securities to be issued that all share in assets of the master trust. Each series of notes typically has a revolving period during which no principal is paid on the notes, with the notes paying down once the amortisation period starts. The structure also allows for some series to be in their revolving period while other series are in their amortisation period. The master trust receives the proceeds from the repaid loans and uses these in part to pay interest and principal on the issued notes.

CLO-Type Structures

The CLO is actively managed and will acquire and maintain a diversified pool of underlying loans that is managed to conform to a number of concentration limits for the pool, with the goal of maximising return while maintaining the required pool diversification and other relevant transaction criteria. As noted in **4.11 Activities Avoided by SPEs or Other Securitisation Entities**, this has impacts on the Investment Company Act and Volcker Rule analysis.

Open-market CLOs will not be subject to US risk retention requirements, as discussed in **4.3 Credit Risk Retention**. The CLO issuer will typically be organised as a Cayman Island company and will structure its loan acquisitions to avoid being engaged in any US trade or business, as discussed in **7. Tax Laws and Issues**.

1.3 Applicable Laws and Regulations

The principal laws and regulations that have a material effect on US securitisation structures are:

- the Securities Act of 1933 (“Securities Act”);
- the Securities Exchange Act of 1934 (“Exchange Act”);
- Regulation AB, as significantly revised and updated in 2014 (“Reg AB II”);
- the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”);
- Regulation RR;
- the Volcker Rule;
- the Investment Company Act of 1940 (“Investment Company Act”);
- SEC Rule 192 under the Securities Act and Dodd-Frank Act (“Rule 192”); and
- the US Bankruptcy Code.

1.4 Special-Purpose Entity (SPE) Jurisdiction

Delaware is the most common organisational jurisdiction for onshore SPEs, due to:

- its market familiarity as a leading corporate jurisdiction;
- ease and low cost of SPE formation and maintenance;
- established body of organisational law;
- stable and predictable legal environment and experienced and sophisticated judicial system;
- deep bench of experienced law firms and legal practitioners, and legislature that is generally responsive to market developments;
- contractual freedom;
- management flexibility;
- ability to utilise different limited liability structures such as statutory trusts and LLCs;
- tax advantages; and
- special bankruptcy remoteness features, such as the ability to contractually restrict fiduciary duties in the SPE's organisational documents.

The most common organisational jurisdictions for offshore SPEs, which are often used in the fund finance and CLO space, are the Cayman Islands, and to a lesser extent, Bermuda. The primary advantages of Cayman and Bermuda include:

- ease and low cost of SPE formation and maintenance;
- their established body of organisational law;
- their stable and predictable legal environment;
- a deep bench of experienced law firms and legal practitioners who may also act as independent directors; and
- tax advantages, including:
  (a) the ability for US-owned SPEs to avoid entity-level taxation; and
  (b) the ability to comply with FATCA disclosure and reporting rules and so avoid FATCA withholding taxes.

1.5 Material Forms of Credit Enhancement

The most typical credit enhancements include over-collateralisation, subordination of junior tranches, cash reserves and excess yield on the underlying assets compared to what is needed to service the asset-backed fixed-income securities. The exact levels and types of credit enhancement will depend on the ratings requirements relating to the desired ratings levels, in addition to commercial constraints on the securitisation.

Some securitisations also include liquidity facilities that can be used to service the outstanding securities during periods of liquidity shortfalls. These can be provided by third-party liquidity providers or as part of the servicing rights and obligations.

2. Roles and Responsibilities of the Parties

2.1 Issuers

Issuers are typically SPEs that are restricted from engaging in activities unrelated to securitisation.

2.2 Sponsors

Sponsors are typically in the business that generates the relevant underlying receivables or other financial assets, and will typically organise and initiate the ABS transaction and engage in selection of the relevant assets. The sponsor is responsible for compliance with risk retention and other relevant regulatory requirements.

2.3 Originators/Sellers

Originators generate and/or own the underlying receivables or other financial assets that are to be securitised, and transfer them to the SPE. The obligations arising with respect to such receivables/financial assets are originally owed to an originator or are acquired by a seller before the transfer to the SPE takes place.

Originators include government-sponsored entities (GSEs), captive financial companies of the major auto manufacturers, other financial companies, commercial banks, building societies, manufacturers, insurance companies and securities firms.

2.4 Underwriters and Placement Agents

Underwriters (including initial purchasers in a 144A transaction) and placement agents are registered broker-dealers responsible for placing the ABS. In some securitisation transactions they are also responsible for establishing and preparing the relevant securitisation structure and documentation.

2.5 Servicers

Servicers are typically the sponsor or an affiliate of the sponsor. The servicer will typically be responsible for collecting payments under, and ensuring that the issuer complies with, the obligations relating to the collateral. In some securitisations, such as CLOs, the servicing role may be quite active, consisting of purchasing and selling relevant assets, participating in any workouts as required and otherwise managing the collateral in accordance with the terms of the transaction. The servicer typically also produces periodic reports and interfaces with the trustee to ensure the correct application of funds in accordance with the applicable priority of payments waterfall.

2.6 Investors

Investors constitute a diverse group. In a typical securitisation the investors will have a right to payment, and investors will also have certain rights to direct the trustee to take enforcement actions. The controlling class of noteholders will thereafter have enhanced ability to direct the trustee in accordance with the terms of the transaction documents.

Typically, investors will not have responsibilities per se, although investors may be subject to certain deemed representations relating to their eligibility to invest in the securitisation. Investors in unfunded ABS tranches will typically have contingent funding obligations and may be required to provide additional credit support, or face replacement if their credit drops below agreed levels.

2.7 Bond/Note Trustees

Indenture trustees act on behalf of noteholders. Owner trustees typically act on behalf of the holders of any trust certificates issued by an issuer trust (if applicable). Trustees typically act as communications and payment agents. The trustees also undertake other specified administrative tasks, but typically avoid taking any discretionary actions other than pursuant to a direction from the relevant noteholders.

The trustees tend to be large banking associations that satisfy relevant regulatory and ratings agency criteria such as requirements under the Trust Indenture Act (for registered ABS issuances) and as required by Investment Company Act Rule 3a-7, where the issuer relies on that exemption.

2.8 Security Trustees/Agents

Security trustees/agents hold a security interest in the underlying pledged assets on behalf

of noteholders, and possess or have control of underlying pledged assets on behalf of noteholders in cases where possession or control is required to perfect such security interest.

The firm acting as the bond/note trustee for an issuance typically also acts as a security trustee/agent.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

The typical items of documentation used to effectuate bankruptcy-remote transfers are:

- asset sale agreements;
- participation agreements; and
- asset contribution agreements.

Title is generally not dispositive of ownership, nor is it necessary for the consideration to be in the form of cash. Contributions to SPEs in exchange for a corresponding increase in the value of any equity held in such SPE would typically also be good consideration. The key is for the relevant documentation to satisfy the true sale criteria discussed in **6.1 Insolvency Laws** (clear identification of sold asset, arm's length price, representations and warranties as of time of transfer, provisions to ensure perfection of transfer, indemnification and limiting repurchase and indemnification obligations consistent with true sale, specifying the intent to treat the transaction as a sale, and, if applicable, a back-up security grant consistent with true sale).

Participation agreements will also typically include provisions relating to a participation buyer's ability to give consent and otherwise participate in voting actions relating to the underlying asset, as well as "elevation rights" that establish when either party to the participation can call for reasonable efforts to effectuate a full assignment of title. The Federal Deposit Insurance Corporation (FDIC) has promulgated non-exclusive safe harbour provisions for participations involving covered banking entities in 12 CFR 360.6 which, if complied with, provide additional comfort that the FDIC, when acting as conservator or receiver, will respect such participations as an assignment.

3.2 Principal Warranties

The typical representations and warranties in the sale agreement address:

- satisfaction of specified eligibility criteria when sold;
- absence of other encumbrances;
- transfer of title;
- all required consents and authorisations having been obtained;
- compliance with the law; and
- various additional tailored representations.

The typical enforcement mechanism is notice and indemnification obligations, coupled with a repurchase obligation in the case of a breach of any asset-level representation that has not been cured in a timely manner. Typically, the power to exercise such rights and remedies is given to the trustee with provisions that entitle the trustee to obtain directions backed by indemnification. In private deals, the investor vote required for certain actions is primarily a negotiated point, although in registered securitisations these requirements are more prescribed. For example, Reg AB II specifies that the transaction documents cannot require more than 5% of the principal amount of notes to direct the trustee to exercise its remedies.

3.3 Principal Perfection Provisions

Typical perfection provisions include:

- a requirement on filing financing statements;
- provisions requiring notification and potentially opinions prior to any changes in the name or jurisdiction of the organisation;
- control over securities accounts, deposit accounts and electronic chattel paper;
- delivery or custody of chattel paper, securities and instruments; and
- representations that the secured party has a perfected security interest.

There may also be additional representations relating to the nature and characteristics of the relevant assets. In some instances, the perfection representations relating to chattel paper may also call for the original being marked as pledged to the trustee, to reduce the risk that a third-party acquirer obtains possession without actual knowledge of the prior security interest.

3.4 Principal Covenants

The principal covenants in a securitisation transaction vary, based on the relevant document and the type of securitisation. The covenants will typically address payment obligations, collateral maintenance and perfection obligations, rights and related procedures concerning adding and removing underlying assets, reporting obligations, and various negative covenants intended to maintain the integrity of the securitisation. In addition, there will typically be separate covenants relating to the trustees' obligations to act, and rights not to act, in accordance with instructions.

Enforcement is usually a combination of events of default under the indenture, which gives the noteholders the right to direct the indenture trustee to take enforcement actions, and servicer defaults, which give the specified class or classes of noteholders rights to replace the servicer.

3.5 Principal Servicing Provisions

The servicing provisions generally relate to continued collection and servicing of the relevant asset, and typically include a number of provisions relating to reporting, notice and turnover of collections. In securitisations with revolving periods, during which there is a constant replenishment period, the servicer will also typically be required to ensure compliance with applicable pool criteria and provide relevant reports in connection with any collateral removal, additions or substitutions. In addition, for some securitisations, there will often be certain obligations around the delivery of reports and other relevant information to a back-up servicer. The agreement will also often contain provisions that define the servicing standard and further address the relevant role and any additional obligations of the servicer.

Where the securitisation involves securities within the meaning of the Investment Advisers Act of 1940, as amended ("Advisers Act"), such as CLOs, and it involves more active or discretionary management of the collateral, the agreement would also typically address requirements and prohibitions under the Advisers Act and rules promulgated thereunder. In CLOs, the servicing agreement is typically referred to as a Portfolio Management Agreement, Collateral Management Agreement or Investment Management Agreement (or similar term).

3.6 Principal Defaults

Securitisation transactions often have three types of default provisions:

- early amortisation events that cause accelerated pay-downs of principal, and terminate

reinvestment or revolving periods (temporarily or permanently);
- servicer termination events that give rise to a right to terminate the servicer; and
- events of default that give rise to a right to accelerate the transaction and exercise remedies, including the ability to enforce against collateral (sometimes with collateral sales being subject to additional consent requirements, unless a sale would generate sufficient proceeds to pay the secured notes in full).

Amortisation events typically include:

- shortfalls in reserves or over-collateralisation;
- outstanding amounts exceeding the applicable collateral borrowing value;
- delinquencies or charge-offs in excess of specified thresholds; and
- servicer termination events.

Events of default usually include:

- failure to pay principal or interest due on specified classes of notes after applicable cure periods;
- the trustee failing to have a first-priority perfected security interest in all (or a material portion) of the collateral;
- the issuer becoming a covered fund under the Volcker Rule, required to register under the Investment Company Act, or subject to entity-level taxes and potentially other regulatory events;
- breach of representations or covenants that continue beyond applicable cure periods; and
- the issuer becoming subject to insolvency proceedings.

Servicer defaults or termination events typically include:

- failure, after expiry of the applicable cure periods, to turn over collections when required to do so;
- misrepresentations or breach of covenants;
- insolvency; and
- often, the occurrence of an event of default.

3.7 Principal Indemnities

Principal indemnities cover losses due to a breach by the seller or servicer of their obligations. In addition, it is typical for trustees to be entitled to indemnification under the transaction for any losses and liabilities that may arise other than as a result of their own gross negligence or wilful misconduct and the trustee will also be entitled to indemnification in connection with any directions given by noteholders.

3.8 Bonds/Notes/Securities

The primary documentation setting forth the terms of the asset-backed securities or loans in a securitisation are:

- indentures or note purchase agreements, in the case of bonds or notes;
- trust agreements, in the case of trust certificates and equity tranches; and
- credit agreements, in the case of loans.

These agreements will typically set forth key economic, structural and payment terms, such as maturity, coupon, payment dates, the payment waterfall, and borrowing base definitions and concentration limits, as well as transfer limitations. Indentures, note purchase agreements and credit agreements will also include covenants and defaults applicable to the issuer and securitised pool, and set forth the voting rights

of noteholders. Trust agreements will specify the governance of the issuer.

3.9 Derivatives

Outside synthetic derivatives, the most commonly used derivatives are interest and currency exchange derivatives in various forms used to hedge interest and currency risk. For synthetic securitizations, various forms of credit derivative swaps (CDS) are used to transfer the credit risk of the relevant reference portfolio.

3.10 Offering Memoranda

Public offerings of securities: The Securities Act requires the filing with and approval by the SEC of a registration statement and delivery of a written prospectus to potential investors that satisfies the disclosure requirements discussed under **4.1 Specific Disclosure Laws or Regulations**.

Private placements of securities: While not legally required, market practice (and the internal policy of many arrangers) is to deliver an offering memorandum to potential investors that to the extent practicable seeks to comply with, the disclosure requirements applicable to registered offerings, other than asset-level disclosures. See also **4.2 General Disclosure Laws or Regulations**.

Exceptions: Offering memoranda are not typically prepared in securitisations where the SPE's obligations are in the form of loans, or where the securities are privately placed to a small number of sophisticated investors, typically in conjunction with a more bespoke transaction.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

Securitisation disclosure requirements are in part governed by generally applicable securities laws, and in part by some ABS-specific requirements. The principal laws that govern securities-related disclosures are the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Securities Act is the principal law governing the offer and sale of securities, and the Exchange Act provides the SEC with broad powers to regulate various market participants and prohibit certain types of conduct in the market, and empowers the SEC to require certain periodic reporting.

Following the 2007–08 financial crisis (the "Global Financial Crisis"), the Exchange Act has been amended to require certain additional disclosure requirements that apply to all ABS, including:

- disclosure of the form and determination of retained risk as specified in the risk retention rules;
- reporting of repurchases and replacements of securitised assets in connection with breaches of representations and warranties and of the conclusions and findings of third-party due diligence reports; and
- disclosure requirements for communications with rating agencies, which, among others, require all information provided to hired Nationally Recognized Statistical Ratings Organizations (NRSROs) in relation to the initial credit rating or any ongoing credit surveillance to be posted to a password-protected website, referred to as the 17g-5 website.

Registered ABS offerings are subject to additional disclosure requirements as set forth in Regulation AB, which was significantly revised and updated in 2014 ("Reg AB II") to address a number of perceived shortcomings in prior practices and to enhance investor protection in the ABS market. In particular, Reg AB II includes expanded asset-level disclosure requirements for registered offerings of securities backed by specified asset classes that reflects a significant departure from the pool-level information that historically has been given and that is still the dominant form of disclosure in private placements. The information must be published at least three days prior to bringing a covered securitisation to market.

Reg AB II enables the SEC to extend the asset-level disclosure requirements to 144A private placements and to additional asset classes. However, the SEC has to date not done so, and the Treasury has recommended against such expansion.

Reg AB II introduced new ABS-specific registration statement forms, Forms SF-1 and SF-3, to reflect the additional disclosure requirements and shelf-eligibility requirements under Reg AB II. The required asset-level disclosure must be provided in a standardised format in a tagged XML format and filed on the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

Reg AB II deviates from the typical shelf registration practice of using a base prospectus and a supplemental prospectus, and instead requires the filing of one integrated prospectus.

4.2 General Disclosure Laws or Regulations

The general construct of the Securities Act is that an offer or sale of securities has to be registered unless made pursuant to an available exemption – ie, a private placement. A security that has been issued in a private placement will typically be subject to resale limitations that may restrict the liquidity of the issued securities. However, transactions that comply with Rule 144A and Regulation S permit "qualified institutional buyers" and foreign persons to freely sell to other "qualified institutional buyers" or other foreign persons.

Only a small minority of new ABS issuances are made in SEC registered form. About 90% of the US securitisation market consists of mortgage-backed securities that were issued or guaranteed by Ginnie Mae, Fannie Mae and Freddie Mac, and are expressly exempt from registration pursuant to the relevant congressional act by which such entities were formed. Most of the remaining ABS are issued in private placements, typically in a manner that permits resales in compliance with Rule 144A.

Agency securities and private placements are not subject to ABS-specific disclosure requirements other than the disclosure requirements relating to risk retention, repurchase requests, the third-party due diligence disclosure and rating agency communication requirements. However, such securities offerings generally will look to, and to the extent practicable seek to comply with, the disclosure requirements applicable to registered offerings. However, asset-level disclosures of the level of detail required in Reg AB II offerings are not commonly included in private placements.

4.3 Credit Risk Retention

The Dodd-Frank Act introduced a mandate to the SEC and the bank regulatory agencies to promulgate rules requiring "securitisers" to retain credit risk, which are generally the same but codified in the relevant sections under the Code of Federal Regulations (CFR) for the relevant regulator. For the SEC, the risk retention rules are codified as "Regulation RR" in 12 CFR part 373.

The Risk Retention Rules require a "sponsor" or one of its "majority-owned affiliates" to retain the required risk exposure in one of the prescribed forms under the rules. For most securitisations, risk retention may take any of three standard forms:

- vertical risk retention by holding of at least 5% of each class of "ABS interests" issued;
- horizontal risk retention by holding junior most interests in an amount equal to at least 5% of the "fair value" of all ABS interests issued; and
- "L-shaped" risk retention, by holding a combination vertical and horizontal risk retention that adds up to 5%.

The person required to retain the risk is the "sponsor", defined as a "person who organises and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer", a phrase that is substantially identical to the definition of "sponsor" under Regulation AB.

Notably, the DC Court of Appeals ruled in 2018 that subjecting managers of open-market CLOs to the Risk Retention Rules exceeded the statutory authority under Section 941 of the Dodd–Frank Act and consequently such CLOs are currently not subject to the risk retention requirements.

The Exchange Act allocates enforcement authority for the risk retention rules to the appropriate federal banking agency with respect to any securitiser that is an insured depository institution and the SEC with respect to any other securitiser.

Penalties for Non-compliance

The Federal Deposit Insurance Act (FDIA) provides the bank regulatory agencies with broad enforcement powers against individuals and entities for violation of the applicable banking laws and regulations, including the Risk Retention Rules. As such, the banking agencies may seek cease-and-desist orders requiring cessation and potential corrective actions. The agencies may also impose civil monetary penalties that can range between USD5,000 and USD1 million per day, and it may seek to impose removal and prohibition orders against any "institution-affiliated party" (a potentially broad list of persons), which may remove and potentially bar the person from participating in the business of the relevant banking entity or other specified entities.

The SEC's enforcement authority and remedies for violations of the Risk Retention Rules would be the same as its general enforcement authority against those in violation of securities laws and regulations and their "control persons", including permanent or temporary cease-and-desist orders, fines, withdrawal of registrations and restrictions on acting as officers or directors of SEC-registered companies, and otherwise may strip a person or entity of privileges afforded to registered persons. Any Exchange Act violation could also result in equitable remedies, including the right of rescission. If the violation of the Risk

Retention Rules also amounts to a disclosure violation, there could be separate SEC or private action on that basis, as discussed in **4.2 General Disclosure Laws or Regulations**.

Wilful violations of the Risk Retention Rules may also give rise to federal or state criminal actions.

4.4 Periodic Reporting

The sponsor must file Form 15-G on EDGAR at the end of any quarter in which there has been a repurchase demand made under the transaction documents for breach of representations and warranties. If there have been no such requests, an annual Form 15-G filing must be made attesting to that fact.

Issuers of securities offered and sold in a registered offering, and issuers with assets in excess of USD10 million at fiscal year end and a class of securities (other than exempted securities) held by more than 2,000 persons (or more than 500 persons that are not accredited investors) may be subject to additional reporting requirements, including:

- annual reports on Form 10-K (with certain ABS-specific modifications specified in Reg AB II);
- current events on Form 8-K; and
- Issuer Distribution Reports on Form 10-D.

Given that privately placed ABS are not likely to be so widely held that these requirements are triggered, they will, as a practical matter, only apply to securities sold in a registered offering.

Broker-dealers may be restricted from providing price quotations for private debt securities by virtue of Rule 15c2-11 unless certain periodic information and information about the issuer and the offering is made available to the public in a manner that complies with the SEC's no-action letter issued on 30 November 2022. That letter postpones the requirement to comply with the rule until 4 January 2025 subject to satisfying certain requirements with respect to the issuer or the securities. As such, broker-dealers can continue to provide quotations for ABS offered under Rule 144A if they reasonably believe that the issuer will provide the information specified in Rule 144(d)(4) upon request. Such information would normally be "a very brief statement of the nature of the business of the issuer and the products and services it offers; and the issuer's most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available)." However, in the Rule 144A adopting release, the SEC noted with respect to asset-backed securities that: "Instead of the financial statements and other information required about issuers of more traditional structure, the Commission would interpret the information requirement to mandate provision of basic, material information concerning the structure of the securities and distributions thereon, the nature, performance and servicing of the assets supporting the structures, and any credit enhancement mechanism associated with the structure."

4.5 Activities of Rating Agencies

Registered rating agencies, referred to as NRSROs, are regulated by the SEC. Sections 15E and 17 of the Exchange Act and the rules promulgated thereunder establish a detailed set of records that must be created and disclosed to the SEC, and mandate that some of this information must be made publicly available free of charge, including the assigned credit rating and any subsequent upgrade or downgrade.

An NRSRO must:

- post specific portions of its Form NRSRO registration on its website;
- maintain certain records, including in relation to its control structure, for three years;
- furnish certain financial reports, including audited financial statements and an annual certification, to the SEC;
- maintain and enforce written policies and procedures to prevent misuse of material non-public information and to address conflicts of interest; and
- abstain from engaging in certain abusive or anti-competitive conduct.

Exchange Act Rule 17g-5 divides conflicts of interest into two categories:

- conflicts that must be disclosed and managed by the NRSRO; and
- prohibited conflicts.

As part of the conflict rules in 17g-5, an NRSRO is required to obtain a representation from the issuer, sponsor or underwriter of an asset-backed security that it will post on a real-time basis information any of them provides to any hired NRSRO in connection with the initial credit rating or subsequent credit surveillance to a password-protected website. The purpose is to allow NRSROs that have not been hired to have access to the same information in real time that is provided to the hired NRSROs.

Rule 17g-7 provides further transparency by requiring the NRSRO to prepare and disclose a comparison of the asset-level representations, warranties and enforcement mechanisms available to investors that were disclosed in the offering document for the relevant ABS and how they differ from the corresponding provisions in other, similar, securitisations.

The SEC has the power to enforce its rules. Penalties for violating the rules can include suspension or revocation of an NRSRO's registration if the SEC makes a finding under certain specified sections of the Exchange Act that the NRSRO violated the conflicts-of-interest rule and the violation affected a credit rating.

4.6 Treatment of Securitisation in Financial Entities

Banks

The US bank regulators have generally implemented the Basel III capital and liquidity rules but with some important distinctions. The US bank capital rules distinguish between "traditional" and "synthetic" securitisations, each with different operational requirements.

The Basel III definition of securitisation is tied to a tranched exposure to a "pool" of underlying exposures. The corresponding rules as implemented in the USA also refer to tranched credit risk, but do not include the pool requirement.

The minimum risk weight that will be given to a securitisation exposure is 20%. Re-securitisations are subject to separate risk weight calculations.

The USA also does not include ABS among high-quality liquid assets (HQLA) in which a bank may invest to cover for its projected net cash outflows over a 30-day period (in the case of the liquidity coverage ratio).

In July 2023, US banking regulators released their proposal for implementing Basel III "Endgame" risk-based capital requirements in the US ("US B3E"). US B3E includes important changes

to the calculation of credit risk weights for securitization exposures, as well as a new operational risk capital charge on certain fees and commissions. These changes would often require banks investing beyond the senior most securitization tranche to hold significantly more regulatory capital for securitised assets than what is required under the current Basel III rules or in other Basel III "Endgame" proposals made by banking regulators in other developed economies. US market participants are concerned that the implementation of US B3E would reduce the ability of banks to participate in the loan securitisation market or to make markets in securitisation bonds. On the other hand, US B3E continues the favorable capital treatment of senior-most securitisation exposures while otherwise increasing the capital requirements for many other bank exposures, thereby incentivizing increased use of securitisation structures.

Insurance Companies

Insurance companies' capital requirements are subject to state regulation. The National Association of Insurance Commissioners (NAIC) has adopted a risk-based capital (RBC) methodology intended to be a minimum regulatory capital standard based on the insurance company's risk profile and is one of the tools that give regulators legal authority to take control of an insurance company.

The specific RBC formula varies depending on the primary insurance type and focus on asset risk, underwriting risk and other risk. The formulae are focused on capturing the material risks that are common for the particular insurance lines of business.

The NAIC has its own credit rating scale that largely ties to ratings from NRSROs, except for an alternative methodology applied to non-agency RMBSs and CMBSs. As such, the mapping of ABS assets to an NAIC rating will often dictate the attractiveness of a particular asset-backed security for an insurance company.

4.7 Use of Derivatives

Title VII of the Dodd-Frank Act

Title VII of the Dodd-Frank Act establishes a comprehensive regulatory framework for OTC derivatives to address a number of aspects of OTC derivatives that were identified as causing vulnerabilities in the financial system; in particular, the complexity, lack of transparency and interconnectivity of the OTC market and the lack of consistent margin requirements. This framework is built around the principles of:

- requiring clearing of standardised OTC derivatives through regulated central counterparties;
- requiring trading of standardised transactions to occur on exchanges or electronic trading platforms when appropriate;
- increasing transparency through regular data reporting; and
- imposing higher capital requirements on non-exchange-traded OTC derivatives.

In addition, Title VII imposes registration, oversight and business conduct standards for dealers and large participants in the derivatives market.

Regulatory Authorities

The regulatory authority is primarily divided between the Commodity Futures Trading Commission (CFTC) and the SEC, with the US banking regulators setting capital and margin requirements for banks. The CFTC has authority over most OTC derivatives, referred to as "swaps" in the Commodity Exchange Act (CEA), whereas the SEC has authority over OTC derivatives

that fall within the Exchange Act definition of "security-based swaps", which covers derivatives linked to single-name loans or securities, narrow-based indexes of loans or securities, events relating to such loans or securities, or their issuers. The Dodd-Frank Act had the effect of causing swaps to be included in the definition of "commodity pool" under the CEA and under the definition of "security" for the purposes of the Securities Act and the Exchange Act.

The industry has been focused on obtaining permanent relief against those aspects of the new regulations that are particularly burdensome for securitisation SPEs.

For example, the CFTC has issued no-action letters exempting certain securitisation entities, which are operated consistent with SEC Regulation AB or Investment Company Act Rule 3a-7, from the definition of commodity pool. To be eligible for the relief provided under these no-action letters, the securitisation issuer must:

- hold primarily self-liquidating assets;
- make payments based on cash flows and not based on changes in the issuer's assets;
- not acquire or sell assets primarily for the purpose of realising market gains or minimising market losses; and
- only hold derivatives for uses permitted under Regulation AB, such as credit enhancement and to alter the payment characteristics of the cash flow.

The CFTC has also issued various interpretations that allow certain securitisation SPEs that are wholly owned subsidiaries of non-financial entities to avail themselves of certain exceptions from otherwise applicable clearing and margin requirements available to non-financial end users.

It is also worth noting that the non-recourse language typically included in agreements with SPEs, including derivative agreements, would cause such derivatives to fall outside the standard terms for derivatives that are currently centrally cleared and traded, although that may change should swaps with such terms be included as part of a traded standard.

Finally, in November 2023, the SEC finalised Securities Act Rule 192, intended to address conflicts of interest inherent in synthetic securitisations. Under Rule 192, a "securitization participant" (ie, underwriters, placement agents, initial purchasers or sponsors of asset-backed securities (including synthetic ABS) and certain of their subsidiaries and affiliates) may not directly or indirectly, before a year has passed after the closing of the sale of the relevant ABS, engage in any transaction that would involve or result in any "material conflict of interest" (as defined by the SEC) between the securitisation participant and an investor in such ABS. A material conflict of interest occurs if the securitisation participant engages in a "conflicted transaction" for which "there is a substantial likelihood that a reasonable investor would consider the transaction important to the investor's investment decision, including a decision whether to retain the ABS". Rule 192 provides for a number of exceptions, including for certain risk-mitigating hedging activities, liquidity commitments, and bona fide market-making activities. Compliance is required for any ABS offering closing 18 months or more after the rule's publication.

Enforcement and Penalties for Non-compliance

Violations of rules pertaining to security-based swaps promulgated by the SEC will be subject to similar enforcement and penalties as other violations of securities laws, as discussed in **4.2**

General Disclosure Laws or Regulations. Violations of the "swaps" rules promulgated by the CFTC will be subject to enforcement and penalties by the CFTC. Furthermore, the CFTC's authority to penalise manipulation and fraud is similar to the SEC's authority under Section 10(b) of the Exchange Act.

In addition, the CFTC has anti-avoidance authority to treat transactions that are wilfully structured to evade the requirements of the Dodd–Frank Act as swaps transactions, and to bring enforcement actions where such transactions fail to satisfy applicable criteria. Furthermore, the Attorneys General of the various US states and territories also have authority to bring enforcement actions under Section 13a-2 of the CEA where their citizens are adversely affected. The penalties range from injunction or restraining orders, to writs or orders mandating compliance, to fines. The CFTC can also impose equitable remedies, including restitution and disgorgement of gains. Wilful violations and abuse of the end-user clearing exception are felonies punishable by a fine of up to USD1 million or imprisonment for up to ten years, or both, together with the cost of prosecution (see CEA Section 13).

4.8 Investor Protection

The primary investor protections follow from the general and specific securities laws described in this chapter. As noted in **4.7 Use of Derivatives**, transactions that violate the securities laws may be voidable and may give rise to both private and public enforcement.

4.9 Banks Securitising Financial Assets

Banks are highly regulated entities and are also subject to a separate insolvency regime compared to other entities. They are therefore not eligible for bankruptcy protection. The comprehensive regulation applicable to banks results in a parallel regulatory structure in the context of banks sponsoring securitisations that will apply to certain aspects of a securitisation transaction by banks. The most relevant of the securitisation-specific rules are:

- the safe harbour provisions of 12 CFR 360.6 relating to transfer of assets in connection with a securitisation, which are discussed in **6.1 Insolvency Laws**;
- the Basel III capital requirements and US B3E proposal discussed in **4.6 Treatment of Securitisation in Financial Entities**; and
- the Volcker Rule discussed in **4.11 Activities Avoided by SPEs or Other Securitisation Entities**.

The banks are also subject to risk retention, but the rules are the same as those applicable to non-banking entities. General banking rules may also come into play when structuring a bank-sponsored securitisation, such as restrictions on affiliate transactions set forth in Sections 23A and 23B of the Federal Reserve Act and the implementation thereof set forth in Regulation W.

4.10 SPEs or Other Entities

Organisational Forms of SPEs Used in Securitisations

SPEs used in securitisations can theoretically take almost any organisational form, including an LLC, a corporation, a trust or a partnership. However, as a practical matter, SPEs organised in the USA overwhelmingly tend to be organised as an LLC or a statutory trust. For certain asset classes it is also typical to use securitisation SPEs organised as foreign corporations in a jurisdiction that does not impose entity-level tax on such corporations. The rules governing such entities will be a combination of:

- the relevant laws relating to the relevant form of organisation in its jurisdiction of formation;
- the applicable tax laws; and
- bankruptcy or other applicable insolvency laws.

Factors in Choosing an Entity

The primary factors driving the type and jurisdiction of the securitisation entity will be bankruptcy remoteness and tax. Other important factors include market practice and acceptance. As outlined earlier, common law trusts are disfavoured compared to statutory entities for bankruptcy-remoteness purposes in light of the separate existence afforded to such statutory trusts. US domestic corporations are generally disfavoured, in part because of the entity-level tax applicable to corporations and in part because of the mandatory fiduciary duty that directors have to the shareholders, which can cause difficulties in de-linking the SPE from its parent.

Delaware statutory trusts (DSTs) and Delaware limited liability companies (DLLCs) are often the entities of choice for securitisations. Delaware is viewed as a favourable jurisdiction for forming business entities. Delaware has up-to-date business entity laws that provide for efficient and quick formation, a sophisticated judiciary and a significant volume of decisions that together provide additional certainty and acceptance.

4.11 Activities Avoided by SPEs or Other Securitisation Entities

Investment Company Act

As a point of departure, any entity of which more than 40% of its relevant assets (ie, excluding cash or US Treasuries) consists of securities within the meaning of the Investment Company Act (a broad term that includes loans) may have to register as an investment company in the absence of an available exemption. Registered investment companies are subject to leverage and capital structure requirements that are incompatible with a securitisation.

The exemptions most commonly used for securitisations are Rule 3a-7, Section 3(c)(5) and Section 3(c)(7).

Rule 3a-7 is available for entities holding primarily self-liquidating assets that are only sold or purchased in accordance with the terms of the transaction, and not for the purpose of capturing market gains or avoiding market losses. The securitisation must also satisfy some additional requirements, including having a trustee with certain minimum qualifications holding either title or a security interest in the assets, and investors in securities that are either below investment grade or not fixed-income securities must satisfy certain qualification requirements.

The Section 3(c)(5) exemption is available for issuers securitising accounts receivable; loans to manufacturers, wholesalers, retailers or purchasers of specified merchandise, insurance or services; as well as for mortgages and other liens on and interests in real estate, as long as a holder of any such issuer's securities does not have the right to require early redemption of such securities.

Section 3(c)(7) provides a general registration exemption for issuers that do not publicly offer their securities, and it limits their investors to "qualified purchasers". The Volcker Rule discussed below has made it less attractive for securitisation SPEs to rely on Section 3(c)(7), although the exemption is still relied on by actively managed CLOs.

The Volcker Rule

The Volcker Rule prohibits banks from holding an "ownership interest" in, or sponsoring entities that are, "covered funds" for purposes of the Volcker Rule. Ownership interest is a broad term that captures, among others, any security with equity-like returns or voting rights (including the right to replace the investment manager, which is typically a right of the senior-most class of investors in the event of such manager's default). Consequently, in order to be attractive to banks, securitisation entities tended to avoid becoming a "covered fund" under the Volcker Rule. This may change based on amendments to the rule (effective since 1 October 2020), which clarify that a right to remove an investment manager for "cause" (as defined in the rule) is not an ownership interest.

The covered fund definition only captures entities that would have to register under the Investment Company Act, but for the exemption set forth in Section 3(c)(7) or 3(c)(1), or that are commodity pools for which the commodity pool operator has claimed an exemption from registration and record-keeping requirements pursuant to Section 4.7 of the CEA, or that are "substantially similar" commodity pools. Consequently, the traditional means of addressing the Volcker Rule have been to avoid relying on any of these exemptions. If that strategy is not available, there are a number of potential exclusions from the covered fund definition in the Volcker Rule itself, of which the "loan securitisation" exemption is most important in the securitisation context.

While "loans" is a broad term for the purposes of that exclusion, there are significant limitations on an SPE's ability to hold derivatives (other than for the purposes of hedging interest and currency risk) and securities (other than for certain short-term cash-management purposes). However, the recent October amendments to the Volcker Rule allow for a small bond basket, thereby removing one of the restrictions that have prevented CLO managers from engaging in a bond/loan arbitrage that was popular prior to the promulgation of the Volcker Rule.

4.12 Participation of Government-Sponsored Entities

Ginnie Mae, Fannie Mae and Freddie Mac are the principal agencies and GSEs engaged in the securitisation of mortgages. Ginnie Mae does not itself issue MBSs, but instead provides a guarantee, backed by the full faith and credit of the US government, of securitisations by participating institutions of government-insured mortgages.

Fannie Mae and Freddie Mac are GSEs chartered by Congress for the purpose of providing a stable source of liquidity for the purchase and refinancing of homes and multi-family rental housing. These GSEs purchase loans that satisfy their origination criteria and issue securities backed by pools of such loans that are guaranteed by the relevant GSE. In addition, the GSEs issue some risk transfer securitisations that are not guaranteed.

The GSEs traditionally used separate, but similar, platforms to issue their pass-through securities. Starting on 3 June 2019, they have transitioned to a single security and single securitisation platform initiative referred to as Uniform Mortgage-Backed Securities (UMBS). The agency securitisation model and the related guarantees allow investors to focus primarily on the payment characteristics of the underlying pools of mortgages rather than the credit risk. In turn, this has allowed for the emergence of a highly liquid "to-be-arranged (TBA) market", where pools of

MBSs are deemed to be fungible, and traded, on the basis of a few basic characteristics, such as the issuer, amortisation type (eg, 30 years or 15 years), the coupon rate, the settlement date and the maximum number of mortgage securities per basket.

There is a liquid TBA market for settlement up to three months after the trade date. The actual information about the pool only needs to be provided two business days prior to settlement. As such, the TBA market permits lenders to lock in rates for mortgages before they are originated, which, in turn, allows borrowers access to lower, locked-in rates.

Agency securitisations represent by far the biggest part of the securitisation market.

4.13 Entities Investing in Securitisation

Investors in securitisations include banks, asset managers, insurance companies, pension funds, mutual funds, hedge funds and high net worth investors. A detailed description of the regulatory and other investment drivers for each of these diverse investor classes is beyond the scope of this summary; however, a few points that affect the structuring and offering of ABS are worth noting.

Banks

The Basel III capital rules penalise banks that invest below the most senior position in a securitisation, thereby impacting banks' willingness to invest in mezzanine tranches and below. Banks that are primarily constrained by the leverage ratio, as compared to the risk-weighted assets (RWA) ratio, will also typically view highly rated, but lower-yielding, senior securities as less attractive investments, whereas insurance companies and banks that are primarily constrained by the RWA requirements may find the highly rated senior tranche highly attractive due to the small amount of regulatory capital required. Furthermore, FDIC-insured banks may face higher insurance premiums for taking on exposures in securitisations collateralised predominantly by sub-prime and other high-risk assets, which reduces the attractiveness of such securitisations.

Insurance Companies

Insurance companies' capital rules are typically more closely tied to ratings. In addition, insurance regulations typically specify concentration limits for various categories of investments. Insurance companies are also often focused on obtaining longer-duration assets. The flexibility to structure securitisations to such needs often makes securitisations particularly attractive to insurance companies.

4.14 Other Principal Laws and Regulations

The principal laws and regulations are all mentioned in **1.3 Applicable Laws and Regulations**.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are permitted. The Dodd-Frank Act added a new Section 27B to the Securities Act intended to address certain conflicts of interest. In November 2023, the SEC adopted Rule 192, which implements this provision. Rule 192 creates significant hurdles for synthetic securitisations that are not for the purpose of risk-mitigating hedging activities (see **4.7 Use of Derivatives**).

Regulation

The SEC regulates the offer and sale of securities issued by a synthetic securitisation and the issuer's Investment Company Act exemptions are the same as in a traditional securitisation. The derivatives underlying such securitisation are regulated by the SEC if they reference a single security, a single loan or a narrow-based security index and by the CFTC if they are deemed to be swaps (in which case the SPE may also be a commodity pool).

Principal Laws and Regulations

The offering of securities in a synthetic securitisation is governed by the Securities Act. The SEC has generally indicated that CDSs, the most common type of derivative used in synthetic securitisations, are not self-liquidating financial assets. Consequently, one may conclude that the payments to the holders of the issued securities do not depend primarily on the cash flow from self-liquidating assets, in which case the issued securities fall outside the "asset-backed security" definition in the Exchange Act. This means that risk retention and certain other rules applicable to asset-backed securities would not apply. The nature of the CDS may also impact the Investment Company Act analysis for the issuer.

As noted in **4.7 Use of Derivatives**, both the SEC and the CFTC have comprehensive regulations around entering into derivatives, and such instruments may be subject to clearing, settlement and margin requirements specified in the securities acts and the Commodities Exchange Act.

A primary motivator for synthetic securitisations is regulatory capital relief, and whether a transaction achieves that result hinges, in part, on whether it satisfies the "synthetic securitisation" criteria under the applicable bank capital rules. The Board of Governors of the Federal Reserve System (the "Board") also recently provided guidance (in a response to frequently asked questions under Regulation Q) that direct-issue credit-linked notes may satisfy those requirements.

Principal Structures

In its simplest form, a synthetic securitisation will invest the proceeds from issuing securities in permitted investments and sell CDS protection on a particular financial asset. The issuer will receive cash flows from the permitted investments and the CDS protection premiums. If a credit event occurs under a CDS, then the SPE will fund its payment obligation with proceeds from the permitted investments. As noted above, the Board may also accept direct issue credit-linked notes (ie, which do not utilise an intermediate SPE or CDS) as a form of synthetic securitisation for the purposes of providing regulatory capital relief.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

If a debtor becomes subject to bankruptcy proceedings, creditors will, with some exceptions, be automatically stayed from collecting and enforcing against the debtor and any posted collateral. Lifting the stay may be time-consuming and costly, and subject to the broad statutory and equitable powers of the bankruptcy court. The court also has the power to:

- release the creditors' rights to excess collateral;
- allow additional debt to be secured by the collateral;

- substitute collateral; and
- reject executory contracts.

Creditors may also be restricted from exercising rights that are triggered by a debtor's bankruptcy or financial condition (so-called ipso facto clauses). Unlike many other jurisdictions where bankruptcy effectively amounts to liquidation proceedings, bankruptcy proceedings in the USA also encompass a workout regime (Chapter 11 bankruptcy). Workouts are highly variable, and specific to facts and circumstances, which makes it difficult to predict the duration of the stay and the impact on a particular creditor.

Consequently, a key aspect of securitisations is to isolate the issuer and its assets from such bankruptcy risks by:

- transferring the securitised assets to the issuer in a perfected true sale;
- reducing the risk of the issuer becoming subject to involuntary or voluntary bankruptcy proceedings; and
- reducing the risk of the issuer becoming substantively consolidated with any affiliates, should they become subject to bankruptcy proceedings.

As an alternative to a true sale structure, it is also possible to transfer exposure to the securitised assets using contracts that are protected against the most troublesome bankruptcy powers.

6.2 SPEs

Establishing a bankruptcy-remote SPE is a key aspect of a typical securitisation transaction.

The transaction documents typically include non-petition clauses that restrict involuntary bankruptcy filings against the SPE.

However, an outright prohibition against the SPE itself voluntarily filing for bankruptcy is unenforceable as being against public policy, and such risk must therefore be mitigated by more indirect means. Limiting the SPE's unrelated activities and restricting the SPE from having employees and unrelated property reduces the risk of unrelated liabilities. Appointing an independent director whose fiduciary duty runs to the SPE and not to its shareholders, and employing an entity type that allows for such redirection of fiduciary duties, reduces the risk of a filing for the benefit of its shareholders.

The independent director(s) also provide(s) important protection against dissolution of the SPE, in part by requiring such a director's participation in a dissolution decision, and in part by providing that such independent director becomes a "springing member" or "springing partner" if the absence of a member or partner would cause dissolution. The number of independent directors should at least be equal to the minimum number of members or partners required to continue the SPE's existence.

Substantive consolidation is an equitable doctrine that permits a bankruptcy court to disregard the separateness of an entity that is not itself in bankruptcy and that provides an alternative pathway for an SPE to become entangled in its affiliate's bankruptcy proceedings. Although the analysis differs somewhat between various US circuits, in general, a bankruptcy court may order substantive consolidation where the separateness of the entities has not been sufficiently respected or where the affairs of the debtor entities are so entangled that unscrambling them will be prohibitive and will hurt all creditors.

Multi-factor Analysis

Under older practice, which still applies in some circuits, the courts may rely on a multi-factor analysis. Consequently, the risk of substantive consolidation is generally addressed by requiring the SPE and its credit to be separate from its affiliates based on factors that speak for substantive consolidation identified in the case law. One list of such factors is collected in the Tenth Circuit opinion of Fish v East, 114 F2d 117 (10th Circuit 1940), as follows:

- the parent corporation owns all or a majority of the capital stock of the subsidiary;
- the parent and subsidiary corporations have common directors or officers;
- the parent corporation finances the subsidiary;
- the parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation;
- the subsidiary had grossly inadequate capital;
- the parent corporation pays the salaries or expenses or losses of the subsidiary;
- the subsidiary has substantially no business except with the parent corporation, or no assets except those conveyed to it by the parent corporation;
- in the papers of the parent corporation and in the statements of its officers, the subsidiary is referred to as such or as a department or division;
- the directors or executives of the subsidiary do not act independently in the interest of the subsidiary, but take direction from the parent corporation; and
- the formal legal requirements of the subsidiary as a separate and independent corporation are not observed.

A second commonly cited list of such factors appears in the case of in re Vecco Constr Indus 4 BR 407, 410 (Bankr ED Va 1980), as follows:

- the degree of difficulty in segregating and ascertaining individual assets and liabilities;
- the presence or absence of consolidated financial statements;
- the profitability of consolidation at a single physical location;
- the commingling of assets and business functions;
- the unity of interests and ownership between the various corporate entities;
- the existence of parent or intercorporate guarantees or loans; and
- the transfer of assets without formal observance of corporate formalities.

An additional factor, articulated by the Fourth Circuit Court of Appeals in Stone v Eacho, 127 F2d 284, 288 (4th Circuit 1942), has also been cited by a number of cases, namely whether "by... ignoring the separate corporate entity of the [subsidiaries] and consolidating the proceedings... with those of the parent corporation... all the creditors receive that equality of treatment which it is the purpose of the bankruptcy act to afford".

The presence or absence of some or all of these factors does not necessarily result in substantive consolidation. In fact, many of these elements are present in most bankruptcy cases involving holding company structures or affiliated companies, without thereby leading to substantive consolidation. Various courts have noted that some factors may be more important than others; in particular, the "consolidation of financial statements", "difficulty of separating assets", "commingling of assets" and "profitability to all creditors".

6.3 Transfer of Financial Assets

For a sale of financial assets to be valid and enforceable against third parties, it has to "attach" and be "perfected", similar to what applies to a security interest in collateral. The rights of a purchaser of such assets attach if:

- "value" has been given;
- the transferor has rights in the relevant asset, or the right to grant rights in the relevant asset; and
- there is a signed agreement that reasonably identifies the relevant rights and assets.

Although it is possible for a security interest to attach in some circumstances without a written agreement, it is not practicable to rely on those circumstances always being present in a securitisation transaction.

The available mode of perfection differs, based on the type of asset and type of transfer. Broadly speaking, perfection can be:

- automatic;
- by control (or possession); or
- by the filing of a UCC statement.

The general means of perfecting a security interest in financial assets other than a deposit account is by filing a UCC financing statement in the applicable filing office. A security interest in deposit accounts can only be perfected by control. The perfection of a security interest in a financial asset automatically also perfects a security interest in related supporting rights, such as collateral or letter of credit rights. A security interest perfected by control or possession often has higher priority than a security perfected by other means. Nevertheless, since filing a UCC financing statement is easy and cheap, and provides perfection regardless of whether the transfer is respected as a sale or whether it is characterised as a loan, such filing is typically the primary means of perfection.

True Sale v Secured Loan

If the transfer of an asset is respected as a sale, then such asset will cease to belong to the seller and therefore the buyer's rights in such asset will typically not be affected by a subsequent bankruptcy of the seller. On the other hand, if such transfer is treated only as a granting of a security interest in collateral, then bankruptcy of the seller will subject the buyer's rights with respect to such assets to the automatic stay and other bankruptcy powers. In determining whether a transfer is a true sale or a disguised loan, courts look to a number of factors. Not surprisingly, the more numerous the secured loan characteristics, the greater the likelihood that the transaction is viewed as such. Conversely, the more numerous the sale characteristics, the greater the likelihood that a purported sale will be respected as such. However, not all factors are given equal weight in this analysis.

Key factors include:

- the parties' intent, though courts typically deemphasise the language used in a document and instead consider the intent reflected by the economic substance and actual conduct;
- recourse and collection risk, which generally is the most important factor;
- the transferor's retention of rights to redeem the transferred property or to receive any surplus from the asset; and
- the transferor's continued administration and control of the assets, particularly if the obligor is not notified of the sale (however, under current market practice, transferors often act as servicer of the sold assets and such continued involvement is generally not viewed

as dispositive of the loan or sale characterisation).

The courts have also identified a variety of other factors that do not fall within the categories above but may be indicative of a secured loan, including:

- the transferor being a debtor of the transferee on or before the purchase date;
- the transferor's ability to extinguish the transferee's rights in the transferred assets by payments or repurchase by the transferor or from sources other than collections on the asset; and
- the transferor's obligation to pay the transferee's collection costs for delinquent or uncollectible financial assets.

Some states have sought to bolster securitisations by restricting recharacterisation of a purported sale transaction. However, there is significant uncertainty around a bankruptcy court's acceptance of such statutes, and securitisations are therefore typically structured to comply with the judicially created true sale criteria.

It is common to obtain a true sale opinion in securitisation transactions that evaluates the relevant facts in light of the factors outlined above. Generally, the opinion will describe the salient facts and analyse these facts in light of the factors identified by the courts as relevant to the true sale determination. The opinion will usually identify these key factors and draw a conclusion based on the overall analysis and reasoning in the opinion letter.

6.4 Construction of Bankruptcy-Remote Transactions

Most derivatives, certain mortgage repurchase transactions and many securities contracts are protected against the automatic stay and some of the most troublesome bankruptcy powers. These types of contracts can therefore be used as a means of transferring exposure to the assets underlying a securitisation as an alternative to a true sale. Synthetic securitisations typically use credit default swaps (CDSs) to transfer such exposure. If the CDS counterparty becomes subject to bankruptcy proceedings, the SPE will nevertheless have the right to terminate and close out each swap entered into with that counterparty, and realise against any collateral or other credit support relating to such swap, without being subject to the stay or the prohibition against ipso facto clauses.

It is, however, not common to obtain a bankruptcy opinion for such protected contracts.

6.5 Bankruptcy-Remote SPE

The organisational documents of the SPE and other transaction documents will typically include a provision limiting recourse solely to the SPE's assets and a non-petition covenant that restrict involuntary bankruptcy filings against the SPE, subject to applicable law. Additionally, the transaction documents will also typically include other protections such as the appointment of independent directors whose fiduciary duties run to creditors and whose consent is required for a bankruptcy filing. See **6.2 SPEs**.

7. Tax Laws and Issues

7.1 Transfer Taxes

In the USA, taxes can theoretically be assessed at federal, state and local level. There is no federal value added tax, sales tax or stamp tax on the transfer of financial assets to a securitisation SPE, but in some cases the transfer of loans or leases accompanied by transfers of the underly-

ing assets securing such loans or leases could trigger certain state or local sales tax.

The sale of loans and other receivables can also trigger certain gains or losses, generally depending on whether the SPE is part of the same tax-consolidated group as the transferor, and may, depending on applicable law and the characterisation of the transfer, also have consequences for the transferor's continued ability to deduct losses from bad loans.

Many of these issues are addressed as part of the structuring of the SPE. For example, a single-member LLC is, for federal tax purposes, disregarded (in the absence of the SPE electing any contrary tax treatment) and therefore any transfer of assets from a parent to its wholly owned LLC will not be a taxable event. An SPE that is organised as a partnership or an LLC that has elected to be treated as a partnership for tax purposes would not be subject to entity-level tax, but transfers to a securitisation SPE that is treated as a partnership for tax purposes may have different tax consequences than transfers to a disregarded entity and, as such, it is possible to structure the SPE (and use a multi-SPE structure) so as to optimise the securitisation for the desired tax neutrality.

From an investor's perspective, if an SPE is treated as a partnership for tax purposes, and the notes issued by the SPE to such investor were to be treated as equity for tax purposes, then the noteholder would be taxed individually on its share of the SPE's income, gain, loss, deductions and credits attributable to the SPE's ownership of the assets and liabilities of the SPE, without regard to whether there were actual distributions of that income. This, in turn, could affect the amount, timing, character and source of items of income and deductions of the noteholder, compared to what would be the case if the notes were respected as debt for tax purposes.

7.2 Taxes on Profit

An SPE that is subject to entity-level tax, such as a corporation or a partnership that is taxed as a corporation, will potentially incur tax liability for any gains resulting from the sale of financial assets and any income otherwise paid with respect to the financial assets in excess of deductible expenses.

Consequently, the SPE is usually structured to avoid entity-level taxation. For example, this can be done by using a tax-transparent organisational form or by incorporating the SPE in a jurisdiction that does not impose such taxes. SPEs established as single-member LLCs or Delaware statutory trusts can be readily structured to avoid entity-level tax. Partnerships and entities treated as partnerships are also generally treated as pass-through entities for tax purposes, depending on the number of partners, the trading activities in any equity (or securities deemed to be equity for tax purposes) in such partnerships and the availability of relevant safe harbours.

A partnership that is deemed to be a publicly traded partnership for US tax purposes could be subject to entity-level tax as if it were a corporation. Applicable tax laws may also cause debt instruments to be characterised as equity interests for purposes of that determination. As such, it is typical to obtain the opinion of counsel relating to the treatment of the notes issued by the SPE as debt for tax purposes and, depending on the activities of the SPE and the level of comfort provided under such opinions, to include additional transfer restrictions on instruments that

are, or could be, equity for tax purposes so as to avoid the SPE becoming taxed as a corporation.

7.3 Withholding Taxes

Payments based on US-source income to foreign individuals and corporations are potentially subject to withholding tax. Interest paid or accrued by a typical securitisation SPE to a foreign person will – subject to the satisfaction of certain requirements relating to the investor's US activities and the investor's equity, or control relationship with the SPE and related persons – usually be exempt from withholding tax by virtue of falling within the "portfolio interest" exemption from withholding. In circumstances where that exemption does not apply, the withholding tax could still be reduced or eliminated by virtue of applicable income tax treaties.

In addition, the Foreign Account Tax Compliance Act (FATCA) imposes a withholding tax on certain payments (including interest in respect of debt instruments issued by a securitisation SPE and gross proceeds from the sale, exchange or other disposition of such debt instruments) made to a foreign entity if the entity fails to satisfy certain disclosure and reporting rules. FATCA generally requires that:

- in the case of a foreign financial institution (defined broadly to include a hedge fund, a private equity fund, a mutual fund, a securitisation vehicle or other investment vehicle), the entity must identify and provide information in respect of financial accounts with such entity held directly or indirectly by US persons and US-owned foreign entities; and
- in the case of a non-financial foreign entity, the entity must identify and provide information in respect of substantial US owners of such entity.

Foreign entities located in jurisdictions that have entered into intergovernmental agreements with the USA in connection with FATCA may be subject to special rules or requirements.

7.4 Other Taxes

Another tax issue that arises in connection with the use of foreign SPE issuers that are treated as corporations for US federal tax purposes is whether the SPE is engaged in a US trade or business for US federal income tax purposes. If a foreign securitisation issuer were to be engaged in US trade or business for US federal income tax purposes, it would become subject to US federal income tax and potentially, also subject to state and local income tax. To avoid this outcome, foreign securitisation issuers tend to conduct their activities in accordance with detailed guidelines that aim to ensure that they are not engaged in loan origination or otherwise treated as conducting a lending or other financial business in the USA.

7.5 Obtaining Legal Opinions

In a securitisation transaction it is common for tax counsel to provide an opinion addressing the tax treatment of the issued securities; in particular, whether the offered notes would be treated as debt securities for US federal income tax purposes. The level of comfort is reflected in terms such as "will", "should" and "more likely than not", where "will" is the highest level of comfort and "should" still provides a high level of confidence but with a more than insignificant risk of a different conclusion. It is also common as part of the closing opinions for a securitisation to include an opinion that the securitisation entity would not be taxed as a corporation for federal tax purposes. The latter opinion is frequently also required in the case of certain amendments to the corporate documents.

In the case of foreign SPEs that are treated as corporations for US income tax purposes and that rely on not being taxed in the USA, there are various sensitive activities that could give rise to adverse tax treatment. Because of the significant consequences to the securitisation transaction, the rating agencies tend to require an opinion to the effect that the SPE's activities would not amount to it engaging in a US trade or business.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

The intersection of legal and accounting requirements often plays a significant role in structuring a securitisation transaction. For example, whether, and with whom, to consolidate a securitisation SPE can be a complex analysis that hinges on identifying who controls the aspects of the SPE that most significantly impact the SPE's performance. This analysis will typically focus on the entities that have the ability to direct the SPE's activities (and may also look at activities that took place prior to the relevant transaction). While that analysis is not a legal analysis per se, it will involve a review of the various contractual rights existing in the transaction documents.

As such, an awareness of the types of features that drive the consolidation analysis is often important in structuring the SPE and drafting the relevant transaction documents.

Legal and accounting criteria also come together as part of the true sale analysis. One of the requirements for achieving sale accounting for financial assets under US Generally Accepted Accounting Principles (GAAP) is that the transferred financial assets have been isolated from the transferor even in bankruptcy or other receivership, and a part of that analysis looks to the legal true sale analysis.

8.2 Dealing with Legal Issues

Under the GAAP accounting rules, "a true sale opinion from an attorney is often required to support a conclusion that transferred financial assets are isolated from the transferor and its consolidated affiliates. In addition, a non-consolidation opinion is often required if the transfer is to an affiliated entity" (ASC 860-10-55-18A), although the opinion may not be required if the accountants are comfortable "that the appropriate legal opinion(s) would be given if requested" (55-18B).

The accounting literature includes commentaries on the legal opinion requirements, including the opinion expressly mentioning each area of continued involvement between an originator and its affiliates and the securitisation SPE. The accounting standards also include a discussion of various types of qualifiers and assumptions that are deemed not to be appropriate for accounting purposes. For example, an opinion assuming that the transfer is a true sale for accounting purposes would have to carve out the legal isolation analysis from such assumption. Consequently, a true sale and non-consolidation opinion delivered as part of a securitisation transaction may receive additional comments from accountants relating to assumptions and qualifications that are viewed as potentially problematic under applicable accounting literature.

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