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Securitisation in Luxembourg
A comprehensive guide

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Launch

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Preface

We are happy to present to you the 2016 update of our brochure "Securitisation in Luxembourg". After 12 years of Luxembourg Securitisation Law[1] in place, meanwhile this represents the fifth edition of the brochure and we are delighted to having received many positive comments about the contents contained and to know that many are regular using it as a kind of handbook. Appreciating this and as this brochure will now be a part of a group of publications related to securitisation in Luxembourg, we have added to this brochure a new subtitle: "A comprehensive guide".

The overall securitisation market has changed tremendously in the last years. The financial crisis, with all its implications, has led to various government reactions. Authorities want more supervision and more transparency in the financial market, including on securitisation products, partly considered responsible for the crisis.

Despite the decline in reputation of the "securitisation" product, the number of Luxembourg securitisation vehicles and its compartments has had a positive development and maintained its steady growth. By the end of March 2016, there were at least 1,084 vehicles representing more than 4,000 compartments in Luxembourg. This growth will likely continue in the following years, due to different initiatives, like the Capital Markets Union pushing for a well-functioning European securitisation market.

This new edition of our brochure gives an overview of securitisation in Luxembourg and the relevant regulations, with a focus on recent changes and hot topics, especially in the area of accounting, tax, and legislation in Luxembourg.

In chapter 4, we put a spotlight on the impacts of Anti-Money-Laundering regulation, IFRS, and AIFMD, as well as on the Capital Markets Union and the STS securitisations. We also give insights on Prospectus and listing requirements resulting from the structure/distribution, as well as on the responsibilities of the Board of Directors of a securitisation vehicle. The remaining topics – Basel III and Solvency II – relate more to the business needs of originators and investors. We will show how the chosen structure can affect the originator and investor's financial statements.

We have chosen to publish our brochure in an electronic version to facilitate its update and stay in line with our corporate objectives to minimise our carbon footprint. However, if you would like to receive a hardcopy, please let us know.

We hope that our choice of topics, together with our input, will provide you with a good understanding of the securitisation market and best practices in Luxembourg.

Holger von Keutz

[1] Law of 22 March 2004 on securitisation.

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1. General securitisation

1.1 Introduction

Before the financial crisis, securitisation was the funding and risk transfer method of choice for a huge number of issuers. It was also the largest growing contribution to the global capital markets. During the financial crisis, securitisation gained a bad reputation in the in the eyes of the public, but also of many investors, like banks and insurers. This decline in reputation was partly justified by the misuse of the product to securitise highly risky assets.

However, simple and transparent securitisation structures, with high quality assets, have confirmed their stability during and post-crisis. This proves that the technique of securitisation is a funding and risk transfer method fit for a high number of issuers. Although the market has decreased in the last years, securitisation is and will be a large contributor the good functioning of capital markets. The European Commission's objective to create an EU-wide securitisation market through its Capital Markets Union initiative is further proof that securitisation is here to stay.

Securitisation may be of interest to any large corporate that owns suitable financial assets, whether a pool of debts or discrete revenue streams. The technique of securitisation is a financial method offering benefits for both originators and investors.

For the banking and the insurance system, securitisation allows lower solvability ratios and risks linked to financial sectors and regions; for companies and households, better financing conditions.

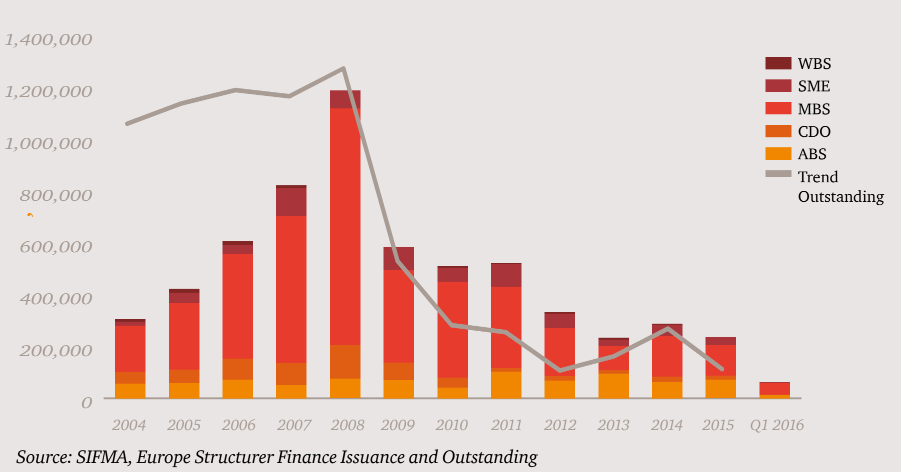
Today, securitisation vehicles are also adopted in real estate and private equity structures, in infrastructure financing projects, in Islamic finance transactions, and in various investment vehicles. Even some Fintech entities use securitisation as part of their services.

1.2 Market overview and trends

The effects of the financial crash in 2008 is key in analysing the securitisation market. At the end of 2015, the European securitisation market's outstanding volume was only around half of the 2009 volume. From a one year perspective the outstanding volume in Europe decreased by 15%.

Analysing the issuance volume in 2015, USD 235.9 billion were issued. The subprime mortgage scandal in the US, the European sovereign debt crisis and the underlying risk of recession have been important factors in the development of the European securitisation market, which seems to have reached a stable volume of around USD 250 billion in recent years. In 2015, 38.2% of the issued volume was placed, an increase of more than 2% compared to the previous year and an increase by more than 30% compared to the crisis year 2009.

Figure 1: European securitisation issuance



Source: SIFMA, Europe Structurer Finance Issuance and Outstanding

Like in the previous years, UK Residential Mortgage-Backed Securities ("RMBS") have remained the key driver in the securitisation market in Europe, followed by the securitisation of other types of collateral such as cars, credit cards, leases, loans, receivables and others. SME securitisations decreased in 2015, but are still the third biggest asset class.

As to the type of investors in debt or equity instruments issued by securitisation vehicles, there is a concentration of investment funds with 49% and banks with 33%, as a certain level of expertise is required. Central banks and public entities have increased their investment to 13%, partly due to the ABS Purchase Program of the ECB. Insurance companies have invested less in securitisation as it appears that this asset class is getting less attractive due to the Solvency II regulation.

The securitisation industry is on its way to heal its damaged reputation and restore investor confidence. First positive signs are already visible. Initiatives started already in 2014 from the European Central Bank and the Bank of England identifying principles of "Qualifying securitisation" that should be simpler, more structurally robust and transparent. The European Banking Authority has also moved forward, defining the three pillars of simplicity, standardisation and transparency for top-tier or "qualifying" securitisations and again from the European Central Bank in the framework of their asset-backed securities purchase programme ("ABSPP") using similar criteria.

The speed to revitalise the European securitisation market has been increasing since last year. In February 2015, the European Commission issued its "Green Paper on the Capital Markets Union". One of the main topics is to develop an EU framework for high-quality securitisation, the so-called "STS Securitisation", as securitisation is seen as a crucial element of well-functioning financial markets. On 30 September 2015, two draft EU regulations were issued by the European Commission to define criteria for a simple, transparent and standardised securitisation framework, as well as to propose a privileged regulatory treatment for securitisations fulfilling these criteria. The so-called foundation criteria are:

Simplicity criteria, including provisions requiring the underlying exposures to be homogeneous (i.e. ensuring no mixed pool of asset types). The use of derivatives is restricted to hedging purposes only. Re-securitisations are explicitly excluded, as they are typically complex with a loss waterfall that is difficult to understand due to re-tranching (e.g. in-collateralised debt obligations "squared").

Transparency criteria, including provisions to make transactions comply with transparency and disclosure requirements, such as providing loan-level data.

Standardisation criteria, including provisions requiring that the transfer of the underlying exposures to the securitisation vehicle be sufficiently robust from a legal point of view (e.g. there is a "true sale"). Additionally, it cannot be a synthetic securitisation.

The European Commission considers securitisations an important element of a well-functioning capital market and recognises the reputational damage induced by the US sub-prime crisis in 2007-2008. Therefore, it was highly appreciated by the market participants that a common definition of STS-securitisation was proposed, which will be valid for all investor groups, like banks, investment funds, and insurance companies and that this can lead to a significant harmonisation. On the other hand, there were some main points of criticism which could hinder the revitalisation of the European securitisation market. The main items were the self-certification of the originator, the high sanctions in case of non-compliance, the exclusion of synthetic securitisations and the proposed risk weights, which are high than the current rates. These numerous points of criticism lead to some modification proposals from the council of the European Union. Although some items, like synthetic securitisations, have been approached, there are still many open questions. The self-certification will be replaced by a third-party verifying the STS compliance, but it is still unclear who will perform this certification in the future. The proposed sanctions are still prohibitive high. One main item is still the non-adjusted risk weights for STS securitisations. Due to this ongoing discussion, we do not expect a final regulatory framework already in 2016.

1.3 What is securitisation?

Securitisation is known as a financial practice of pooling various assets funded by the issuance of securities. Historically, asset securitisation began with the structured financing of mortgage pools in the 1970s. Over the years, securitisation transactions have become a mature and significant sector of the European capital markets with transactions using several asset types as collateral (e.g. residential mortgages, debt, trains, wagons, properties and rent) as well as car loans, credit-card receivables and consumer loans. As securitisation was regarded as one driver for the financial crisis, the securitisation market has nearly collapsed. Today, it is recovering as the instrument of securitisation has been recognised as an efficient tool to provide funding to the market. In addition, structured-product securitisation vehicles synthetically transferring the performance of reference assets through derivatives have been established in order to issue certificates for retail clients.

Broadly speaking, a pool of cash generating financial assets is transferred from a so-called “originator” to a “Special Purpose Vehicle” (the “SPV”). This SPV finances the acquisition of these assets by the issuance of securities, whose interest and principle payments are derived from and backed by the assets transferred.

More generally, SPVs may only acquire a risk without the acquisition of the reference assets (transferring the performance through derivatives instead). Due to this repackaging, new fungible financial assets are created, which benefit from a portfolio effect.

From an originator’s perspective the securitisation

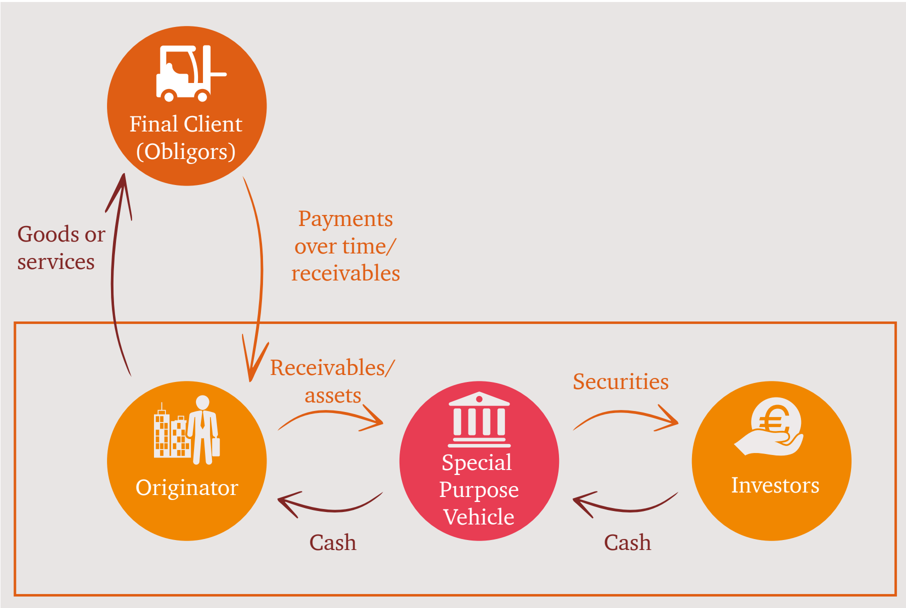
- enables the transfer of specific ownership risks to parties who have higher capabilities to manage these risks, and
- grants access to capital markets with potentially a better debt rating than the general corporate rating of the originator.

Further benefits are described in chapter 1.5 below.

Acquisition, classification, collateralisation, composition, pooling and distribution are functions within this process.

The “structuring” process is one of the central elements of a securitisation transaction. securitisation typically splits the credit risk into several tranches with different risk profiles. This allows the issuer to attract a range of investors with different risk/reward appetites. A very common allocation of tranches is 80% senior tranches with the remaining part split into other tranches, often called subordinated, mezzanine or junior tranches. The most senior tranche is usually very high-rated and is protected from credit losses by having priority

Figure 2: Securitisation schema



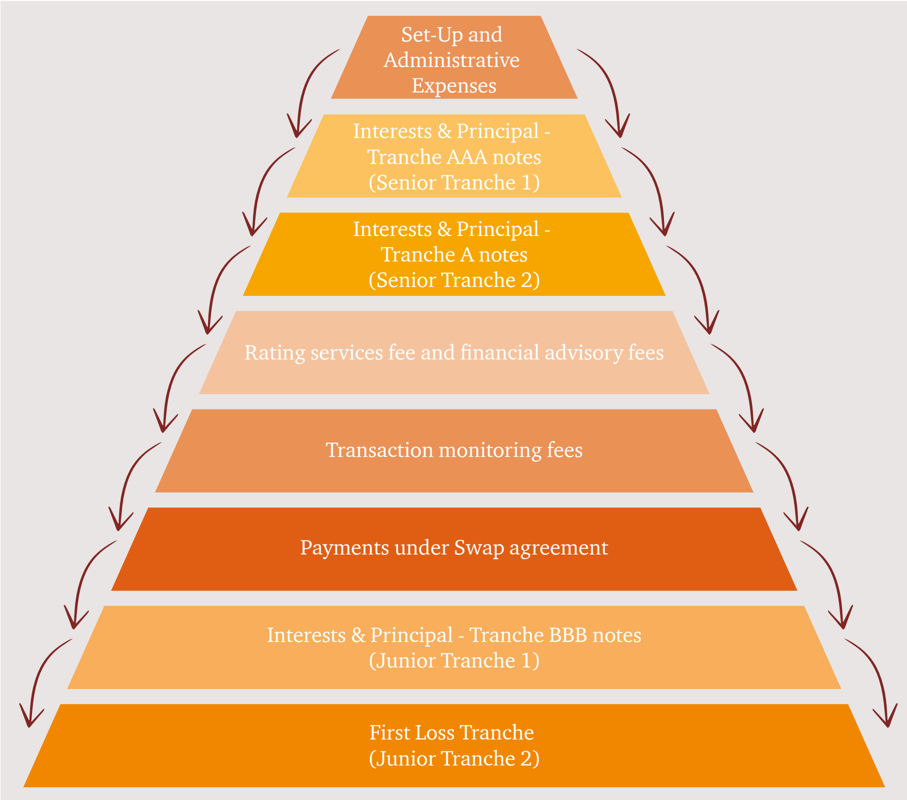
on the cash flow from the assets. The tranches below are rated lower and designed to first absorb any credit losses. These tranches have higher margins to compensate for the additional risk.

Further to be taken into consideration are the first-loss tranches (or so-called "first-loss pieces') which are often held by the originator and offer a high risk/reward profile. The most probable credit losses of a securitisation transaction are concentrated in this tranche. The first-loss tranche is usually capped at "expected" or "normal" rates of portfolio credit losses, so all credit losses up to this point are effectively absorbed by this tranche. It typically receives portfolio cash flow after expenses (which include expected losses) in the form of excess spread.

This structuring concept is called the "waterfall" payment sequence because of its similarity to a champagne waterfall with various levels of glasses balanced on one another. The champagne waterfall may be transferred to securitisation as shown on figure 3 beside.

The waterfall shows the order of the cash return on assets, which allows both interest and transaction-related fees to be paid and the repayment of the notes issued. The underlying portfolio's cash flow is used to fill or refill the requirements of the top tranche (senior tranche). The surplus cash flow then flows down to fill or refill the requirements of the second tranche (i.e. junior, mezzanine and subordinated), and so on. This process will last until the cash flow is exhausted. The first-loss tranche at the bottom will receive the residual cash flow after all prior claims have been satisfied. The residual cash flow thus represents a high rate of return if the underlying assets are performing well, and vice versa.

Figure 3: The "waterfall" payment sequence



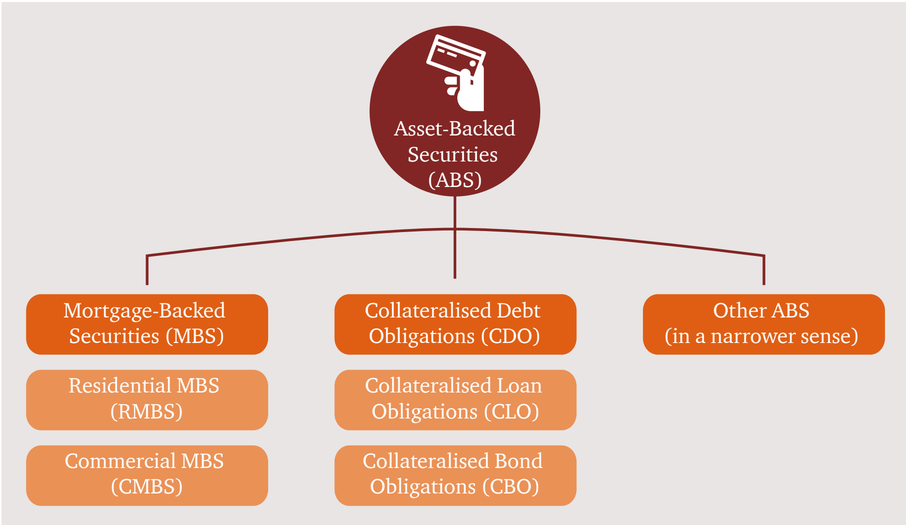
1.4 Types of transactions

Different criteria can be applied to distinguish between different types of securitisation transactions. The list is not exhaustive, but the following criteria should help to distinguish the different kinds of transactions available and should make their purpose easier to understand.

Transactions by asset classes referring to the underlying risk

Within the securitisation market a trisection was established to differentiate the following asset classes according to underlying risk: Mortgage-Backed Securities (MBS), Asset-Backed Securities (ABS) and Collateralised Debt Obligations (CDO).

Figure 4: Asset classes according to the underlying risk



Mortgage-Backed Securities (MBS) include all notes whose collateral for repayment consist of a mortgage loan or a pool of mortgage loans secured on real estate property. Investors receive payments of interest and principal derived from payments which are received on the underlying mortgage loan. In addition, a differentiation between Residential MBS (RMBS) with underlying mortgages of individuals and Commercial MBS (CMBS) with underlying mortgage loans secured by commercial properties is possible.

Collateralised Debt Obligations (CDO) are usually based on corporate risks: loans, assets or credit derivatives. Common types of transactions are Collateralised Loan Obligations (CLO) or Collateralised Bond Obligations (CBO). These transactions can be classified into static or dynamic structures. In a static structure, the entire portfolio is fixed at the closing date of the transaction. As a result, the assets are not actively changed, irrespective of the performance of a single credit risk in the underlying portfolio. The number of underlying assets will only change in the event of full repayments or defaults, but defaults cannot usually be replaced. In dynamic or actively managed transactions, the responsible asset manager can replace one or more underlying assets to decrease the credit risks or to increase the performance. This means that the assets will be exchanged and credit events may be avoided.

Other Asset-Backed Securities (ABS) represent the residual part of the securitisation market, which is characterised by the heterogeneity of the underlying assets. The underlying of ABS transactions may vary from consumer loans, secured credit-card receivables, trade receivables and student loans to the securitisation of life-insurance policies, intangibles, etc.

Term securitisation vs. securitisation by Asset-Backed Commercial Paper (ABCP)

Term securitisations are long-term placements on the capital market. When the underlying portfolio (assets or loans) is paid back, the transaction is naturally closed.

Securitisations issued by ABCP allow for short-term financing on a roll-over basis on the money market. These transactions are regularly set up for an unlimited period.

True sale vs. synthetic transactions

With regard to the transfer of rights of the assets, there are two forms of securitisation transactions:

(i) True sale transactions

In a traditional true sale structure, the originator sells a pool of assets to an SPV by removing them from its balance sheet. The SPV funds the purchase of these assets by issuing notes, which are usually rated by a rating agency. The notes' ratings reflect the fact that the SPV is isolated from any credit risk of the originator and the credit enhancement of the pool. The originator therefore transfers both the legal and beneficial interest in the assets to the SPV. As a result, the investor of the SPV receives the legal and beneficial rights to the underlying assets.

(ii) Synthetic transactions

In a synthetic securitisation, the originator buys protection through a series of credit derivatives instead of selling the asset pool to the SPV. Such transactions do not provide the originator with funding. They are typically undertaken to transfer credit risk and reduce regulatory capital requirements.

As a general rule, the owner of the assets (the "Protection Buyer") transfers the credit risk of a portfolio of assets (a "Reference Portfolio") to another entity (the "Protection Seller"). Although the credit risk of the Reference Portfolio is transferred, its actual ownership remains with the Protection Buyer.

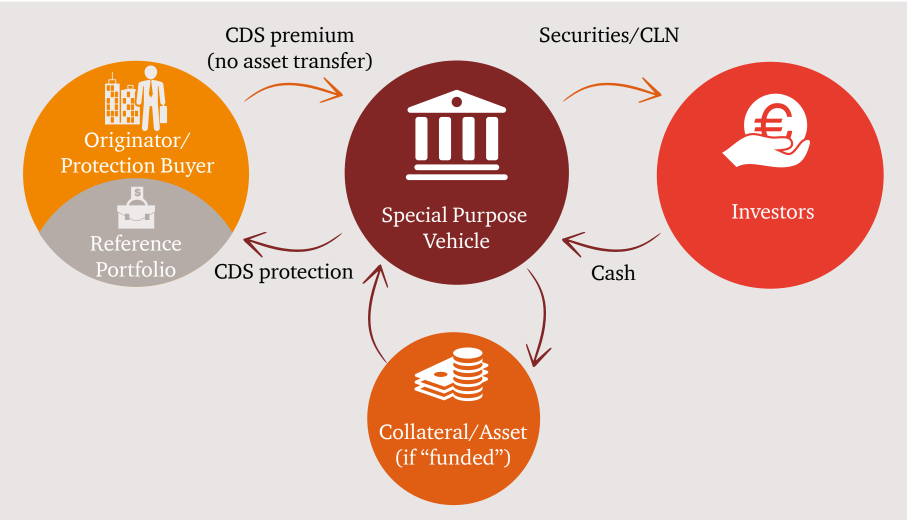
Credit risk may be transferred in a number of ways:

- The Protection Buyer might issue Credit-Linked Notes (CLN) to the Protection Seller. The terms of the notes would provide for a reduction in the Protection Buyer's repayment obligation on the notes upon defaults or other credit events arising with respect to the Reference Portfolio.

- Alternatively, the Protection Buyer may enter into a Credit Default Swap (CDS), total return swap or other credit derivative transaction with the Protection Seller. In return for certain payments, the Protection Seller agrees – in the event of default or another credit event in respect of a Reference Portfolio– to pay an amount to the Protection Buyer. This is calculated based on the amount of payment defaults or the reduction in market value of the defaulted Reference Portfolio.

The transaction may be funded or unfunded. In a funded transaction, the investors make an initial payment (e.g. to the counterparty or as cash deposit or to purchase a risk-free investment) that serves as collateral to cover the counterparty risk. In an unfunded transaction, no such initial cash flow is required.

Figure 5: Typical synthetic securitisation structure



1.5 Benefits of securitisation

Obviously, setting up an SPV– a separate legal entity requiring several service providers (cf. chapter 1.7 Parties involved in securitisation transactions) – incurs a certain amount of costs. For the involved parties to accept these costs there must be measurable benefits linked to this transaction. Below we present a non-exhaustive list of the usual benefits of a securitisation transaction, which may be favourable to one or more of the various parties. However, securitisation transactions are complex structured financing methods and it is crucial that potential issuers understand the range of options and related implications in order to make an informed decision. While these benefits have varying degrees of importance for different originators, the common characteristic of securitisation is the demand for lower capital cost.

Benefits for originators

Securitisation improves return on capital by converting an on-balance-sheet lending business into an off-balance-sheet fee income stream that is less capital-intensive. Depending on the type of structure used, securitisation may have the following benefits:

- **Provide efficient access to capital markets:** Structuring with high ratings is possible on most of tranches of notes issued. The non-existing link between originator's credit rating and the rating of the securitised assets reduces the funding costs; for instance, a company rated BBB but having an AAA-worthy cash flow from some of its assets, would be able to borrow at AAA rates. This is the main reason for securitising cash flow to achieve significant impact on borrowing costs.

- **Minimise issuer-specific limitations on ability to raise capital:** Funding depends on the terms, credit quality, prepayment assumptions, and servicing of the assets and prevailing market conditions. Entities that are unable to fund themselves easily due to their individual credit quality, or who do so only at a significant cost, may be able to conduct securitisation transactions. This also applies to entities that are unable to raise equity.

- **Convert illiquid assets to cash:** Assets that are not readily sellable may be combined to create a diversified collateral pool funded by notes issued by a securitisation vehicle.

- **Diversify and target funding sources, investor base and transaction structures:** Businesses can expand beyond existing bank lending and corporate debt markets by tapping into new markets and investor groups. The new funding sources may also reduce the costs of other types of debt by reducing the volume issued and allowing placements with marginal purchasers willing to pay a higher price. Especially for complex organisations, segmenting revenue streams or assets backing particular debt offerings enable issuers to market debt to investors based on their appetite for particular types of credit risk, while allowing these investors to minimise their exposure to unrelated issuer risks. Similarly, complex principal and interest payment structural features targeting the investment objectives of particular buyers can be incorporated into the debt. This segmentation of credit risk and structural features should minimise the overall cost of capital to the seller.

- **Raise capital to generate additional assets or apply to other more valuable uses:** For example, it allows credit lines to be recycled quickly to generate additional assets, as well as freeing long-term capital for related or broader uses. The capital raised can be used for any allowable purpose, such as retiring debt, repurchasing stock, purchasing additional assets or completing capital projects.

- **Raise capital without prospectus-type disclosure:** Allows sensitive information about business operations to be kept more confidential, especially by issuing through a "conduit" or as a private placement.

- **Generate earnings:** When a true-sale securitisation transaction takes place between the originator and the SPV, it must take place at the market value of the underlying assets. The transaction is reflected in the originator's balance sheet, which will eventually boost earnings or lock the level of profit resulting from the sale of assets for the particular quarter or financial year by the amount of the sale while passing the risks on.

- **Complete mergers and acquisitions, as well as divestitures, more efficiently:** May assist in creating the most efficient combined structure and may serve as a source of capital for transactions. By segmenting and selling assets against debt issued, it may be possible to optimise the closure of business lines that no longer meet corporate objectives.

- **Transfer risk to third parties:** Financial risk from defaults on loans or contractual obligations by customers can be partially transferred to investors and credit enhancers.

- **Lower capital requirements for banks and insurance companies:** The supervisory authorities set out minimum capital requirements for banks and insurance companies, in accordance with the size and nature of the risks borne by the company. By removing assets from the company's balance sheet, related capital requirements are released, which can then be used for other purposes. These capital requirements are described in more detail in chapter 4.

Benefits for investors

- **Broad possible combinations of yield, risk and maturity:** Securitised assets propose a range of attractive yields and offer flexibility because of their payment streams and risk profiles. Securitised assets are usually structured to meet investors' investment strategies, requirements and appetite for risk.

- **Tailored investment sources:** Investors who would normally not invest directly in the originator's securities would tend to have a different perspective and be attracted by the characteristics of securitised assets.

- **Portfolio diversification:** Some investors, like hedge funds or institutions, tend to invest in bonds issued by securitisation vehicles, which are uncorrelated to their other investments.

- **Higher returns:** As a result of securitised assets and underlying risk-return-maturity profile, investors may potentially earn a higher rate of return on investments in a specific pool of high-quality credit-enhanced assets.

Benefits for borrowers

- **Better credit terms:** Borrowers benefit from the increasing availability of credit terms, which lenders may not have provided if they had kept the loans on their balance sheets. For example, lenders can extend fixed-rate debt, which many consumers prefer to variable-rate debt, without overexposing themselves to interest rate risk. Credit card lenders can originate very large loan pools for a diverse customer base at lower rates.

1.6 Types of credit enhancements

Beside the proper segregation of credit risk, the avoidance of co-mingling of accounts between the originator and the SPV and no double taxation of the vehicle, setting up credit enhancements is an essential step of the structuring process that drives the ultimate rating of the securities issued.

Defined as initiatives taken by the originator to enhance the creditworthiness of the securities issued to protect investors, so that the pool of underlying assets is able to withstand fluctuations in the economy, credit enhancements protect investors from bearing all the credit risks in the pool of assets. In addition, this increases the probability of the investors receiving the cash flow to which they are entitled, and gives the securities a higher credit rating than the originator. Accordingly, both internal (techniques structured within the transaction) and external (insurance-type policies purchased to protect investors in the event of default) mechanisms are typically built into the structure.

Most structures contain a combination of one or more of the enhancement techniques described below. From an issuer's point of view the objective is to find the most practical and cost-effective credit-protection method for the securities' desired credit rating and pricing. Most securities also contain performance-related features designed to protect investors (and credit enhancers) from portfolio deterioration. The originator will often negotiate type and size of the internal and external credit enhancements with the rating agencies.

The following example illustrates a credit enhancement: As usual, a rating of AAA implies with almost absolute certainty that the interest and principal on the debt issued will be paid on time. Although it is highly unlikely that an entire pool of residential mortgage loans will have such a rating, it is possible that a large portion of the portfolio will do. The remaining portion of the portfolio is divided into different tranches, from A and BBB to the unrated first-loss piece (which is typically held by the originator). Losses on the portfolio are first allocated to the unrated position and then, usually, to the lower-rated securities up to the senior AAA position.

Common types of credit enhancements can be summarised as follows:

Internal credit enhancements

Over-collateralisation
Over-collateralisation is a commonly used form of credit enhancement. With this support structure, the face value of the underlying asset portfolio is higher than the face value of the securities it backs. In other words, the securities issued are over-collateralised. So even if some of the payments from the underlying assets are late or defaulted, principal and interest payments on the securities issued can still be arranged.

Subordination
A class of securities with rights that are subordinated to the rights of other classes of securities issued in connection with the same transaction. Subordination usually relates to the rights of investors to receive promised payments, particularly in situations where there is not sufficient cash flow to pay promised amounts to all investors. However, it may also relate to the investors' right to vote on issues concerning the operation of the transaction. Subordinated securities are repayable only after other classes of securities with a higher ranking have been satisfied ("waterfall payment"). The payments of senior tranches are protected by subordinated tranches in the event of loss.

Excess spread
Net amount of interest payments of underlying assets after transaction administration expenses and investors' interest payments have been made. The excess can be used to cover losses and top up reserve funds.

Reserve fund
An account available for use by the SPV for one or more specified dedicated purposes. Some reserve accounts are also known as "spread accounts". Virtually all reserve accounts are at least partially funded at the start of the related transaction, but many are designed to be built up over time using the excess cash flow that is available after making payments to investors.

External credit enhancements

Third-party/Parental guarantees
A policy provided by a third party or, in some cases, by the promoter of the securitisation transaction, that reimburses the SPV for losses up to a specified amount. Transactions can also include agreements to advance principal and interest or to buy back any defaulted loans. AAA-rated financial guarantors or monoline insurance companies typically provide third-party guarantees.

Letters Of Credit
With a letter of credit (L/C), a financial institution – usually a bank – is paid a fee for providing a specified amount of cash to reimburse the SPV for any cash shortfalls from the collateral – up to the required credit support amount. L/Cs are becoming less common forms of credit enhancement, as much of their appeal was lost when the rating agencies downgraded the long-term debt of several L/C-provider banks in the fixed-income sectors. Because notes enhanced with L/Cs from these lenders faced possible downgrades as well, issuers began to use cash collateral accounts instead of L/Cs in cases where external credit support was needed.

Surety bonds
A policy provided by a rated insurance company to protect principal and interest payments for certain investors. Surety bonds are granted on investment-grade securities provided that other forms of credit enhancement are used as well. The ratings of securities paired with surety bonds are the same as those of the surety bond's issuer.

1.7 Parties involved in securitisation transactions

In addition to the parties directly involved, there are many others, generally defined as service providers, which are usually involved in the securitisation process. Here is an overview of the most relevant parties:

Obligor/Borrower

Obligors owe the originator payments on the underlying loans/assets, and are therefore ultimately responsible for the performance of the issued securities. As obligors are often not informed about the sale of their payment obligation, the originator often maintains the customer relationship as servicer.

Originator

The originator is the entity to assign assets or risks in a securitisation transaction. It is usually this party (lender) who originally underwrites and securitises the claims (loans). The obligations arising from such loans are therefore originally owed to this entity before the transfer to the SPV takes place. Occasionally, the originator may be a third party who buys the pool with the intention to securitise it later; in this case, the originator may also be named as "sponsor". Originators include captive financial companies of the major car manufacturers, other financial companies, commercial banks, building societies, manufacturers, insurance companies and securities firms.

Investor

Investors buy the securities issued by the SPV, and are thus entitled to receive the repayments and interest based on the cash flow generated by the underlying assets. Collaterals ensure the pecuniary claims from these assets. The largest investors in securitised assets are typically pension funds, insurance companies, investment fund managers and – to a lesser extent – commercial banks. The most compelling reason for investing in Asset-Backed Securities is their higher rate of return compared to other assets with a comparable credit risk.

Asset servicer

The servicer is the entity to collect principal and interest payments from obligors and administer the portfolio after the transaction has closed. The originator regularly, but not always, acts as servicer. For example, in most Non-Performing Loans (NPL) transactions, specialised servicers tend to carry out this role. Servicing includes customer service and payment processing for the obligors in the securitised pool and collection actions in accordance with the pooling and servicing agreement. Servicing can further include default management, liquidising collateral and preparing monthly reports. The servicer is typically compensated with a fixed servicing fee.

Backup servicer

If the original servicer defaults, the backup servicer replaces them. They take over all the responsibilities allocated to the servicer.

Trustee

Acting in a fiduciary capacity, the trustee is primarily concerned with preserving investors' rights. The trustee's responsibilities will vary from one case to the next and are described in a separate trust agreement. Generally, the trustee oversees the receipt and disbursement of cash flow as prescribed by the indenture or pooling and servicing agreement, and monitors other parties to the agreement to ensure that they comply with the appropriate covenants. If problems occur in the transaction (e.g. defaults), the trustee pays particular attention on the obligations and performance of all parties associated with the securities issued, notably the servicer and the credit enhancer. Throughout the lifetime of the transaction, the trustee receives periodic financial information from the originator/servicer detailing amounts collected, amounts charged off, collateral values, etc. The trustee is responsible for reviewing this information and ensuring that the underlying assets produce adequate cash flow to serve the securities issued. The trustee is also responsible for declaring default or amortisation events.

Investment bank

Investment banks mainly structure, underwrite and market the securitisation transaction.

Tax and accounting adviser

These advisers provide assistance on the accounting and tax implications respectively of the proposed structure of the transaction. Issuers usually aim to choose structures that will allow the tax impact on the securities issued to be minimised.

Rating agencies

The securities issued are usually assessed by a rating agency to allocate a rating to them. A wide range of investors requires a minimum rating of investment grade or higher. The rating process is currently dominated by big rating agencies Standard & Poor's, Moody's, and Fitch. They use their accumulated expertise, data and modelling skills to assess the expected loss of debt securities issued by the securitisation vehicle.

In general, rating agencies review the following factors:

- Quality of the pool of underlying assets in terms of repayment ability, maturity diversification, expected defaults and recovery rates;
- Abilities and strengths of the originator/servicer of the assets;
- Soundness of the transaction's overall structure, e.g. timing of cash flow (or mismatch) and impact of defaults;
- Analysis of legal risks in the structure, e.g. effectiveness of transfer of title to the assets;
- Ability of the asset manager to manage the portfolio;
- Quality of credit support, e.g. nature and levels of credit enhancements.

Paying agent

The paying agent is the bank that has agreed to settle the payments on the securities issued to investors. Payments are usually made via a clearing system.

Legal adviser

As the legal structure and legal opinions are crucial to securitisation, considerable legal work goes into documentation. A typical transaction involves numerous documents: sale and purchase agreements, offering documents, etc.

Credit enhancement provider

Credit enhancement is used to improve the credit rating of the issued securities. Therefore, credit enhancement providers are third parties agreeing to elevate the credit quality of another party or a pool of assets by making payments, usually up to a specified amount. This provision is made in case that the other party defaults on their payment obligations or the cash flow generated by the pool of assets is less than the amounts contractually required due to defaults of the underlying obligors.

Calculation and reporting agent

This entity calculates the waterfall principal and interest payments due to creditors and investors.

Figure 6: The securitisation service providers

Liquidity provider

Liquidity providers are usually banks to provide the SPV with the necessary cash to avoid any unsteadiness of the cash flow to the investors. It is a kind of bridge loan and short-term financing, and it is not used for defaults within the underlying asset portfolio.

Asset manager

Asset managers are responsible for selecting underlying assets, monitoring the portfolio and, if foreseen, replacing underlying assets. They are common in CDO/Structured Credit transactions.

Custodian

The custodian bank is responsible for safekeeping the securitisation vehicle's liquid assets and transferable securities, including the pool of assets transferred in the event of true sale transactions.

Auditor

In Luxembourg the annual accounts of securitisation vehicles have to be audited by one or more independent auditors ("Réviseurs d'entreprises") appointed, as the case may be, by the securitisation company's management body.

1.8 Taxation in securitisation

The success of products on the capital market partly depends also on their taxation regime. For a securitisation transaction, tax neutrality is one of the key success factors in optimising investors' returns and the originator's funding costs. Any tax levied on the securitisation vehicle or in relation to the securitisation itself would clearly increase the overall costs of the transaction, thus reduce its effectiveness. As a result, a securitisation transaction is generally structured on a tax-neutral basis to maximise its benefits and avoid a double taxation of the investors in practice. This means that all structural features of a securitisation transaction must be clearly analysed from a tax perspective to ensure that none of the features either lead to an additional tax burden or accelerate tax liabilities that would not incur had the securitisation not taken place. In practice however, a securitisation transaction often leads to some level of tax costs. In these circumstances, it is important that such costs are well-known in advance and that there are no future uncertainties, so that the originator and/or investors can decide whether these costs are acceptable, considering the overall commercial benefits of the transaction. A yearly tax aspect review is recommended.

Achieving a high level of certainty in relation to the issuer's tax position is also a basic requirement in any securitisation transaction. To confirm the rating assigned to the securities, rating agencies will require a high level of assurance that the issuer will not be subject to any unexpected tax charges.

Generally, it is possible to structure securitisation transactions to achieve the required tax treatment. However, it is vital that relevant tax advice is provided at a very early stage to ensure that potential tax pitfalls are identified and properly addressed in the structure prior to the evaluation of external parties (e.g. rating agencies, legal and regulatory authorities, investors, etc.). In addition, any option for advance tax clearances from tax authorities should be considered early on.

2. The Luxembourg securitisation business and regulations

2.1 Luxembourg market overview

Luxembourg remains one of the most attractive markets for securitisation in Europe. Contrary to the European or global securitisation market trends of the past decade, Luxembourg has not been badly hit by the decline following the financial crisis of 2008.

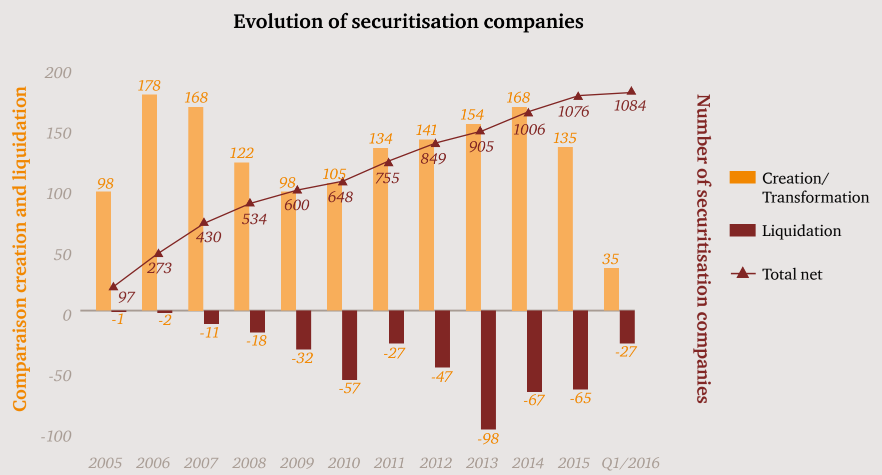
Figure 7 below shows the yearly evolution of the Luxembourg securitisation vehicles. By the end of March 2016, more than 1,500 securitisation vehicles have been created since the Luxembourg Securitisation Law was enacted. Currently, this is leading to a number of 1,084 active securitisation vehicles. Only companies falling under the Luxembourg Securitisation Law have been considered in this statistics, however. Admittedly, other Luxembourg entities may also perform securitisation transactions without benefitting from the advantages of the Luxembourg Securitisation Law, though.

It also needs to be pointed out that the total number of securitisation companies alone does not adequately illustrate the development of the Luxembourg securitisation market. The Luxembourg Securitisation Law allows securitisation companies to create more than one compartment, thereby structuring more than one securitisation transaction within one legal entity. Some vehicles have already set up several hundreds of compartments. We estimate more than 4,000 compartments to having been created within the 1,084 vehicles captured by our statistics.

Nearly all securitisation vehicles are set up in the form of securitisation companies; the small number of securitisation funds can be neglected. 56% of securitisation companies are incorporated as public limited companies ("S.A."), 41% as private limited liability companies ("S.à r.l."), and 2% as partnerships limited by shares ("S.C.A.") and cooperative companies organised as a public limited company ("SCoop S.A.").

Proof of the big success of the Luxembourg market place is that in the last five years much more than 100 securitisation vehicles have been created annually. In the first quarter of 2016 alone, 35 new vehicles have been launched, which shows that this steady rise in the number of securitisation vehicles, despite the international financial crisis, the goal of creating an attractive legal, regulatory and tax framework for securitisation vehicles in Europe – and especially in Luxembourg – has been achieved. It has allowed Luxembourg to become one of the leading centres for securitisation and structured finance vehicles. The main features of the Luxembourg Securitisation Law, including the high degree of flexibility and certainty it provides to all originators, investors and creditors in Luxembourg and abroad, are summarised in the following chapters.

Figure 7: Yearly evolution of Luxembourg securitisation vehicles

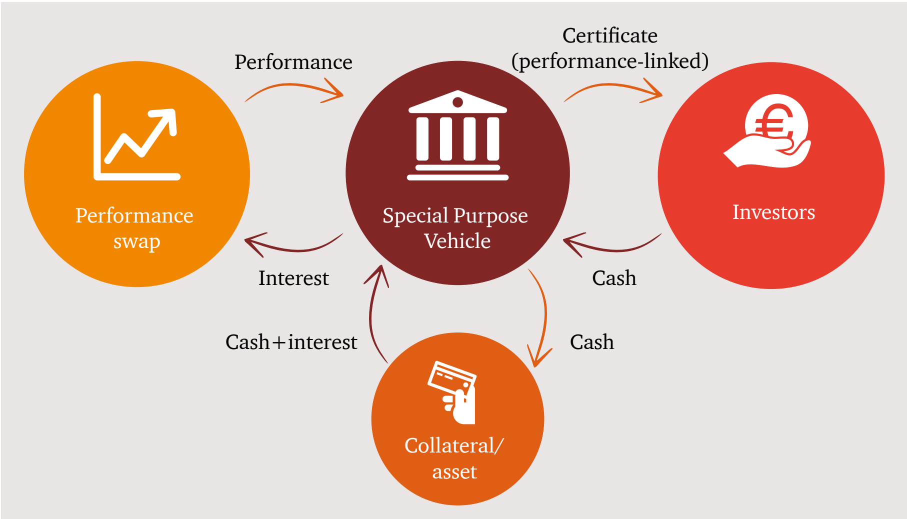


Source: PwC survey based on Luxembourg Official Journal "Mémorial, Recueil des Sociétés et Associations"

Currently, the main asset classes are auto loans, lease receivables, trade receivables, customer loans, mortgages and non-performing loans, but also other securities like repackaging deals or structured investment products. Securitisation vehicles are also used within real estate, private equity and Islamic finance structures, or within other types of structuring like hedge fund transactions. Another structure is the securitisation of Small and Medium Enterprises (SMEs) financing products by using the capital market. Last year also structures investing in P2P-Lending platforms and other Fintech related activities have been launched in Luxembourg using a securitisation vehicle. Among the existing securitisation vehicles as of 31 March 2016, only 32 are regulated vehicles, each incorporated as a public limited company. The total amount of assets securitised through regulated securitisation vehicles as of 31 December 2015 is about EUR 30.3 billion (2014: EUR 23.8 billion), i.e. an increase of EUR 6.5 billion. In nearly all cases, the regulated securitisation companies created several compartments. Regulated securitisation companies use various models, but one main structure is to be highlighted. The majority of the regulated entities issue certificates as investment products for retail investors. They invest in almost risk-free collateral, like a deposit or a government bond, and swap the interest received against the performance of an underlying index, a basket of securities, etc. The investors receive this performance as variable interest and/or the repayment amount of the securities issued which depend on the underlying performance. Each certificate is usually represented by one compartment (see figure 8).

The outlook for the securitisation business in Luxembourg remains positive. A number of retail investment products and financing instruments using securitisation vehicles with assets from the United Kingdom, France, Eastern Europe and Germany have been set up over the past few years. In addition, the Capital Markets Union proposal by the EU to redevelop the European securitisation market will also promote the Luxembourg securitisation market's growth in the coming years, as securitisation structures help the capital market to function.

Figure 8: Typical structured product issuing retail certificates



2.2 Scope of Luxembourg securitisation vehicles

2.2.1 Broad definition of securitisation

Compared to the commonly referred to definitions of securitisation derived from the Capital Requirements Regulation (CRR)[2] or Solvency II Directive[3], and the proposed securitisation regulation[4] published by the EU on 30 September 2015, which focus on credit risk and tranching, the definition of "securitisation" provided by the Luxembourg Securitisation Law is rather broad. It encompasses all transactions wherein a securitisation vehicle acquires or assumes (directly or indirectly) any risk relating to claims, other assets or obligations assumed by third parties or inherent in all or part of the activities of third parties and issues transferable securities (shares, bonds or other transferable securities) whose value or yield depends on such risks.

To qualify as a Luxembourg securitisation vehicle governed by the Luxembourg Securitisation Law, entities must only state in their articles of incorporation or management regulations (for securitisation funds) that they are subject to the provisions of the Luxembourg Securitisation Law ("opt-in").

2 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.

3 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).

4 COM(2015) 472: Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

2.2.2 Few limits for securitisation activities

The Luxembourg Securitisation Law allows a wide range of assets such as trade receivables, mortgage loans (commercial or residential), shares, bonds, commodities and, essentially, any tangible or intangible asset or activity with a reasonably ascertainable value or predictable future stream of revenue to be securitised. These assets or risks are represented by registered or bearer securities (e.g. shares, bonds and certificates).

Securitisation transactions may be achieved by transferring the legal ownership of the assets ("true sale") or by only transferring the risks linked to the assets, e.g. via derivatives ("synthetic"). They can be set up either as a long-term securitisation or as a short-term Commercial Paper Programme ("Asset-Backed Commercial Paper" or "ABCP").

The specific nature of the securitisation undertaking's activity requires the risks it securitises result exclusively from assets, claims or obligations assumed by third parties or inherent in all or part of the third parties' activities. They cannot be generated by the securitisation undertaking or result as a whole or in part from the securitisation undertaking's activity itself acting as entrepreneur.

The role of the securitisation undertaking is limited to administering financial flows linked to the securitisation transaction itself and to the "prudent-man" management (in contrast to "active management") of the securitised risks, while any activity likely to qualify the securitisation undertaking as an entrepreneur is prohibited.

The Luxembourg Securitisation Law itself gives only limited guidance to what exactly has to be inferred by those terms. Therefore, the Luxembourg financial supervisory authority Commission de Surveillance du Secteur Financier ("CSSF") has interpreted them in a "Frequently Asked Questions" section published on its website.[5]

Any management by the securitisation undertaking of claims, assets or activities of third parties that creates an additional risk owing to the activity of the securitisation undertaking on top of the risk already inherent in these claims, assets or activities, or which aims to create additional wealth or promote the commercial development of the securitisation undertaking's activities, would be incompatible with the purpose of the Luxembourg Securitisation Law.

A securitisation undertaking can only assign/sell its assets in accordance with the provisions laid down in its articles of incorporation or its management regulations. However, those transactions shall not aim to taking advantage of short-term fluctuations of market prices. Furthermore, according to the CSSF, the issue documents must specify for each issue how and by whom the decisions relating to the sale of assets will be made. Having delegated the actual management of the assets, claims and activities to an external service provider does not change this conclusion.

5 This interpretation is primarily addressed to securitisation vehicles supervised by the CSSF (cf. 2.4). Nevertheless, in practice, it serves as reference interpretation of the Luxembourg Securitision Law.
https://www.cssf.lu/en/supervision/ivm/securitisation/faq/

Nevertheless, the following types of transactions also qualify as securitisation transactions under the Luxembourg Securitisation Law:

- Granting loans instead of acquiring them on the secondary market, provided that the investor is sufficiently informed and that the securitisation vehicle is not acting on its own account, i.e. that those loans are set up upstream by or through a third party;
- Securitising existing portfolios of partially drawn credits and of automatically revolving credits under predefined conditions which does not lead by any means to the securitisation vehicle performing a professional credit activity in its own name;
- Acquiring goods and equipment and structuring the transaction in a way similar to a leasing transaction;
- Repackaging structures consisting in setting up platforms for structured products;
- Holding shares and fund units provided that the securitisation vehicle does not actively intervene in the management of such entities and acts solely as a financial investor interested in receiving cash flow (e.g. dividends).

2.3 Flexible and robust legal environment

The legal aspects described in this section illustrate some of the main characteristics of the Luxembourg Securitisation Law, including high flexibility, investor protection and efficiency for the originator.

2.3.1 Several possible legal forms

Modelled on the well-known investment fund regime in Luxembourg, the Luxembourg Securitisation Law introduced securitisation vehicles in the form of both corporate entities and securitisation funds managed by a management company and governed by management regulations. The following figure provides an overview of the legal forms of Luxembourg securitisation vehicles.

Securitisation companies can take one of many legal forms such as:

- "Société Anonyme" ("S.A." equivalent to a public limited company); or
- "Société à Responsabilité Limitée" ("S.à r.l." equivalent to a private limited liability company); or
- "Société en Commandite par Actions" ("S.C.A.", partnership limited by shares); or
- "Société coopérative organisée comme une S.A." (a cooperative company organised as a public limited company).

As described in chapter 2.1, the main legal forms are the "Société Anonyme" and the "Société à Responsabilité Limitée".

Should the securities be issued in a public offering, only an S.A. or an S.C.A. can be opted for, since a S.à r.l. cannot currently issue public instruments on the capital markets.

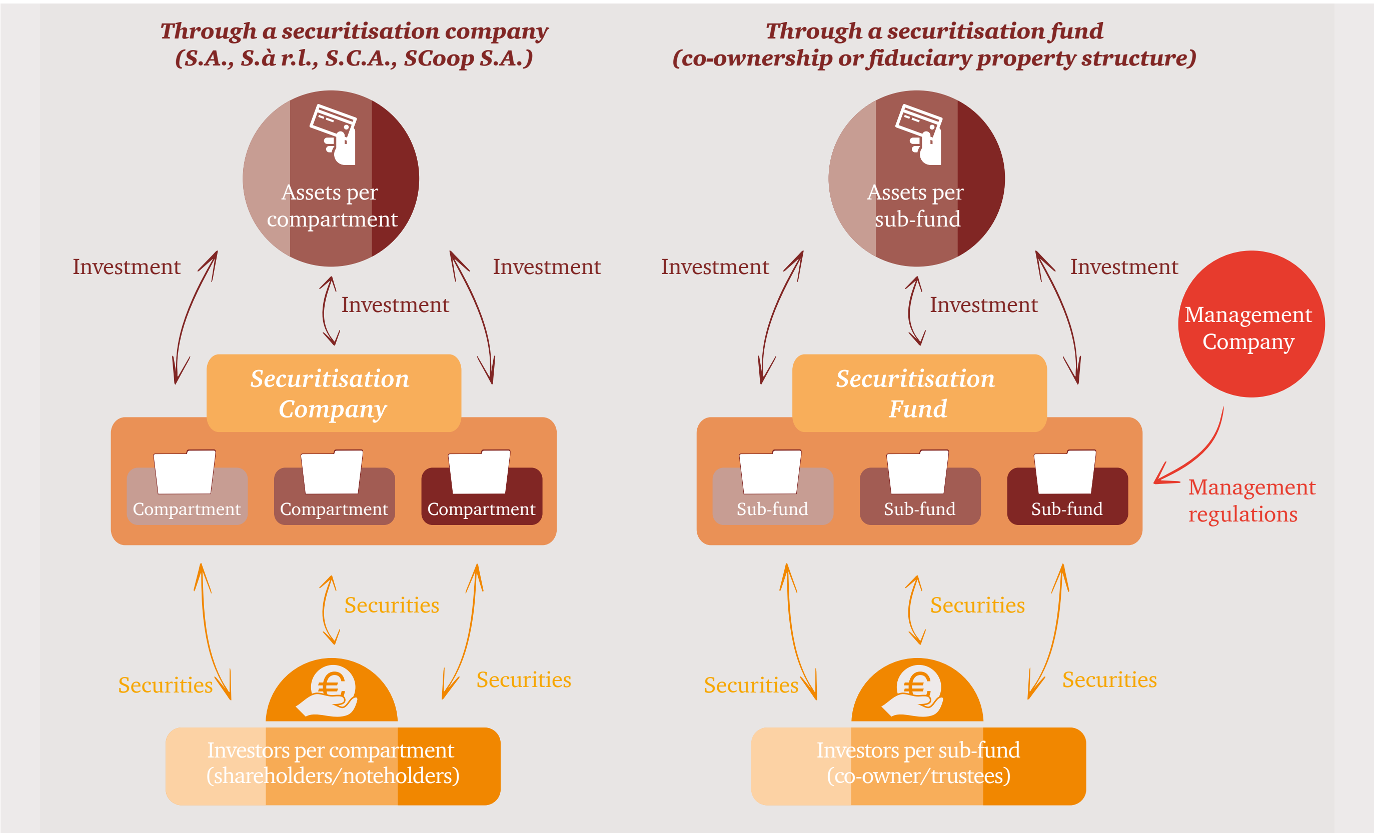
Securitisation companies are not subject to a specific minimum capital requirement, other than described in the Law of 10 August 1915 ("Luxembourg Commercial Law"). Consequently, the minimum share capital depends on the legal form and ranges between EUR 12,500 for a S.à r.l. and EUR 31,000 for an S.A. This minimum share capital refers to the legal entity as a whole and not to each single compartment.

A securitisation vehicle can also be organised in a purely contractual form as a securitisation fund. The ***securitisation fund*** does not have legal personality. It will, however, be entitled to issue units representing the rights of investors, in accordance with the management regulations (see figure 9).

In the absence of legal personality, the securitisation fund may be organised as a co-ownership or a trust. In both cases, the securitisation fund will be managed by a management company, being a commercial company with legal personality. As for the securitisation company, the fund may be split into sub-funds, which may then again be liquidated separately. The characteristics and rules applicable to each sub-fund may be governed by separate management regulations.

Securitisation funds are not subject to any minimum capital. Only the management company must meet the minimum capital requirement, which depends on the chosen legal form. Thus, the required capital ranges between EUR 12,500 for a S.à r.l. and EUR 31,000 for an S.A.

Figure 9: Legal forms of securitisation vehicles and creation of compartments



2.3.2 Ability to create compartments

One of the main advantages cited by many market participants is the possibility to create several compartments within one legal entity. This concept is adapted from the popular umbrella-fund structure. Precondition for several compartments is simply the authorisation of the Board of Directors to create separate compartments in the securitisation company's articles of incorporation. This allows each compartment to correspond to a distinct portion of assets financed by distinct securities. The compartments allow a pool of assets and corresponding liabilities to be managed separately, so that the result of each pool is not influenced by the risks and liabilities of other compartments. Each compartment can be liquidated separately.

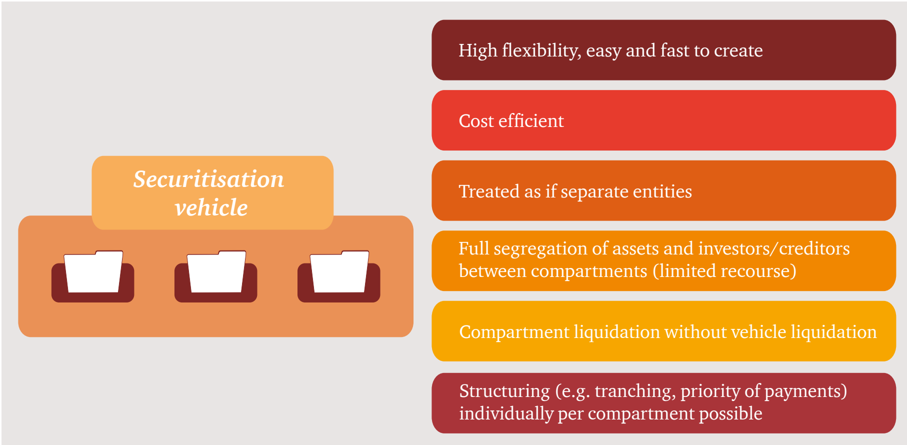
The compartment segregation of the securitisation vehicle – a technique initially applied to investment funds in Luxembourg – also characteristically illustrates the great flexibility that securitisation transactions in Luxembourg provide, as this technique is not allowed in the majority of countries competing with Luxembourg. This segregation needs to be mentioned in the articles of incorporation of a securitisation company or in the management regulations of a securitisation fund.

Compartment segregation means that the assets and liabilities of the vehicle can be split into different compartments, each of which is treated as a separate entity executing distinct transactions. The rights of investors and creditors are limited to the risks of a given compartment's assets. There is no recourse against the assets allocated to other compartments in the event that the claims under the securities held by the investors are not fully satisfied with the assets of the compartment in which they have invested. Each of the compartments can be liquidated separately without any negative impact on the vehicle's remaining compartments, i.e. without triggering the liquidation of other compartments. If the securitisation vehicle is a corporate entity, all compartments can be liquidated without necessarily liquidating the whole vehicle.

In addition, the securitisation vehicle or one of its compartments may issue several tranches of securities corresponding to different collaterals/risks and providing different values, yields and redemption terms. Limited recourse, subordination and priority of payment provisions, contractually agreed upon between the investors of tranches, may freely organise the rights and the rank between the investors and the creditors of a same compartment.

However, this is only possible if provided for in the articles of incorporation, management regulations or issuance agreement. In the case of a dual structure, where the acquisition vehicles are separated from the issuing vehicle, the value, yield and repayment terms of the transferable securities issued by the issuing vehicle may also be linked to the assets and liabilities of the acquisition vehicles.

Figure 10: Compartment segregation



2.3.3 Numerous asset classes allowed

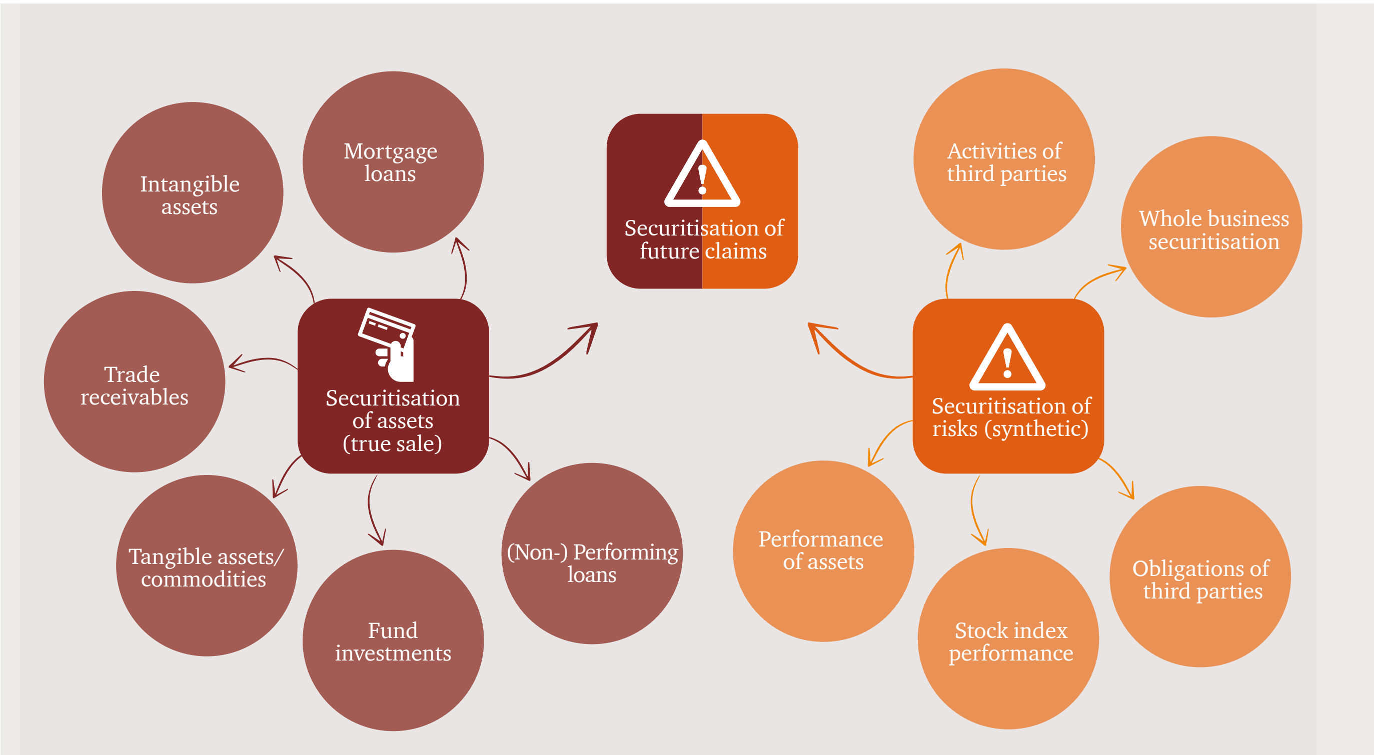
Another aspect of the Luxembourg Securitisation Law's great flexibility is the wide range of asset classes that qualify for securitisation. The Luxembourg Securitisation Law does not limit securitised assets. In its early phases of development, the securitisation market essentially covered assets like loans and receivables of financial institutions, such as mortgage-backed loans, credit card receivables and student loans. Today, however, securitisation transactions also cover tangible asset classes, such as railcars, diamonds and champagne, as well as intangible assets, such as intellectual property or any type of rights.

Under the Luxembourg Securitisation Law, also risks (without acquiring the asset) may be securitised. These risks relate to the holding of assets, whether movable or immovable, tangible or intangible. These risks can also result from the obligations assumed by third parties, as well as relating to all or part of the activities of third parties. The securitisation vehicle can assume these risks by acquiring the assets, guaranteeing the obligations or committing itself in any other way (see figure 11).

Existing claims can be assigned to a securitisation vehicle, but it is also possible to do this for future claims. These may arise (i) from an existing or future agreement, provided that such claims can be identified as being part of the assignment at the time they come into existence; or (ii) from future claims originating from future contracts provided that such claims are sufficiently identified at the time of the sale or any other agreed time.

The main asset classes securitised through Luxembourg securitisation vehicles are securities, loans, mortgages, non-performing loans, car loans, lease receivables, trade receivables, receivables in connection with real estate or loans in relation with SME financing. Recent years have also seen the development of "Trackers" certificates, directly or indirectly linked to the value of an index or another transferable security, which are structured for retail investors. In the last year also Fintech related activities, e.g. P2P-lending and crowdfunding using a Luxembourg securitisation vehicle have been developed.

Figure 11: No restrictions for asset classes and risk transfer



2.3.4 Different forms of risk transfer and transaction types possible

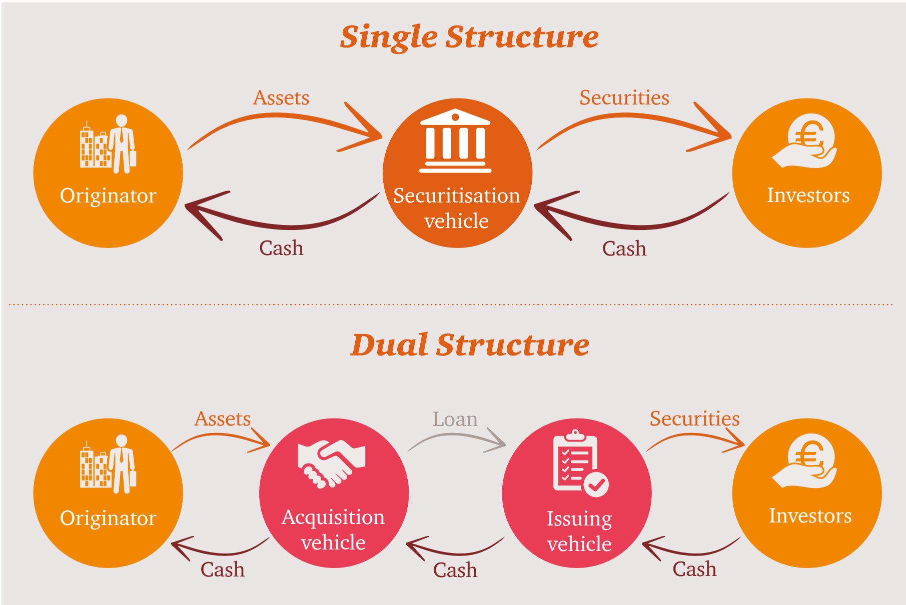
True sale vs. synthetic

Securitisation transactions can be executed in the two forms already described in chapter 1.4 Types of transactions. Within the scope of a “true sale” transaction, the originator sells a pool of assets to a securitisation vehicle. Within the scope of a “synthetic” transaction, however, the originator buys credit/market risk protection through a series of credit derivatives or swaps, without transferring the ownership of the underlying assets.

Single vs. dual structure

As shown in figure 12, it is possible to structure securitisation transactions as single structures or as dual structures. In a single structure, one securitisation vehicle purchases the assets or the risks and issues the securities. In contrast, in a dual structure, two or more vehicles will be constituted. Some of them will act as “acquisition” vehicles, which purchase the assets or risks.

Figure 12: Transaction structures



They are funded by loans provided by an “issuing” vehicle issuing securities to the market whose repayment is linked to the repayment of the loans granted to the acquisition vehicles. On the other hand, these loans are a mode of assuming a risk linked to underlying assets and whose repayments are linked to the cash flow resulting from this underlying. In a dual structure, the acquisition vehicles can also be established in the country of the originator or in the country where the transferred assets are located.

2.4 Supervision of securitisation vehicles

2.4.1 Preconditions for authorisation requirement

Regarding the authorisation and supervision of securitisation vehicles, the Luxembourg Securitisation Law differentiates between authorised and non-authorised entities. Authorised securitisation vehicles are authorised and supervised by the CSSF, which is responsible for ensuring that they comply with the Luxembourg Securitisation Law and fulfil their obligations.

A securitisation vehicle is subject to mandatory CSSF supervision if it issues securities to the public on a continuous basis. These two conditions ("to the public" and "on a continuous basis") are cumulative for the vehicle. Since neither the Luxembourg Securitisation Law nor parliamentary works define the notion of "public", the CSSF has published the following criteria to clarify the concept:

- issues to professional clients within the meaning of Annex II to the MiFID Directive (2004/39/EC) are not issues to the public;
- issues whose denominations equal or exceed EUR 125,000 are assumed not to be placed with the public;
- the listing of an issue on a regulated or alternative market does not ipso facto imply that the issue is deemed to be placed with the public;
- issues distributed as private placements, whatever their denomination, are not considered to be issues to the public. The CSSF assesses whether the issue is to be considered a private placement on a case-by-case basis according to the communication means and the technique used to distribute the securities. However, the subscription for securities by an institutional investor or financial intermediary for a subsequent placement of such securities with the public constitutes a placement with the public.

Therefore, issues to professional investors and private placements are not considered to be issues to the public.

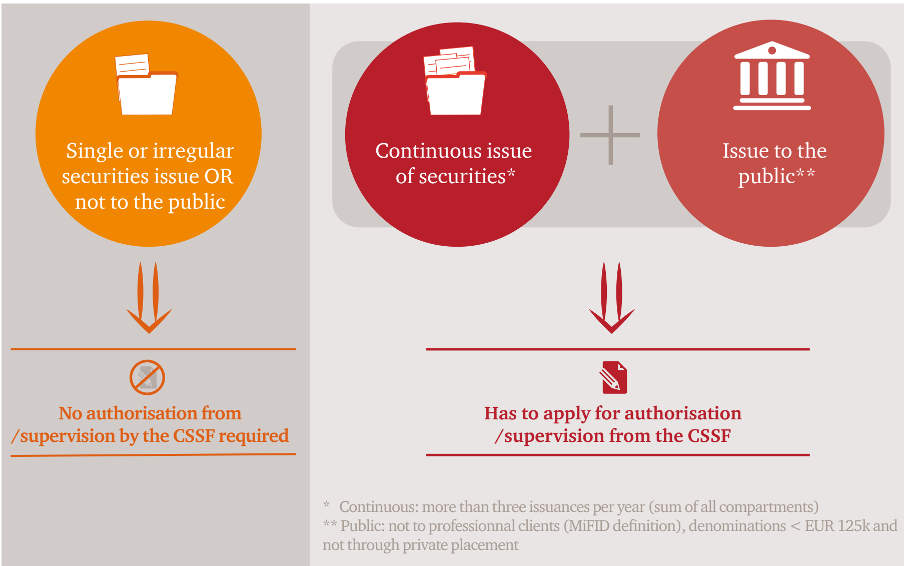
The definition of the term "public" in the area of securitisation is not in line with that of the Law of 10 July 2005 on prospectuses for securities, which defines the notion "offer to the public" and whose determining criterion is that of a proactive approach of solicitation and a specific offer adopted by the banker.

The CSSF considers the notion "on a continuous basis" to be fulfilled from the moment the securitisation vehicle launches to the public more than three issues per calendar year. However, a securitisation vehicle that launches at least four issues on an annual basis is not subject to CSSF supervision if it issues denominations exceeding EUR 125,000.

As a consequence, a one-off issue of securities to the public as well as the continuous issue of securities with a denomination above EUR 125,000 may be carried out without prior approval from the CSSF.

In the case of a multi-compartment securitisation vehicle, the CSSF clarified that the number of issues per year has to be determined on the level of the securitisation company and not on compartment level.

Figure 13: CSSF supervision



2.4.2 Initial authorisation by the CSSF

Authorisation by the CSSF means that the CSSF has to approve the articles of incorporation or management regulations of the securitisation vehicle and, if necessary, authorise the management company. The same procedure applies for existing securitisation vehicles that have not been authorised because of not having issued securities to the public on a continuous basis.

To grant approval, the CSSF must be informed on the identity of the members of the securitisation vehicle's administrative, management and supervisory bodies. In case of a regulated securitisation fund's management company, the shareholders being in a position to exercise significant influence further need to be named. There must be at least three directors in a securitisation company or management company of a securitisation fund, and these directors must be of good repute and have adequate experience and means required to perform their duties. The CSSF also allows legal persons to act as directors. In such cases, the CSSF will assess the criteria regarding the directors' competence and reputation at the level of the representatives of the legal persons.

Securitisation companies and management companies of securitisation funds must have adequate organisation and human and material resources to exercise their activities correctly and professionally. Structuring and management of the assets can be delegated to other professionals, including in foreign countries. Yet in such a case, an appropriate information exchange mechanism between the delegated functions and the Luxembourg based administrative body must be established. The organisational structure must allow the external auditor and the CSSF to exercise their supervisory tasks.

The prudential supervision exercised by the CSSF aims to ascertain whether the authorised securitisation vehicle complies with the Luxembourg Securitisation Law and its contractual obligations. Any change to the securitisation vehicle's articles of incorporation, managing body or external auditor must be reported to the CSSF immediately and is subject to the CSSF's prior approval. Any change in the control of the securitisation company or management company is subject to the CSSF's prior approval.

A further requirement for regulated securitisation vehicles is that their assets (securities and cash) must be held in custody by a Luxembourg credit institution.

For the authorisation process, at the least the following elements must be included in the approval file to the CSSF:

- the securitisation vehicle's articles of incorporation or management regulations, or their drafts;
- the identity of the members of the Board of Directors of the securitisation vehicle or its management company, as well as the identity of the other managers of the securitisation vehicle or its management company, their CVs and extracts from their police records;
- the identity of the shareholders who are in a position to exercise a significant influence on the business conduct of the securitisation vehicle or its management company and their articles of incorporation;
- the identity of the initiator and, where applicable, its articles of incorporation;
- information concerning the credit institution responsible for the custody of assets;
- information concerning the administrative and accounting organisation of the securitisation vehicle;
- the agreements or draft agreements with service providers;
- the identity of the external auditor;
- the draft documents relating to the first issue of securities, or, for active securitisation vehicles,
- the agreements relating to the issue of securities and other documents relating to securities already issued.

In addition to the approval file, the CSSF usually requires the initiator to present the intended securitisation transaction.

After authorisation, the CSSF enters the authorised securitisation vehicle on an official list. Such entry is tantamount to authorisation and the securitisation vehicle is notified accordingly. This list and any amendments are published on the CSSF website.

2.4.3 Continuous supervision by the CSSF

The Luxembourg Securitisation Law has vested the CSSF with the authority to supervise securitisation vehicles on a continuous basis. It has wide investigative powers regarding all elements likely to influence the security of investors. For this purpose, the CSSF may request any information from the regulated entity. For the time being, the CSSF has not provided any specific information defining reporting requirements. Until more sophisticated standardised reporting is implemented, each regulated entity will receive a separate letter detailing reporting requirements. The reporting can be classified into three categories:

(i) The following documents need to be submitted to the CSSF on an ad hoc basis:

- The final issue documents relating to each issue of securities;
- A copy of the financial reports drawn up by the securitisation vehicle for its investors and rating agencies, where applicable;
- A copy of the annual reports and documents issued by the external auditor resulting from its audit of annual accounts (including the management letter or, where no such management letter has been issued, a written statement from the external auditor confirming that fact);
- Information on any change of service provider and substantive provisions of a contract, including the conditions applicable to the issued securities; and
- Information on any change relating to fees and commissions.

(ii) On a semi-annual basis, the CSSF requires the securitisation vehicles to provide statements on new issues of securities, outstanding issues and issues that have been redeemed during the period under review. In connection with each issue the securitisation vehicle should report the nominal amount issued, the nature of the securitisation transaction, the investor profile and, where applicable, the compartment concerned. In addition, the semi-annual report should include a brief statement of the securitisation vehicle's financial position and notably a breakdown (by compartment, where applicable) of its assets and liabilities. At the financial year-end, a draft balance sheet and a profit-and-loss account must further be added. The semi-annual report must be submitted to the CSSF within 30 days. There are no special requirements regarding the submission format or information medium used.

(iii) The third category of reporting is the year-end reporting, which consists of the audited annual accounts and the management letter issued by the auditor.

The CSSF may also require any other information or perform on-site inspections and review any document of a securitisation company, Management Company or credit institution in charge of safekeeping the assets of the securitisation undertaking, so as to verify compliance with the provisions of the Luxembourg Securitisation Law and the rules laid down in the articles of incorporation or management regulations and securities issue agreements, as well as the accuracy of the communicated information.

No regulatory requirements are provided for securitisation vehicles making a single securities issue or irregular issues, or issuing securities in a private placement.

2.5 Luxembourg as attractive marketplace

2.5.1 Enhanced investor protection

As there is no limitation on the investor basis, investments into a Luxembourg securitisation vehicle are open to all types of investors. Therefore, one of the most important aspects of the Luxembourg Securitisation Law is to ensure enhanced investor protection. The bankruptcy remoteness principle separates the securitised assets from any insolvency risks of the securitisation vehicle or of the originator, service provider and all other involved parties. In the event of bankruptcy of the originator or the servicer to whom the securitisation vehicle has delegated the collection of the cash flow from the assets, the Luxembourg Securitisation Law states that the securitisation vehicle is entitled to claim the transfer of ownership of the securitised assets and any cash collected on its behalf before liquidation proceedings are opened.

Moreover, the Luxembourg Securitisation Law allows for contractual provisions that are valid and enforceable and which aim to protect the securitisation vehicle from the individual interests of involved parties, consequently enhancing the securitisation vehicle's protection as follows.

- **Subordination provision:** Investors and creditors may subordinate their rights to payment to the prior payment of other creditors or other investors. This provision is crucial for tranching the securitisation transaction.
- **Non-recourse provision:** Investors and creditors may waive their rights to request enforcement. This means, for example, that if payment of interest is in default, the investor may agree to wait for payment and not resort to legal action, as the situation is known or is temporary.
- **Non-petition provision:** Investors and creditors may waive their rights to initiate a bankruptcy proceeding against the securitisation vehicle. This clause protects the vehicle against the actions of individual investors who may have, for example, an interest in a bankruptcy proceeding against the vehicle.

In addition, the Luxembourg Securitisation Law provides that the assets are exclusively available to satisfy investors' claims in the securitisation vehicle or in a compartment if several compartments have been created, and to satisfy creditors' claims in connection with such assets. Therefore, compartment segregation prevents insolvency contamination between different compartments.

2.5.2 Qualified service providers

The following parties provide high investor protection as well as business opportunities for Luxembourg market players.

2.5.2.1 The custodian

The custodian is an important player in the securitisation vehicle's business activities. The custodian is responsible for keeping the documentation proving the existence of securitised assets and guaranteeing that these assets, in the form of cash or transferable securities held by a securitisation vehicle, are kept under the best conditions for the investor.

To guarantee this, the Luxembourg Securitisation Law requires that authorised securitisation vehicles must entrust the custody of their liquid assets and securities in a credit institution established or having its registered office in Luxembourg. As there is no specific regime for the custody of the assets, the custodian of an authorised securitisation vehicle is not subject to any supervisory duty, but only to the duty of properly safekeeping the assets entrusted under custody. A different custodian may be designated for each compartment.

There are no such requirements for unauthorised vehicles.

2.5.2.2 The auditor

Whatever their legal form and accounting framework adopted, securitisation vehicles must be audited by an independent auditor ("Réviseur d'entreprises"). For an authorised securitisation vehicles supervised by the CSSF, the independent auditor must be authorised by the CSSF all the same ("Réviseur d'entreprise agréé").

2.5.2.3 The fiduciary representative

Fiduciary representatives are professionals of the financial sector who can be entrusted with safeguarding the interests of investors and certain creditors.

In their capacity as fiduciary representatives and in accordance with the legislation on trust and fiduciary agreements, the fiduciary representatives can accept, take, hold and exercise all sureties and guarantees on behalf of their clients and ensure that the securitisation vehicle manages the securitisation transactions properly. The extent of such rights and powers is laid down in a contractual document to be concluded with the investors and creditors, whose interests the fiduciary representatives are to defend. If and for as long as one or more fiduciary representatives have been appointed, all individual rights of represented investors and creditors are suspended.

Fiduciary representatives also require authorisation by the CSSF. They must have their registered office in Luxembourg and they may not exercise any activity other than their principal activity, except on an accessory and ancillary basis. The authorisation for exercising the activity of a fiduciary representative can only be granted to stock companies with a share capital and own funds of at least EUR 400,000.

Even after the Luxembourg Securitisation Law having been in place for more than 12 years no fiduciary representative is registered in Luxembourg, although the Luxembourg Securitisation Law provides a special legal framework for such independent professionals, who are responsible for representing investors' interests. In practice, Luxembourg securitisation vehicles usually appoint trustees governed by foreign law.

2.5.3 Defined liquidation process

When a securitisation transaction matures and all obligations have been repaid, the securitisation vehicle is usually liquidated if it is not re-used for another transaction. There is a fine line between the definitions of "liquidation" and "dissolution". Dissolution is a legal concept referring to the formal death of an entity. Once a company completes its dissolution process, it is no longer a formal legal entity. Liquidation refers to the complete realisation of a company's assets and liabilities.

Liquidation can occur on a voluntary or forced basis.

There are two different procedures for the standard voluntary liquidation of a securitisation vehicle: a normal procedure and a simplified procedure (for vehicles with a single shareholder). The normal liquidation procedure falls under the law on commercial companies, whereas the simplified procedure is an administrative practice.

For the **normal liquidation procedure**, the decision to liquidate has to be taken at an extraordinary general meeting (EGM) of the shareholders. This EGM must appoint a liquidator responsible for preparing a detailed inventory of the vehicle's assets and liabilities, realising the assets, paying the debts and distributing the remaining balance (if any) to the appropriate parties. The liquidator may also bring and defend any legal action on behalf of the company. The different steps of the procedure are as follows:

- EGM with decision to liquidate and appointment of liquidator(s);
- Sale or transfer of assets and liabilities;

- Intermediate accounting statement to be prepared;
- Preparation of a Liquidator's report;
- Ordinary General Meeting to appoint the "Commissaire à la liquidation";
- Preparation of a Report of the "Commissaire à la liquidation";
- Ordinary General Meeting to close the liquidation;
- Publishing of the dissolution.

The second shareholders' general meeting appoints a "Commissaire à la liquidation" who must be a "Réviseur d'entreprises agréé". The "Commissaire à la liquidation" reviews the work performed by the liquidator and prepares a report for the attention of the shareholders.

Under simplified liquidation, all of the liquidated vehicle's assets and liabilities are transferred to the sole shareholder who takes over responsibility for the debts. The main steps are the following:

- Sale or transfer of assets;
- Intermediate accounting statement to be prepared;
- Agreement with a notary;
- Ordinary General Meeting in the presence of the notary to close the liquidation;
- Publishing of the dissolution.

In case of a forced liquidation, the court appoints a bankruptcy judge ("juge-commissaire") and one or more liquidators, and determines the method of liquidation. Once the liquidation is complete, the liquidator delivers a report to the court on the use made of the assets of the undertaking and submits supporting accounts and evidence. The court then appoints one or more Réviseurs d'entreprises agréé(s) to examine these documents.

For a forced liquidation, any legal action against the liquidators, in their capacity as such, lapses five years after the publication of the close of the liquidation proceedings.

If the vehicle is supervised by the CSSF, the liquidators must be authorised by the CSSF and have the necessary good repute and professional qualifications, and the liquidation is subject to CSSF supervision.

As mentioned above, each compartment of a securitisation undertaking may be liquidated separately without such liquidation resulting in the other compartments being liquidated. For the liquidation of a compartment, there is no specific requirement other than a formal approval of the securitisation company's governing body.

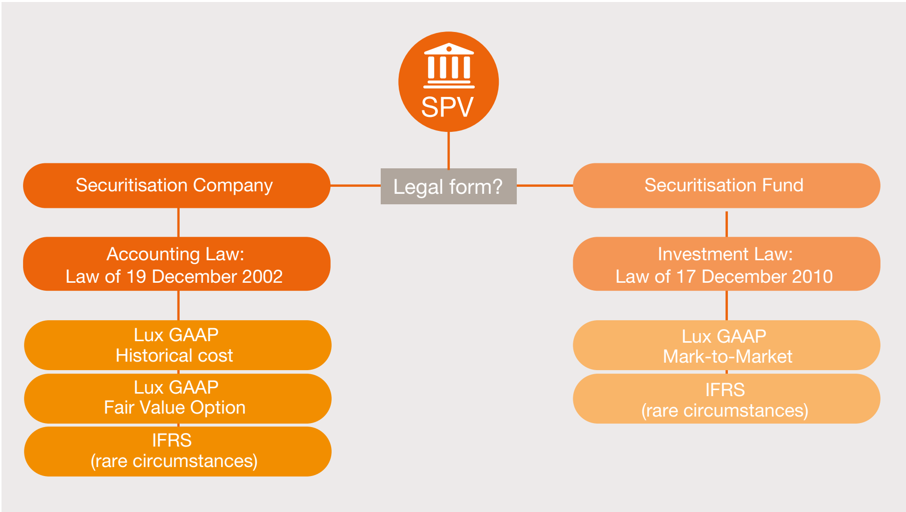
For a **securitisation fund** (and the related management company), there is a significant difference: since the securitisation fund has no legal personality, it ceases to exist once all its sub-funds have been liquidated.

3. Accounting & Tax

3.1 Accounting

The Luxembourg Securitisation Law itself does not contain any provisions with respect to accounting. Instead, it makes reference to other laws depending on the legal form of the securitisation vehicle.

Figure 14: Luxembourg Accounting Law's flexibility



3.1.1 Securitisation company accounting

General accounting framework

Securitisation vehicles established as securitisation companies must comply with the provisions of chapters II and IV of title II of the Law of 19 December 2002 on the trade and companies register and the accounting and the annual accounts of companies (hereafter the "Accounting Law"). This Law sets the legal framework for the accounting principles applied in Luxembourg, often referred to as "Luxembourg GAAP".

An interesting feature of securitisation companies is the flexibility that Luxembourg GAAP offers to the preparers of annual accounts. The Accounting Law contains a choice between different accounting frameworks for valuing financial assets: (i) Luxembourg GAAP under the historical cost model, (ii) Luxembourg GAAP under the fair value model or (iii) International Financial Reporting Standards as adopted by the European Union ("IFRS"). Further details about Luxembourg GAAP can be found in our brochure "Handbook for the preparation of annual accounts under Luxembourg accounting framework" and our "Illustrative financial statements" also belonging to this series "Securitisation in Luxembourg", all available on our website *www.pwc.lu*.

Under Luxembourg GAAP (historical cost model), a securitisation company's assets are valued either at acquisition cost or at the lower value attributed to them. Under historical cost convention, a valuation above the acquisition cost, e.g. based on higher market values, is generally not feasible. However, when a value attributed to an asset is lower than the acquisition cost, a value adjustment must be made either for each case ("lower of cost or market value" or "LOCOM") or for durable value depreciations only ("acquisition cost").

In addition, Luxembourg GAAP offers the possibility to value most financial instruments at fair value without being subject to the provisions of the IFRS (fair value model). Nevertheless, some additional disclosure on the fair value instruments and valuation models, if any, must be made in the notes to the annual accounts. For some instruments, e.g. investments in subsidiaries and associates and some non-financial assets, the fair value option can only be applied when complying with the full valuation and disclosure requirements of the relevant IFRS standards.

The third option for securitisation companies is to prepare their annual accounts according to IFRS, instead of preparing Luxembourg GAAP accounts (while still remaining subject to some of the Luxembourg GAAP disclosure requirements). In practice, only a few securitisation vehicles prepare their annual accounts under IFRS.

Management report and listed entities

A securitisation company is required to prepare a management report if the size criteria of article 35 of the Accounting Law are exceeded or if it has its securities listed on an EU-regulated market[6] regardless of size. This management report must contain all material information relating to its financial position which could affect investors' rights. In case a securitisation company has its securities listed on an EU-regulated market, the management report must include (or refer to) a corporate government statement that contains a description of the principal characteristics of internal control system and risk-management procedures regarding financial reporting. For further details and an illustrative management report, you can also refer to our "Handbook for the preparation of annual accounts under the Luxembourg accounting framework".

Securitisation companies with transferable securities quoted on an EU-regulated market may also have to comply with further disclosure requirements pursuant to the Transparency Directive[7] and/or the Prospectus Regulation[8]. For example, the Prospectus Regulation requires the financial information to contain a cash flow statement which may have to be added to the annual accounts under Luxembourg GAAP. However, the stand-alone financial information may still be prepared according to national accounting standards, i.e. Luxembourg GAAP. An obligation to use International Financial Reporting Standards ("IFRS") exists only for consolidated financial statements, which a securitisation vehicle as passive, non-controlling vehicle should be exempted from.

Such companies may also be required to have an Audit Committee[9]. However, exemptions may apply, e.g. if the Board as a whole performs the function of the audit committee (Art. 74 (1)) or if its sole business is to act as issuer of asset-backed securities (Art. 74 (6)).

3.1.2 Securitisation fund accounting

A securitisation fund managed by a management company and governed by management regulations is subject to the accounting and tax regulations applicable to investment funds provided by the Law of 17 December 2010 on undertakings for collective investment. So in general, the valuation of a securitisation fund is based on the mark-to-market principle unless otherwise stated in the management regulations.

However, from an economic perspective, a securitisation fund is more comparable to a securitisation company than to an investment fund. Since the reference to investment laws relates only to the accounting and tax provisions – and not to disclosure requirements – a securitisation fund could apply the same rules as a securitisation company. For the latter, detailed disclosure requirements are defined in the aforementioned Accounting Law. Therefore, the required disclosures for an investment fund – like the statement of change in net assets or explicitly disclosing the portfolio – usually will not create any added value to the annual accounts of a securitisation fund, but still might be appropriate in some cases.

3.1.3 Multi-compartment vehicles

One of the distinctive features of Luxembourg's asset management industry is the way in which a securitisation vehicle may be split into one or more separate compartments, each corresponding to a distinct part of its assets financed by distinct securities. A compartment's assets are available exclusively to satisfy the rights of investors in relation to this very compartment and the rights of creditors whose claims have arisen in connection with the creation, operation or liquidation of the compartment.

As far as accounting is concerned, the CSSF confirmed that multi-compartment securitisation companies should present their annual accounts and related financial notes in such a way that the financial data for each compartment is clearly stated. It is possible, however, to combine the notes to the annual accounts of several compartments. As a result, a securitisation vehicle with several compartments is regarded as a combination of several companies under one legal entity. Concerning the financial disclosure of a multi-compartment structure, please note that the disclosure of only a combined balance sheet and a combined profit and loss account will not provide a true and fair view of the securitisation vehicles' activities and financial position. Therefore, either separate balance sheets and profit and loss accounts for each compartment need to be disclosed in addition to the combined one, or a special note must be added in the notes to the annual accounts, describing the compartment structure, including the assets and liabilities and the income and charges of each compartment. In a separate publication within the series "Securitisation in Luxembourg", we present an illustrative example of the annual accounts of a securitisation company, including an example of how to meet the disclosure requirements for a multi-compartment structure.

Under certain circumstances, an additional separate audit opinion can be expressed on parts of the securitisation vehicle's annual accounts (e.g. for one compartment only). However, this does not prevent the securitisation vehicle from preparing and publishing audited annual accounts for the entity as a whole.

3.1.4 Treatment of (unrealised) gains and losses for the security holders ("equalisation provision")

From the investors' perspective, the securitisation vehicle is bankruptcy remote. A bankruptcy remote structure provides reasonable certainty that the securities issued are collateralised by a pool of assets that have been legally isolated from the transferor in all possible circumstances, including insolvency. As a consequence, no recourse can be made by the transferor's creditors or liquidator to the securitisation vehicle's assets.

On the other hand, the recovery of the securities issued is entirely dependent on the securitisation vehicle's asset pool generating sufficient cash flow, as the investors usually have no recourse to the transferor beyond its structural support should asset cash flow be less than originally anticipated.

The ability of the asset pool to meet the obligations to the holders of the funding instruments is largely assessed on projected asset cash flows under various scenarios. These scenarios are,

6 As defined by art. 4 paragraph (1) point 14 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

7 Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC; transposed into Luxembourg law by the Law of 11 January 2008 (the "Transparency Law").

8 Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC.

9 Based on Art. 74 of the Law of 18 December 2009.

in principle, illustrated in the offering documents using key assumptions for prepayments and credit losses due to delinquencies and defaults. In some structures, cash flows from the pool may be used to acquire new assets from the originator or, in the case of a CDO, from the secondary market until the end of a revolving period, at which stage collections are used to repay the funding instruments. To minimise the risk of investors that the securitisation vehicle subsequently invests in new assets of lower quality, these new assets must meet various eligibility criteria.

Moreover, an investor's risk is often further reduced by the structuring of the securitisation vehicle and securities issued. This is most typically achieved by issuing at least one senior and one subordinated security ("tranching") each having a different seniority as to payment from the cash flow of the pool of assets. When the cash flow from the asset pool is collected, it is firstly used to meet the obligations of the most senior security holders. Any residual cash flow after payment of the most senior class is then again used to pay the less senior security holders. This mechanism is known as the "waterfall" or "priority of payments" and has the effect of allocating potential cash flow shortfalls to the most junior debt holders or investors.

Should losses resulting from the assets be significantly higher than anticipated and exceed the transferor's interest, the security holders are exposed to credit losses. To provide a true and fair view, these losses (impairments) must be disclosed in the annual accounts. Therefore, a value adjustment will be made in respect of the assets, so that the assets are shown at the lower value to be attributed to them at the balance sheet date. This value adjustment will lead to a loss in the profit and loss account. As described above, the loss will be absorbed by the holders of the securities issued. Consequently, the potential amount repayable will decrease. To reflect this in the annual accounts and avoid an "accounting mismatch", a provision for value diminution must be made in respect of the liabilities, so that the liabilities are disclosed at the lower value to be attributed to them at the balance sheet date. This will lead to an unrealised gain in the profit and loss account and should be described as "equalisation provision" in the notes to the annual accounts. As a result, the total net effect on the profit and loss account will be nil. However, this should not be confused with a write-off of the notes repayment obligation; the obligation remains based on the notional and the repayment formula or waterfall; therefore only the estimated value of the reimbursement changes.

To enable better understanding, a description of the valuation method used to calculate the equalisation provision should be given in the notes to the annual accounts. In addition, a summary of the waterfall structure and the consumption of the waterfall should be presented in the notes to the annual accounts.

The reverse effect applies when the repayable amount of the securities issued increases with an increase in asset value. As a securitisation vehicle usually distributes all the cash flow received to the investors or other involved parties, but not necessarily in the same period in which the profit takes place, it will usually neither disclose a profit nor a loss in the profit and loss account.

In such cases, the liability's higher reimbursement value must be shown in the annual accounts. Consequently and to furthermore avoid an accounting mismatch, the accounting options for asset valuation described above should be used in order to also show the related higher asset value and the (unrealised) gain in the annual accounts.

Since a caption called "equalisation provision" is not provided for by the Accounting Law[10] or the Standard Chart of Accounts (see below), we suggest to directly deduct or add the total equalisation provision from the notes value and to disclose these effects in the profit and loss account under "other operating income" and "other operating charges" respectively. Further explanation should be disclosed in the notes to the annual accounts. Our publication "Illustrative financial statements" provide an example for a possible disclosure.

3.1.5 Standard Chart of Accounts and electronic filing

In Luxembourg, legislation prescribes the use of a Standard Chart of Accounts ("SCA") and electronic annual accounts filing formats ("eCDF") for most companies. All securitisation companies that do not fall under the CSSF's supervision are obliged to use SCA and eCDF, among others. Companies that prepare and publish their annual accounts under IFRS are exempted from filing their balance of accounts under the SCA and the eCDF.

The Luxembourg authorities have left it to each company subject to the SCA to determine whether to use the SCA within their accounting system for daily bookkeeping purposes or to keep their own chart of accounts for internal purposes as long as they file their balance of accounts in the SCA format with the Trade and Companies Register ("RCS").

Despite the absence of mandatory reconciliation between the annual accounts and the SCA, preparers subject to the SCA requirement should follow the layout provided for by the templates for preparing the trial balance, balance sheet and profit and loss account to be prepared for electronic filing via the electronic platform "plateforme électronique de Collecte des Données Financières". For more information about the SCA and the electronic filing process, please refer to the publications on our website *www.pwc.lu*.

For companies subject to the SCA, the eCDF uploads are the official accounts which need to be approved by the Board of Directors / Managers and audited by

10 The flexibility to adjust the balance sheet and profit and loss account layout is no longer applicable since the amendments to the Accounting Law by the Law of 30 July 2013.

an independent auditor. Any deviation from the eCDF templates for the financial year while preparing the annual accounts is considered to be non-compliant with laws and regulations and may be rejected by the RCS. In practice, the balance sheet and profit and loss account prepared in the eCDF format should be directly integrated into the annual accounts to be audited.

The reduced flexibility in balance sheet and profit and loss account layout when applying SCA and eCDF have raised some questions for securitisation vehicles on how to best present their annual accounts, especially for multi-compartment securitisation vehicles and with regard to the equalisation provision.

For the annual accounts of multi-compartment vehicles, best practice is to present a combined balance sheet and combined profit and loss account in the SCA/eCDF format and, additionally, to disclose a separate balance sheet and profit and loss account for each compartment (or similar compartment-specific information) as part of the notes to the annual accounts. In addition, an "equalisation provision" cannot be disclosed as such on the face of the balance sheet and the profit and loss account, as such captions are not provided for. Therefore, we propose - and regard as current best practice - to disclose the equalisation provision as a consequence of a loss on the asset side in the section "other operating income" and the investor gains in "other operating charges" respectively, plus providing further detailed information in the notes to the annual accounts.

Luxembourg-based companies not subject to SCA/eCDF also no longer have the possibility to adapt the balance sheet and profit and loss account layout. In other words, it is no longer possible:

- to use more detailed captions;
- to change the denomination;
- to add new items; or
- to remove accounts where the balance equals zero.

Consequently, securitisation companies not presenting their annual accounts in SCA/eCDF format (i.e. those supervised by the CSSF) have to disclose their (combined) balance sheet and profit and loss account in a manner that shows all captions required by the Accounting Law, regardless of whether they contain values or nil balances.

Recent amendments of the Accounting Law will apply for financial years beginning as from 1 January 2016 (please also refer to our Flash News published on 9 December 2015). The impact on securitisation companies is limited and mainly affects balance sheet and profit and loss account layout as well as disclosure. For example, notes have to be presented in a specific order, gross amounts have to be disclosed in the case of netting and extraordinary items are not disclosed on the face of the profit and loss account but require notes disclosure. Furthermore, a vertical profit and loss account format (a list mixing income and charges positions by nature, similar to international accounting standards) has to be used rather than a horizontal format separating income and charges.

Filing with the RCS

As per article 75 of the Accounting Law, all Luxembourg-based companies are required to file their annual accounts with the RCS electronically. The filing procedure applies to all relevant documents, such as:

(i) the annual accounts, which comprise the balance sheet, profit and loss account, notes to the annual accounts and other financial statements

(ii) the trial balance presented under the SCA format, if applicable, and

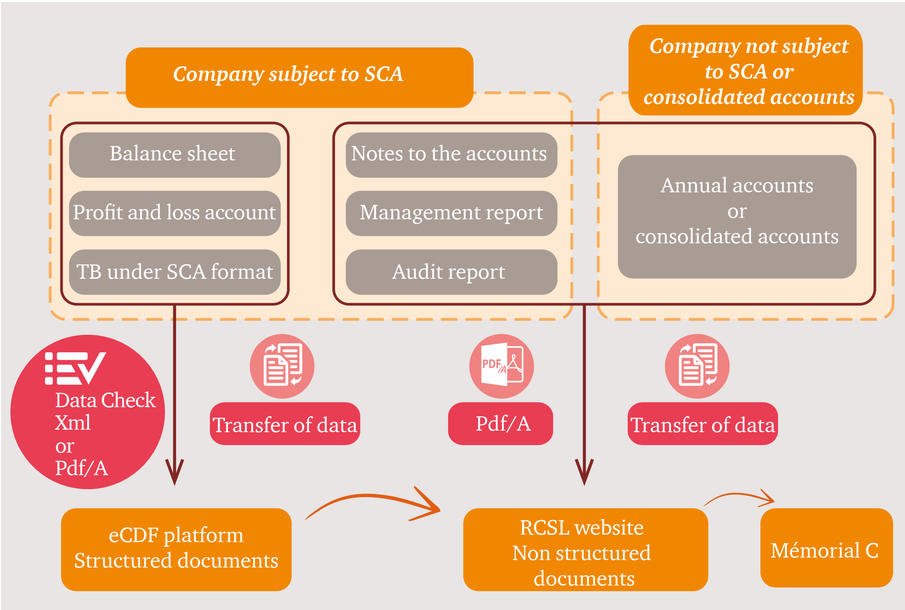
(iii) all other documents to be filed in the same context (e.g. management report and audit report).

For companies obliged to file their trial balance in the SCA format, a two-step approach needs to be taken. Some of the documents filed need to be processed in a predefined structured form (trial balance, balance sheet and profit and loss account) via the eCDF platform, which then transmits the data to the RCS. The other information (notes to the annual accounts, audit report, etc.) will be filed directly with the RCS in a non-structured format.

For companies not obliged to file their trial balance in the SCA format (e.g. CSSF-supervised securitisation companies), the full set of annual accounts must be filed electronically on the RCS website (and not via the eCDF platform).

The main stages of the e-filing process are highlighted in figure 15.

Figure 15: e-filing procedure



3.2 BCL reporting

The European Central Bank (ECB) has adopted several EU regulations concerning statistical reporting on the assets and liabilities of financial vehicle corporations (FVCs) engaging in securitisation transactions in order to provide the ECB with adequate statistics on the financial activities of the FVC subsector. Subsequently, the Banque centrale du Luxembourg (BCL) has developed a data collection system for securitisation vehicles, which is defined in the BCL Circular 2014/236.

These regulations are directly applicable to Luxembourg securitisation vehicles subject to the Luxembourg Securitisation Law, as well as to commercial companies outside the scope of the Luxembourg Securitisation Law but which conduct securitisation transactions.

The circular defines a concerned securitisation vehicle as an undertaking whose principal activity meets both of the following criteria:

(a) it intends to carry out, or carries out, one or more securitisation transactions and its structure is intended to isolate the payment obligations of the undertaking from those of the originator, or the insurance or reinsurance undertaking; and,

(b) it issues, or intends to issue, financing instruments and/or legally or economically owns, or may own, assets underlying the issue of financing instruments that are offered for sale to the public or sold on the basis of private placements.

In this context three types of securitisation are identified for statistical purposes:

a. **Traditional securitisation**, referring to a securitisation involving the economic transfer of the exposures being securitised to a financial vehicle corporation (FVCs) which issues securities. This shall be accomplished by the transfer of ownership of the securitised exposures from the originator or through sub-participation. The securities issued do not represent payment obligations of the originator.

b. **Synthetic securitisation**, referring to a securitisation where the tranching is achieved by the use of credit derivatives or guarantees, and the pool of exposures is not removed from the balance sheet of the originator.

c. **Other**, referring to FVCs which do not fall in the two first categories.

Therefore, each vehicle falling under the definition must comply with the following BCL reporting requirements:

In order to receive an identification code from the BCL, each Luxembourg securitisation vehicle shall spontaneously inform the BCL of its existence within one week after its incorporation date. A registration form in Excel format requesting legal information about the securitisation vehicle, the nature of securitisation, ISIN codes of securities issued and information about the reporter (i.e. the entity submitting the data) is available on the BCL website.

Afterwards, the securitisation vehicles must provide the BCL with regular information about their assets and liabilities and the transactions made. This information must be filed within 20 working days with the BCL in the form of the following three reports:

- Quarterly: S 2.14: Quarterly statistical balance sheet of securitisation vehicles;
- Quarterly: S 2.15: Transactions and write-offs/write-downs on securitised loans of securitisation vehicles;
- Monthly: TPTTBS “Security by security reporting of securitisation vehicles”.

A vast amount of information must be provided about the securitised assets, including a breakdown of the country and economic sector of the counterparts, the currency and maturity as well as nominal values. Yet, also information about the issued securities needs to be reported. Therefore, the reporting entity must ensure that all the data is made available in time in order to comply with the BCL requirements.

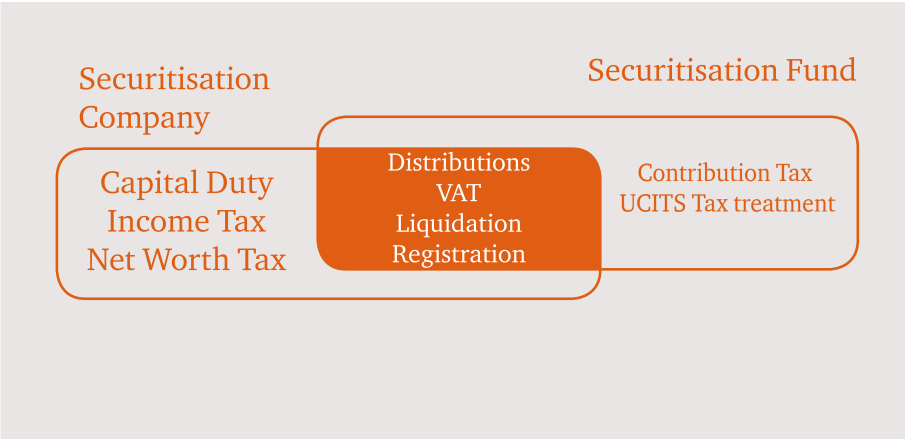
The BCL has exempted securitisation vehicles from the reporting requirement, given that the securitisation vehicles contributing to the quarterly aggregated assets/liabilities account for at least 95% of the aggregated assets of all Luxembourg securitisation vehicles. Currently, this threshold amounts to EUR 70 million since 2014.

In addition, all concerned securitisation vehicles, even those exempted from regular reporting, have to provide their annual accounts to the BCL if they are not public, e.g. published in the RCS within the legal deadline of seven months after closure. The BCL also accepts draft balance sheets, but the signed Financial Statements must be provided as soon as they are available.

3.3 Tax neutrality

As mentioned in chapter 1, tax neutrality is one of the key advantages of securitisation transactions. The Luxembourg Securitisation Law has been successful in achieving almost complete tax neutrality. The following scheme shows the different tax types applicable to the two types of securitisation vehicles.

Figure 16: Tax types applicable to the two securitisation forms



3.3.1 Tax specificities of securitisation companies

Securitisation vehicles organised as corporate entities are, as a rule, fully liable to corporate income tax and municipal business tax at an aggregate tax rate of 29.22% (tax rate currently applicable for entities based in Luxembourg City). Therefore, they are in principle taxed on their net accounting profit (i.e. gross accounting profits minus expenses). According to the Luxembourg Securitisation Law, however, a securitisation company's commitments to remunerate investors for issued bonds or shares and other creditors qualify as interest on debt even if paid as return on equity. They are therefore fully tax-deductible, so the tax impact should be rather limited if not nil. However, it may be vital to secure the tax treaty benefits depending on the nature of the assets. Structuring the cash flow so as to leave an arm's length remuneration of the securitisation vehicle could play a crucial role in this respect.

Please note that a corporate income tax reform has been proposed by the government to be further debated end of 2016.

It has been contemplated to reduce the corporate income tax from 21% to 18% over 2017 and 2018. The government announcements do not foresee any change to the "solidarity surcharge" on the corporate income tax, nor any change in the rate of the municipal business tax due by companies. If agreed on, the corporate income tax would be reduced to 19% for 2017, leading to an overall tax rate for companies of 27.08% in Luxembourg City for FY 2017 (taking into account the solidarity surcharge of 7% on the corporate income tax rate, and including the 6.75% municipal business tax rate applicable). The corporate income tax rate would be further reduced to 18% for 2018 leading to an overall tax rate of 26.01% in Luxembourg City for FY 2018.

In addition, all securitisation companies are subject to a net worth tax, named "minimum net worth tax" in Luxembourg as from 1 January 2016. (This minimum net worth tax has replaced the previous minimum tax on corporate income tax from 2013 to 2015. There is no minimum corporate income tax as from 1 January 2016.) This tax amounts between EUR 535 and EUR 32,100 for 2016, depending on the company's total assets. A EUR 3,210 fixed minimum net wealth tax applies when two cumulative conditions are fulfilled: the sum of fixed financial assets, transferable securities and cash must exceed both 90% of the total gross assets and EUR 350,000.

The question as to whether Luxembourg participation exemption on corporate income tax applies to an investment made in securitisation by Luxembourg corporates is not straightforward. The participation exemption regime on corporate income tax should not apply at the level of the Luxembourg corporate investors that receive dividends or derive capital gains from their investment in a securitisation vehicle.

On the other hand, dividends received and capital gains realised by a securitisation vehicle from fully taxable subsidiaries should benefit from the participation exemption regime.

Finally, dividends paid by a fully taxable Luxembourg joint-stock company to a securitisation company should benefit from the withholding tax exemption provided by the Luxembourg Tax Law. We recommend, nevertheless, conducting a detailed analysis to ascertain the overall tax treatment of structures using securitisation vehicles.

As from January 2015, the Luxembourg legislature enacted a new general transfer pricing regime applicable to all transactions between associated enterprises. The new legislation restates the arm's length principle which becomes more aligned with the OECD Model Tax Convention. The provisions now provide for both upward and downward profit adjustments where transfer prices do not reflect the arm's length principle. In addition, the legislation has been amended to clarify that the current disclosure and documentation requirements for taxpayers to support their tax-return positions also applies to transactions between associated enterprises (in addition to the documentation requirement that was already in place for intra-group financial intermediation activities). In the absence of proper transfer pricing documentation, when intra-group transactions exist, this may result in a reversal of the burden of proof towards the taxpayer. As a result of the extension and clarification of the transfer pricing Law, the Luxembourg tax authorities have been increasing their scrutiny of entities (including securitisation vehicles) engaged in related-party transactions.

Since securitisation companies are fully taxable resident companies, they benefit from Luxembourg's tax treaty network and from the EU Parent-Subsidiary Directive. At present, Luxembourg has concluded the following 77 treaties, and 22 others are under negotiation (*):

Figure 17: Tax environment (cont.)

Africa	America	Asia and Oceania		Europe	
Botswana*	Argentina*	Armenia	Saudi Arabia	Albania*	Macedonia
Egypt*	Barbados	Azerbaijan	Singapore	Andorra**	Malta
Mauritius	Brazil	Bahrain	South Korea	Austria	Isle of Man
Morocco	Canada	Brunei*	Sri Lanka	Belgium	Moldova
Senegal*	Mexico	China	Syria*	Bulgaria	Monaco
Seychelles	Panama	Georgia	Thailand	Croatia**	Netherlands
South Africa	Trinidad and Tobago	Hong Kong	Taiwan	Cyprus*	Norway
Tunisia (neg.)	United States (neg.)	India	Tajikistan	Czech Rep. (neg.)	Poland
	Uruguay*	Indonesia	UAE	Denmark	Portugal
		Israel	Uzbekistan	Estonia	Romania
		Japan	Vietnam	Finland	Russia
		Kazakhstan		France	San Marino
		Kyrgyzstan*		Germany	Serbia*
		Kuwait*		Greece	Slovakia
		Lebanon*		Guernsey	Slovenia
		Laos		Hungary (neg.)	Spain
		Malaysia		Ireland	Sweden
		Mongolia		Iceland	Switzerland
		New Zealand*		Italy	Turkey
		Oman*		Jersey	United Kingdom (neg.)
		Pakistan*		Latvia	Ukraine*
		Qatar		Liechtenstein	
				Lithuania	

- Luxembourg Double Tax Treaty (DTT) network
- 75 DTTs enforced, among which five are under negotiation (neg.)
- 17 under negotiation (*)
- Two new DTTs entering into force on 1 January 2017 (**)

3.3.2 Tax specificities of securitisation funds

Since securitisation funds are treated in the same way as investment funds in Luxembourg, they are exempt from corporate income tax and municipal business tax. Securitisation funds furthermore benefit from a subscription tax ("taxe d'abonnement") exemption.

3.3.3 Other tax considerations

The shareholders of the securitisation company or the unit holders of the securitisation fund are treated like bondholders. Dividend distributions and payments on fund units made by a securitisation vehicle are thus exempt from withholding tax. Interest payments are also exempt from withholding tax.

On 8 February 2012, the US Treasury and Internal Revenue Services ("IRS") issued some proposed regulations on the implementation of the Foreign Account Tax Compliance Act ("FATCA"). The purpose of these provisions is to fight tax evasion by US persons holding accounts or investments abroad.

The regulations impose documentation due diligence, an identification of "US accounts" and a reporting and withholding obligation on foreign financial institutions ("FFI") that enter into an agreement with the IRS. FFIs that do not enter into such agreements would be subject to a 30% withholding tax on certain US source income (notably interest, dividends and gross proceeds from the sale of US securities) and possibly on some non-US source income as from January 2017 (notion of pass-thru payment reserved for future guidance). In order to help Luxembourg Financial Institutions comply with FATCA, Luxembourg signed an Intergovernmental Agreement ("the IGA") with the US on 28 March 2014. According to the IGA, Financial Institutions in Luxembourg should report information about US accounts to the Luxembourg tax authorities, who will then transfer this data to the IRS.

Securitisation vehicles may be treated as FFIs, and generally debt and equity interest issued by securitisation vehicles will be treated as "financial accounts" for FATCA purposes. Securitisation vehicles could also fall into the non-reporting status of Collective Investment Vehicles, having the main advantages that neither registration nor reporting is required. As there is currently no general consideration of securitisation vehicles, we recommend conducting a FATCA analysis in order to assess the potential effects and obligations derived from the vehicle's FATCA status.

On 21 July 2014, the OECD released the full version of the Standard for Automatic Exchange of Financial Information in tax matters (Common Reporting Standard, "CRS"). Like FATCA, the CRS will require financial institutions around the globe to play a central role in providing tax authorities with greater access and insight into taxpayers' financial account data, including the income earned on these accounts.

In short, the CRS is intended to be a standardised, cost effective model for the bilateral and automatic exchange of tax information.

The standard provides for annual automatic inter-governmental exchange of financial account information, including balances, interest, dividends and sales proceeds from financial assets, as reported to governments by financial institutions and covering accounts held by individuals and entities, including trusts and foundations. It sets out the financial account information to be exchanged, the financial institutions to report, the different types of accounts and taxpayers to be covered, as well as common due-diligence procedures to be followed by financial institutions.

In 2017, Luxembourg, together will all other EU Member States, should start automatically exchanging information regarding income paid in 2016. Securitisation vehicles will also have to determine their status under the CRS rules, taking into account their specificities. In order to assess the potential effects and obligations derived from the CRS status of the vehicle and from the participating countries, a thorough analysis will definitely be required.

Until the CRS will come into force, i.e. with the first reporting in 2017 for 2016 income, the EU Savings Directive remains applicable. In practice, this means that payments of interest income made in 2015 by a securitisation vehicle considered a Luxembourg paying agent to EU-resident individuals have to be automatically reported to the Luxembourg tax authorities in 2016. The EC repealed the EU Savings Directive as from 1 January 2016 (1 January 2017 for Austria) when the CRS comes into force within the EU (i.e. for financial income paid as from 1 January 2016 to be reported in 2017) to avoid an overlap of the different mechanisms.

Naturally further significant developments regarding the so-called "BEPS" project - base erosion and profit shifting, launched by the OECD - as well as the Anti-Tax Avoidance package issued on 28 January 2016 by the EC might have an impact on securitisation vehicles, if securitisation vehicles and/or their specificities are not carved out from the aforementioned legislations. Developments of both sets of rules and their application to securitisation vehicles definitely need to be closely followed up.

3.3.4 VAT

3.3.4.1 VAT status of securitisation vehicles – the Luxembourg position

In 2006, the Luxembourg VAT authorities issued a circular letter ("Circular n° 723") regarding the VAT rules applicable to investment funds and similar vehicles, including securitisation vehicles. The aim of Circular n° 723 was notably to clarify the Luxembourg VAT authorities' interpretation of the judgement of the Court of Justice of the European Union ("CJEU") in the BBL case concerning the VAT status of undertakings for collective investment set up as investment companies.

In its Circular n° 723, the VAT authorities took a common approach for all vehicles listed in article 44.1.d) of the Luxembourg VAT Law (i.e. investment funds and similar vehicles, including securitisation vehicles). According to Circular n° 723, securitisation vehicles are in principle considered to be taxable persons for VAT purposes ("entrepreneurs" engaged in an economic activity). However, they are not entitled to recover input VAT incurred on the purchase of goods and services, since they are seen as engaged in exempt businesses only.

As a "VAT-exempt person", the securitisation vehicle would then have to register for VAT as soon as

- it receives services from foreign service providers, on which it has to account for Luxembourg VAT (reverse charge mechanism); and/or
- it performs intra-Community acquisitions of goods for an amount exceeding EUR 10,000 (excl. VAT) per year (i.e. it acquires goods from EU suppliers outside of Luxembourg, where the goods are dispatched from another EU country to Luxembourg).

The VAT registration would require the securitisation vehicle to file VAT returns and pay VAT on certain expenses, which would then again not be recoverable. However, the Luxembourg VAT authorities generally accept that taxable persons carrying out VAT-exempt activities only, with no input VAT credit, register under the simplified regime in order to self-account for Luxembourg VAT under the reverse-charge mechanism. The VAT authorities might request a change of regime from these exempt businesses in order to collect the input VAT self-accounted in a timely manner, further to the new rules laid down in a Grand-Ducal regulation dated 2013. Therefore, the securitisation vehicle would only be required to file a simplified VAT return once a year. Moreover, the VAT registration would allow the vehicle to pay Luxembourg VAT instead of the VAT charged by an EU supplier at a higher rate. In addition, the Luxembourg VAT Law provides for an exemption on a number of services linked to the management of securitisation vehicles (cf. 3.3.4.3). The VAT registration thus often leads to the cost structure being optimised, saving significant irrecoverable VAT amounts.

3.3.4.2 VAT status of securitisation vehicles – the exceptions

The concept of taxable person for VAT purposes is in principle strictly defined by the EU VAT Directive. It does not include persons whose only activity is managing a private portfolio, such as private investors (e.g. pure holding companies). In addition, in some instances the securitisation vehicle could be seen as engaged in activities that are not exempt by the Directive or the Luxembourg VAT Law. The general position taken by the Luxembourg authorities may thus be debatable in a number of specific situations, mainly depending on the type of investments and the contractual environment.

This is shown by the fact that some securitisation vehicles having registered under the normal regime report taxable income and recover part of their input VAT. Others that are not registered, do not reverse-charge Luxembourg VAT on foreign services and incur foreign VAT on their running costs.

The VAT analysis has also been complicated by some judgements of the CJEU, namely in the cases of MKG (treatment of debt purchase and factoring services) and GFKL (purchase of distressed debt).

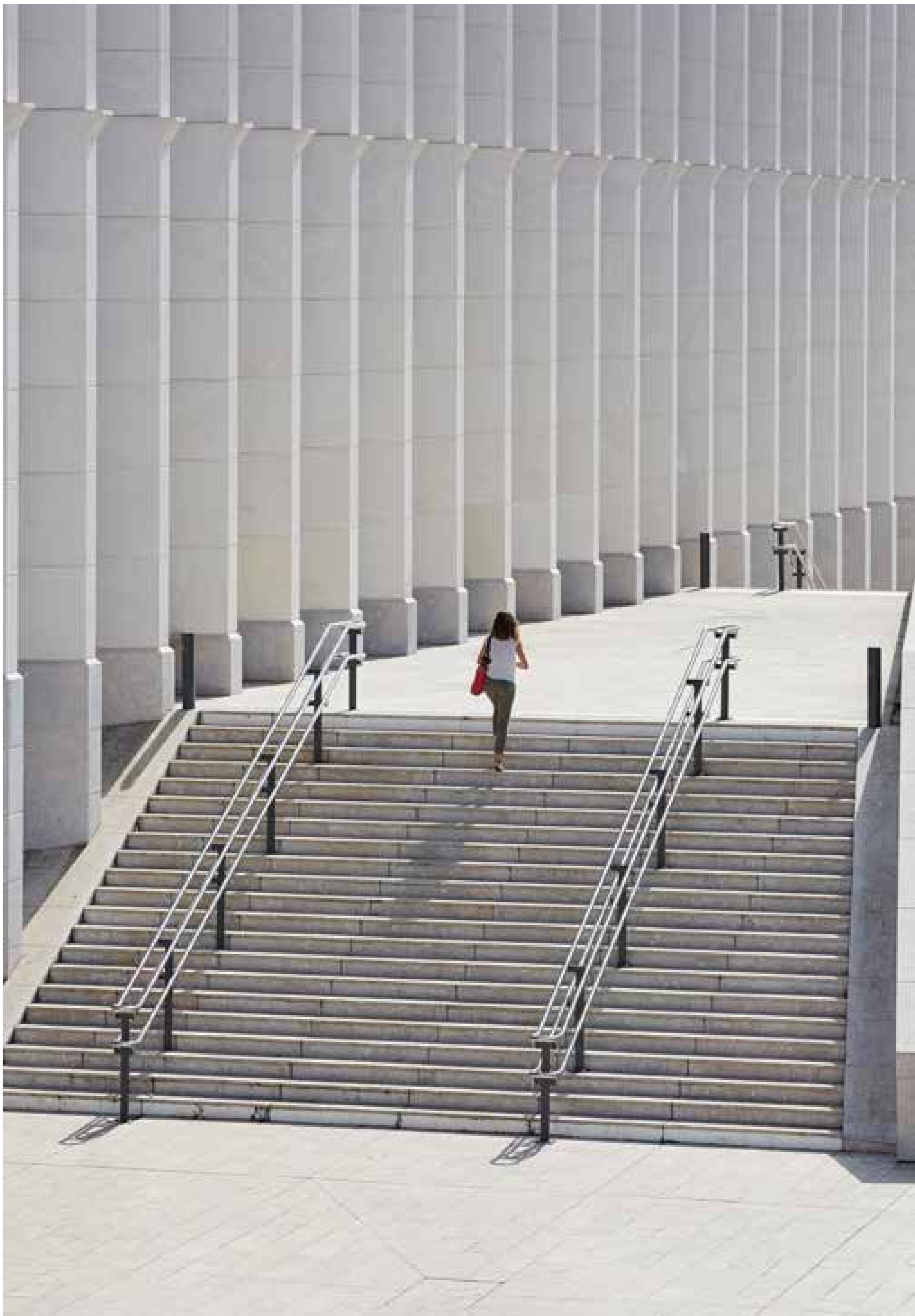
A careful analysis of the activities performed by each securitisation vehicle should therefore be made to determine the VAT reporting requirements correctly.

3.3.4.3 VAT exemption of services rendered to securitisation vehicles

Article 135 1(g) of the VAT Directive (2006/112/EC) provides that the management of special investment funds as defined by Member States is exempt from VAT. Article 44.1.d) of the Luxembourg VAT Law lists the according eligible funds/vehicles. As this list includes securitisation vehicles, management services rendered to Luxembourg securitisation vehicles may consequently be VAT-exempt.

The concept of "management services" is however, not clearly defined, though the management of investment funds has been clarified. In addition to managing the portfolio, some administrative services can benefit from the VAT exemption. In April 2010, the Luxembourg VAT authorities issued Circular letter 723bis ("Circular n° 723bis") aiming to clarify the VAT exemption of outsourced fund management services. Circular n° 723bis also recalls some principles provided by the CJEU in the Abbey National case. In order for outsourced services to be VAT-exempt, they must constitute a distinct whole and be specific and essential to the management of special investment funds. In this circular, the VAT authorities add that if one single type of service is outsourced, the VAT exemption would in principle not apply. Investment management services are also regarded as “management services” benefiting from the VAT exemption according to the CJEU in the GfBK case.

So far, Luxembourg has widely applied the exemption. Still every service rendered to the securitisation vehicle should be carefully analysed. The documentation, services agreement and invoices should be reviewed to determine if the conditions for a VAT exemption might apply. This is particularly relevant for services such as origination, asset servicing, asset management, calculation and report, valuation, etc. If properly structured, a Luxembourg securitisation vehicle is able to significantly reduce the amount of irrecoverable VAT and operational costs.



4. Other issues

4.1 Anti-Money Laundering regulations

The increasingly tighter regulatory requirements regarding the fight against money laundering and the financing of terrorism have become one of the recurring themes in the regulatory framework for financial centres and financial institutions in recent years. This trend shows no sign of stopping, and risks to regulation and reputation continue to represent major concerns for a rising number of company Board members.

More and more sanctions and fines are imposed for non-respect of anti-money laundering and anti-terrorist financing duties by national supervisory authorities and by judges. In order to regain reputation and trust, governments, regulators and financial players worldwide have launched important initiatives to control financial systems more efficiently.

In recent years, regulations combating money laundering and the financing of terrorism – as well as preventing the financial sector from being used for such purposes – have been enlarged. This is seen with the twice-modified Law of 12 November 2004 as well as with the two Grand-Ducal Regulations issued in 2010 and CSSF Regulation n° 12-02 of 14 December 2012, which consistently integrate all the guidelines and instructions concerning professional obligations in order to make the existing regulations more comprehensible. Additionally, the Regulation emphasises the need to have a risk-based approach in place and to document the results of any analysis performed. All financial sector professionals are covered by this legislation, as well as, for example, insurance companies, notaries, auditing companies, casinos, attorneys-at-law, estate agents, tax and financial advisors and persons selling high value goods.

In the latest modification of the Law of 12 November 2004, the scope was enlarged to also include securitisation vehicles, but only in cases where they also carry out service providers' activities with regard to companies and trusts. All the other types of securitisation vehicles are therefore excluded from the scope of the modified Law of 12 November 2004. In practice, Luxembourg securitisation vehicles usually do not carry out such service-provider activities, but use other service providers, who provide services to them and are consequently out of scope.

Nevertheless, many service providers of securitisation vehicles, like domiciliation agents, paying agents, auditors etc., must comply with AML regulations and identify the securitisation vehicles' beneficial owners as well as analyse business connections and investigate the sources of funds. For example, in accordance with the Law of 31 May 1999, companies who have their registered offices at third-party addresses must conclude a domiciliation contract with a domiciliation agent. CSSF Circular 01/29 provides a minimal amount of information on such domiciliation contracts. Accordingly, the domiciliation agent is responsible for identifying the Board of Directors, shareholders and ultimate beneficial owners, as well as monitoring transactions and checking the names of the persons identified against blacklists.

Additionally, the 4th EU AML Directive published on 5 June 2015 and to be transposed into Luxembourg legislation in 2017 at the latest, requires more transparency on the beneficial ownership of legal persons and arrangements. Corporate and legal entities will need to hold accurate and up-to-date information on their beneficial owners. With the 4th EU AML Directive the transparency in the identification of the beneficial owners will be increased. Member States will be required to hold information on the beneficial owners of all corporate and other legal entities incorporated within their territory in a national central register. Competent authorities and entities subject to the Directive will have access to the register, as well as any person demonstrating "a legitimate interest".

Who are the beneficial owners of a securitisation vehicle?

In other words, in the end who are the natural persons to directly or indirectly own or control a securitisation vehicle in law or fact? The current legislation does not provide a clear answer to this question but requires financial-sector professionals to perform and document their own analysis of the securitisation vehicle's beneficial ownership and to define the risk associated to all parties involved in the transaction.

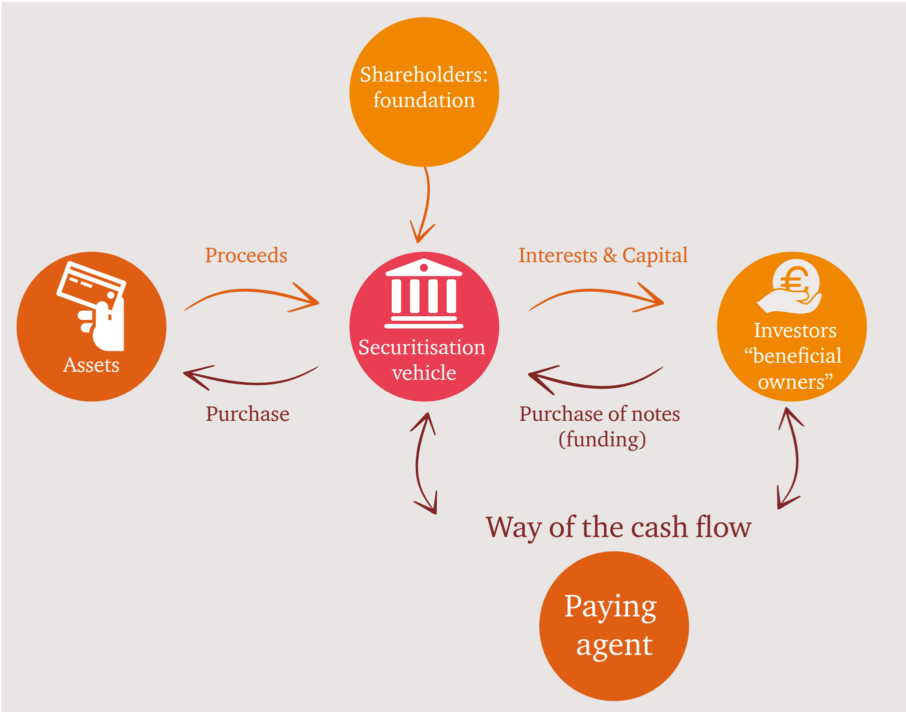
As an example, typical securitisation vehicles are only capitalised with the required minimum capital, which is typically brought in by foundations, like charitable trusts or Dutch "Stichtings". Obviously, these entities are not the beneficial owners of the securitisation vehicle's assets or cash flows.

The beneficial owners of a securitisation transaction are mainly the investors providing the funds to purchase assets for which they received securities, whose interest and capital payments are achieved out of the cash flows of the purchased assets, and who bear the risks and rewards of the transaction. In some other cases, the originator of the securitisation transaction might also be considered as the beneficial owner as they will indirectly control and benefit from the transaction.

The "Paying Agent" is usually responsible for transferring the received cash flows to the investors. In many transactions, a custodian transmits the cash flows resulting from the assets to the securitisation vehicle. These service providers are typically credit institutions, which are subject to supervision by a financial supervisory authority or equivalent identification obligations as the ones mentioned in the Luxembourg AML regulations, if they are located in Luxembourg-equivalent countries.

Securitisation can be a complex set-up that involves several participants: arranger, originator, SPV, depositary, paying agent, etc. The analysis of the role and the risk associated to each participant must be properly documented and kept up-to-date on a regular basis in order to ensure that the requirements to know the beneficial owner, if any, can be met by the service providers involved. Consequently, typical Luxembourg service providers will at least identify the beneficial owner.

Figure 18: Cash flow of a typical securitisation transaction



4.2 IFRS

4.2.1 Accounting impact of the securitisation vehicle from the originator's and investor's perspective

The following paragraphs summarise the consolidation and de-recognition rules for the originator and the securitisation vehicle under IFRS. Given the complexity of the related IFRS standards, this guide only gives a high-level overview. More detailed guidance can be found in dedicated IFRS manuals. Furthermore, a profound case-by-case expert's analysis would normally be required.

The accounting treatment of financial instruments is analysed based on the requirements of IAS 39. Nevertheless, we would like to highlight the fact that this standard will almost certainly be replaced in the future. On 24 July 2014 the IASB published the complete version of IFRS 9, "Financial instruments", which replaces most of the guidance in IAS 39. This includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. It also contains a new impairment model which will result in earlier recognition of losses. No changes were introduced for the classification and measurement of financial liabilities, except for the recognition of changes in own credit risk in other comprehensive income for liabilities designated at fair value through profit or loss.

It also includes the new hedging guidance that was issued in November 2013. These changes are likely to have a significant impact on entities that have significant financial assets and consequently on securitisation vehicles. IFRS 9 will be effective for annual periods beginning on or after 1 January 2018 only. It is not yet endorsed by EU but it is expected to be endorsed before the effective date.

Derecognition

The rules on derecognising financial instruments are defined in IAS 39 "Financial Instruments: Recognition and Measurement". These rules are summarised on figure 19 next page.

Consolidation

IFRS 10 and IFRS 12 cover consolidation requirements. With respect to securitisation vehicles, they refer to "structured entity" defined as "an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements".[12]

IFRS 12 outlines some common characteristics of structured entities; they usually show some or each of the following features:

- Restricted activities.
- A narrow and well defined objective, such as:
    - to effect a specific structure like a tax efficient lease;
    - to perform research and development activities; or
    - to provide a source of capital or funding to an entity or to provide investment opportunities for investors by passing risks and rewards associated with the assets of the structured entity to investors.
- Thin capitalisation, i.e. the proportion of "real" equity is too small to support the structured entity's overall activities without subordinated financial support.
- Financing in the form of multiple contractually linked instruments to investors that create concentrations of credit risk or other risks (tranches).

Furthermore, there are the following considerable common indicators of a structured entity:

- Use of professional directors, trustees or partners.
- Absence of an apparent profit-making motive, such that the structured entity is engineered to pay out all profits in the form of interest or fees.
- Domiciled in "offshore" tax havens.
- Have a specified life.
- Exist for the purpose of achieving a specific financial objective. For example, an institutional investor may approach a bank with the desire to obtain investments of a particular risk profile. The bank may set up a structured entity to aid such a transaction.

Some examples of structured entities as given by IFRS 12 are:

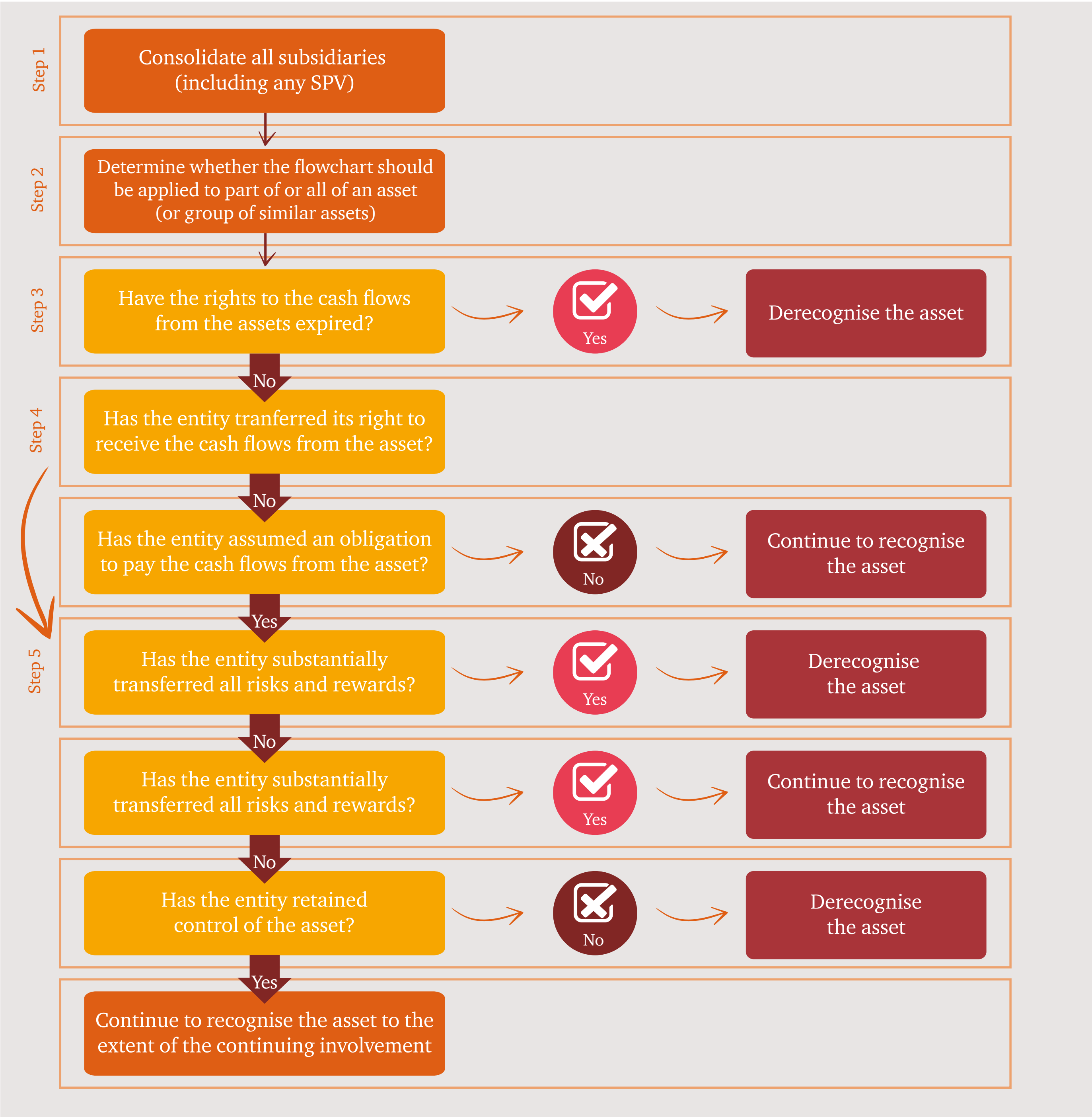
- Securitisation vehicles.
- Asset-backed financings.
- Some investment funds.

The issue is whether one of the parties connected to the structured entity should consolidate it.

This question is not answered solely by legal ownership. Under IFRS 10, the key to determining whether an investor should consolidate a structured entity is whether the investor actually controls that structured entity. IFRS 10 states that "an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee". This definition applies to all entities, including structured entities. The difference with structured entities is that often the normal substantive powers (such as voting rights) are not the means by which the investee is controlled. Instead,

[12] The former guidance in SIC 12 used the term "special purpose entities" (SPEs) meaning those entities that are created to accomplish a narrow and well-defined objective.

Figure 19: Rules of derecognition



relevant activities are directed by means of contracts. If those contracts are tightly drawn, it may initially appear that none of the parties has power. As a result, additional analysis is required to ascertain which party controls the structured entity.

In assessing control over an investee, the investor considers the investee's purpose and design so as to identify the investee's relevant activities, how decisions about such activities are made, who has the current ability to direct those activities and who receives returns from these activities.

The following aspects should be considered as part of the assessment of the purpose and design of an investee being a structured entity:

- Downside risks and upside potential that the investee was designed to create.
- Downside risks and upside potential that the investee was designed to pass on to other parties in the transaction.
- Whether the investor is exposed to those risks and upside potential.

Consider the involvement of various participants in the design of the investee at its inception. Such involvement, by itself, is not sufficient to demonstrate control. However, participants who were involved in the design may have the opportunity to obtain powerful rights. Decisions made at the investee's inception should be evaluated to determine whether the transaction terms provide any participant with rights that are sufficient to constitute power.

An explicit or implicit commitment by an investor to ensure that an investee continues to operate as designed may increase exposure to variability of returns and increase the likelihood of control. However, on its own, this factor is insufficient to demonstrate power or prevent other parties from having power.

IFRS 10 provides a wide range of other factors to consider when the control situation remains unclear after considering all the above factors. These include non-contractual powers and "special relationships". The key is to ensure that a holistic assessment of all relevant facts and circumstances is carried out. These factors should be considered in aggregate. Not all the factors need to be satisfied for an investor to have power. However, it also does not mean that satisfying any one of these factors will always be sufficient.

Disclosures

IFRS 12 addresses the need for transparency about the risks that an entity is exposed to due to its involvement with structured entities, which was highlighted during the global financial crisis. The main requirements include:

- Disclose qualitative and quantitative information relating to involvement with these unconsolidated structured entities;
- Disclose recognised assets and liabilities relating to involvement with the structured entities;
- Disclose maximum exposure to loss, how this is determined and comparison to recognised assets and liabilities;
- Disclose any financial support provided to the unconsolidated structured entity.

4.2.2 Accounting at the level of the securitisation vehicle itself

Investment entity

IFRS 10 requires an entity being a parent to present consolidated financial statements in which it consolidates all of its subsidiaries.

However, there is a limited scope exception for parents that are "investment entities". If an entity is an investment entity under IFRS 10, it is prohibited from consolidating its subsidiaries, with one exception, instead, it is required to account for these subsidiaries at fair value through profit or loss.

Therefore, a securitisation vehicle with investments in subsidiaries shall firstly assess if it is an investment entity before consolidating the respective subsidiaries.

The standard defines an investment entity as "*an entity that*:

- *obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;*
- *commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both; and*
- *measures and evaluates the performance of substantially all of its investments on a fair value basis.*"

For an entity to qualify as investment entity, the above definition must be met. The following typical characteristics of an investment entity must also be considered:

- holding more than one investment;
- having more than one investor;
- having investors that are not the entity's related parties; and
- having ownership interests in the form of equity or similar interests.

The above typical characteristics are indicative and supplement the definition to allow the use of judgement in assessing whether an entity qualifies as an investment entity. If management concludes that the entity is an investment entity in the absence of one or more of the typical characteristics above, it is required to explain in the financial statements in how far the definition of an investment entity is met. It is highly unlikely that an entity will meet the definition of an investment entity if it shows none of the typical characteristics, but still it might be possible.

When considering the term "investment", this might refer to both equity (share investments) and debt (receivables) investments.

The aforementioned IFRS 10 definition does not specify the type of instrument(s) that an entity must hold as its investment. A key consideration is how the entity manages its investments and not whether the investments are in the form of financial instruments, insurance contracts or other assets. The analysis of whether the definition of an investment entity is met should consider the business purpose and activities performed by the entity (for example the amount of strategic advice or active day-to-day management).

Embedded derivatives

A derivative instrument that falls within the scope of IAS 39 need not be freestanding. Terms and conditions may be embedded in a financial instrument or non-financial contract (the "host" contract) behaving like a freestanding derivative. These are referred to as embedded derivatives. The combination of the host contract and the embedded derivative is a "hybrid instrument".

An embedded derivative causes some or all of the cash flows that would otherwise be required by the contract to be modified according to a pre-defined variable, e.g. specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index.

Once an embedded derivative is identified, it is necessary to consider whether its economic characteristics and risks (i.e. the factors causing the derivative to fluctuate in value) are closely related to the economic characteristics and risks of the host contract.

For example, when a derivative that is embedded in a debt instrument embodies an equity instrument's economic characteristics (for example, the derivative has a rate of return that is tied to the DAX 30 index), the economic characteristics of the derivative (equity-price risk) and host contract (interest rate risk) differ. In this situation, the embedded derivative would not be considered closely related to the host contract.

Generally, in a securitisation transaction, the risk of the specific assets in which the securitisation structure invests is passed directly to the investors, because the return on the instruments issued by the securitisation structure is directly linked to the instruments in which the latter invests. The degree and extent to which the cash flows of the debt instruments issued are modified to incorporate the exposure to the risk of the specific assets in which the securitisation structure invests should be analysed on a case-by-case basis. This would allow to see if the respective arrangement triggers the existence of a non-closely related embedded derivative.

For accounting purposes, when the subsequent measurement of the host contract is amortised cost, the non-closely related embedded derivative has to be bifurcated and accounted for separately at fair value. Alternatively, the hybrid instrument can be accounted for as a whole, but in this case it shall be subsequently measured at fair value only.

4.3 Capital Markets Union and STS Securitisation

4.3.1. Capital Markets Union

Building a Capital Markets Union (CMU) is a key initiative of the EC. Its purpose is to ensure greater diversification in the funding of the European economy and to facilitate raising capital. It is expected that more integrated capital markets, especially for equity, would enhance the shock-absorption capacity of the European economy and allow for more investment without increasing levels of indebtedness.

The CMU should enhance the flow of capital through an efficient market infrastructure from investors to European investment projects, improving allocation of risk and capital across the EU and making Europe more robust to future shocks.

The EC has therefore committed to put in place the building blocks of a well-regulated and integrated CMU, encompassing all Member States with a view to maximising the benefits of capital markets and non-bank financial institutions for the wider economy.

On 30 September 2015, the EC adopted an action plan setting out 20 key measures to achieve a true single market for capital in Europe. Amongst other key topics like enhancement of investor protection through modernisation of the Prospectus Directive , the establishment of an EU-wide securitisation regime is clearly a main objective of the programme.

4.3.2 STS Securitisation

The EC's securitisation initiative adopted on 30 September 2015 is a package of two legislative proposals whereof one is a securitisation regulation that will apply to all securitisations and include due diligence, risk retention and transparency rules together with the criteria for Simple, Transparent and Standardised ("STS") securitisations. This proposal has already been amended by the Council of the EU but may still be subject to amendments as some suggestions are still criticised by market participants.

STS criteria

The STS criteria comprise the following main features:

Simple

"Simple securitisation" means that the asset base packaged within one securitisation must be homogeneous loans or receivables, i.e. no amalgamation of different types of assets within one securitisation.

No re-securitisation is allowed.

Loans must have a credit history long enough to allow reliable estimates of default risk. The ownership of a loan must have been transferred to the securitisation issuer, i.e. the securitisation has to be based on a true sale to the entity that will issue the securitisation.

Transparent and standardised

"Transparent and standardised securitisation" means that loans packaged in securitisation must have been created using the same lending standards as any other loan, no "cherry-picking" allowed.

The originator must retain at least 5% of the loans portfolio, to prove the alignment of interest with the investors.

The structure used and the payment waterfall have to be properly documented. Data on underlyings must be published on an ongoing basis. The contractual obligations, duties and responsibilities of all key parties to the securitisation must be clearly defined.

Supervisory authority

The originator, sponsor and issuer of the securitisation need to notify the European Securities Markets Agency ("ESMA") that the securitisation meets the requirements. This notification shall include an explanation by the originator, sponsor and issuer how each of the STS criteria has been complied with or a statement that the compliance with the STS criteria was confirmed by an authorised third party.

Upon communication by the issuer to ESMA, the instrument will be listed in a centralised web data repository listing all STS securitisations. This website will be accessible to all investors.

As securitisation involves several actors, it is important to clarify which authority will be responsible for the supervision of each party. For the sake of simplicity and legal clarity, the authority with oversight of a specific party will have responsibility for the securitisation activities undertaken by that party. For example, the banking supervisor of a bank originating the loans packaged in a securitisation will be responsible for supervising the securitisation activities undertaken by this bank. As each securitisation can involve parties from different sectors (banking, insurance, asset management) and different countries, competent authorities will communicate and collaborate in order to find common approaches on securitisation matters.

Disclosure requirements

The EC's proposal includes precise disclosure requirements from the originator, the sponsor and the issuer. These will be jointly responsible for providing to the investors all the relevant information needed to perform proper due diligence and assess the securitisation's risk level. It is also required that these data are included in a website, following standard templates, and will be accessible to investors on a securitisation-dedicated website.

Sanctions

The EC's proposal also contains provisions regarding sanctions for malpractice. Sanctions are provided for in case of wrongdoing by any party involved in the securitisation process as this is considered essential for the functioning and the credibility of the system.

In particular, if a competent authority ascertains that a securitisation previously considered STS does not fulfil requirements, the product will be removed from the website listing STS products and a financial sanction will be imposed on the originator (minimum EUR 5 million, or up to 10% of the annual turnover of the legal person or other similarly large sums). The originator may also be banned temporarily from issuing STS products.

Member States also have the possibility to introduce criminal charges but they are not obliged to do so.

4.4 Basel III

Basel III is the name widely used for the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR). This framework has been transposed into EU Directive 2013/36/EU and EU Regulation 575/2013. Luxembourg has implemented the framework by transposing the Directive into the Law of 5 April 1993 on the financial sector, whereas the regulation is directly fully applicable and does not need any transposition. The term "CRD IV" is further used in this section and commonly refers to both EU Directive 2013/36/EU and EU Regulation 575/2013.

The CRD IV framework covers the minimum capital requirements and the methodology for calculating the capital adequacy, operational requirements and disclosure by credit institutions. Furthermore, the CRD IV framework contains newly developed ratios, such as the Liquidity Coverage Ratio, the Net Stable Funding Ratio and the Leverage Ratio. Additionally, risk management and supervision are being covered.

CRD IV and securitisation

The capital treatment of securitisation transactions is still one of the most difficult areas to determine.

The following rules concerning securitisation have been adopted by the EC issuing the CRD IV framework.

Minimum capital requirements for securitisation positions

This area is the most important with regard to the capital treatment for securitisation transactions, as it details all quantitative aspects as well as the key qualitative aspects (i.e. operational requirements) to be taken into account when calculating the capital requirements of securitisation transactions.

There are two cornerstones in relation to the regulatory approach described in this area, namely:

a. The "economic substance approach"

The overall CRD IV approach is based on economic substance rather than the legal form. Therefore, the analysis of securitisation transactions follows the same principle.

It is important to re-emphasise, however, that although CRD IV established the "economic substance" approach, it seems, at least implicitly, to only consider risk transfer and funding as drivers of a securitisation transaction and does not take into account other transaction drivers and their impact on the originator's activities.

b. A broad focus on "securitisation exposures"

During the initial stages of CRD IV's development, the role taken by credit institutions was brought into focus. However, there is now a significant shift of focus towards the risk arising from different exposures.

The practical evaluation of securitisation exposures is broader than credit risk exposures, and it includes the evaluation of structural elements (such as early amortisation and clean up calls for instance) as well as commercial aspects such as implicit support. This is in line with the "economic substance approach".

The framework also divides securitisation transactions into two groups: "traditional securitisation" and "synthetic securitisation".

A **traditional securitisation** transaction is defined to be a structure where the cash flow from an underlying pool of exposures is used to service at least two different stratified risk positions or tranches reflecting different degrees of credit risk. Payments to the investors depend upon the performance of the specified underlying exposures. Junior securitisation tranches are established to absorb losses without interrupting contractual payments to more senior tranches, whereas subordination in a senior/subordinated debt structure is a matter of priority of rights to the proceeds of liquidation.

The difference regarding a **synthetic securitisation** is that credit risk from the underlying exposures is transferred, in whole or in part, through the use of funded (e.g. credit-linked notes) or unfunded (e.g. credit default swaps) credit derivatives or guarantees that serve to hedge the credit risk of the portfolio.

For both of these groups, the framework defines certain eligibility criteria in order to assess the transaction's materiality and the risk transfer.

Another important definition is that of the "originator". In general, the credit institution is originating directly or indirectly underlying exposures included in the securitisation. According to this definition, the originator can also act as a "sponsor" in Asset-Backed Commercial Paper (ABCP) transactions. Normally, in such transactions, a credit institution does not tend to originate the assets but rather provides a guarantee (normally at secondary credit enhancement level) for the whole ABCP programme.

Operational requirements

There are detailed operational requirements that an originating credit institution has to comply with in order to be able to calculate its capital requirements. The operational requirements are divided into requirements for traditional securitisations and synthetic securitisations, those related to clean-up calls, those for the use of credit assessments and those for inferred ratings. In essence, the aforementioned requirements aim to ensure that exposures are transferred and that there are no mechanisms allowing these exposures to be returned to the originating credit institution, whereas the latter two aim to ensure that a rating can be relied upon.

From a "principle" point of view, the operational requirements are clear. However, the number of terms used is not clearly defined; thus it can be highly subjective.

Treatment of capital exposures

The treatment of capital exposures for a credit institution is defined on the exposure rather than the role played by the credit institution. There is one aspect differentiating between originator and investor: It is related to exposures mapped to credit quality category 4 for the standardised approach (as detailed below), according to which investors can apply a risk weight of 350% rather than a capital deduction.

Credit institutions are required to hold capital against all of their securitisation exposures, including those arising from:

- The provision of credit risk mitigating a securitisation transaction;
- Investments in ABS;
- Retaining a subordinated tranche;
- Extending a liquidity facility;
- Granting a credit enhancement and providing of implicit support to a securitisation; and
- Repurchased securitisation exposures.

In summary, a credit institution can calculate the capital requirements for credit risk arising from securitisation exposures based upon two approaches: (a) the standardised approach; and (b) the Internal Ratings Based (IRB) approach. It is compulsory to use the very same approach as selected by the credit institution for treating the underlying portfolio of assets. In other words, if for instance, for a Mortgage-Backed Securities transaction, the credit institution has selected the standardised approach for its mortgage portfolio held in the credit institution's books, this approach is to be used for any Mortgage-Backed Securities transaction carried out by the credit institution. In certain instances, a securitisation transaction may contain more than one type of underlying portfolio. In this case, the CRD IV framework clearly states that the approach to be used is that of the dominant portfolio.

a. *The standardised approach*

The standardised approach consists of calculating a risk weighted asset amount of the exposure based on an existing table in the framework. In short, for exposures mapped into credit-quality class 4 and better, there are different risk weights applicable, which vary between 20% and 350%.

Exposures with an assessed credit quality below class 4 are subject to a full capital deduction. Mapping the eligible rating agencies' external ratings to credit-quality classes provided by the CRD IV is part of the responsibility of the European Banking Authority.

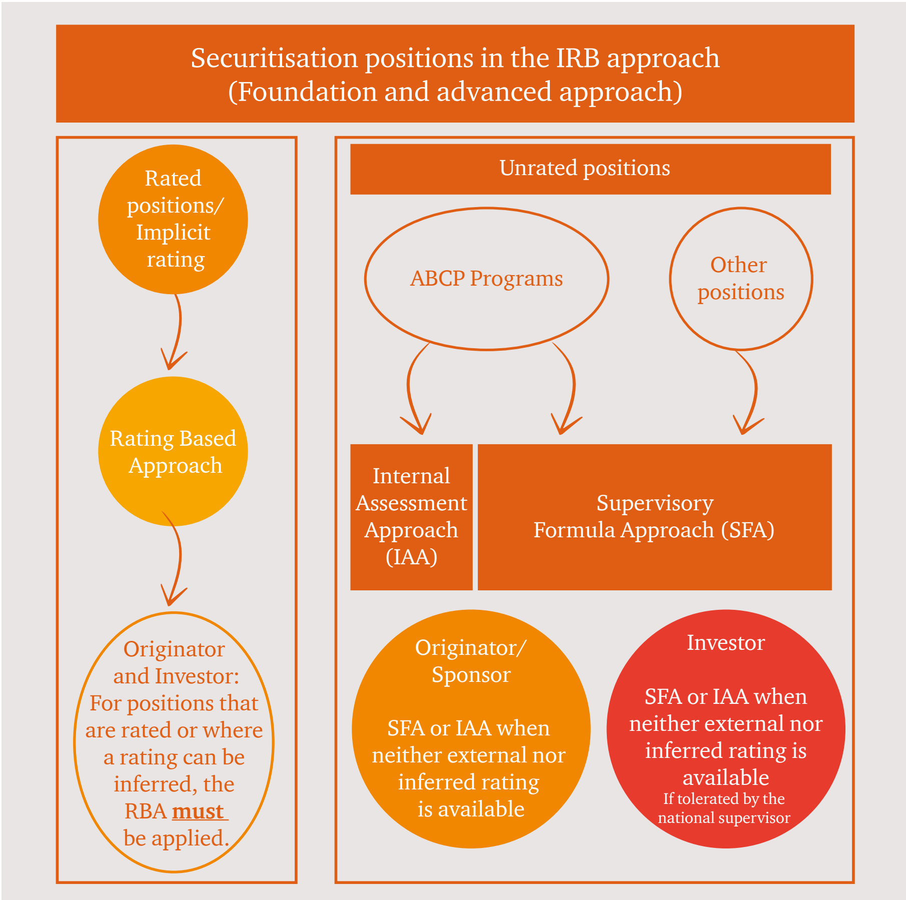
When the exposure is an asset, it is easily quantifiable, as it is generally the book value recorded. However, a more complex analysis needs to be carried out for other types of exposures, like second loss positions, liquidity facilities, cash-advance facilities or early amortisation provisions, which are converted into "assets" by applying Credit Conversion Factors (CCFs).

Standardised approach for exposures with external rating

Credit Quality Step	1	2	3	4 (Only for credit assessments other than short-term credit assessments)	all other credit quality steps
Securitisation positions	*20%*	*50%*	*100%*	*350%*	*1250%*
Re-securitisation positions	*40%*	*100%*	*225%*	*650%*	*1250%*

Source: REGULATION (EU) No 575/2013 of the European Parliament and the Council of June 2013 *b. The IRB approach*

Figure 20: IRB approaches



The IRB approach is subdivided into two potential calculations:

(a) the Ratings-Based Approach (RBA) and (b) the Supervisory Formula (SF) or the Internal Assessment Approach (IAA). The maximum capital requirement of securitisation exposures under the IRB approach is limited to the capital requirement that would have been calculated if the underlying exposures had not been securitised.

There is a hierarchy in applying these approaches: The RBA must be applied for all rated exposures that are either rated or in which a rating can be inferred. For all other exposures, the SF or IAA is to be applied.

The RBA is related to the standardised approach, with the exception that the tables included in the framework are more sophisticated and the risk weight will not only depend on the ratings but also on the granularity of the underlying pool and the seniority of the position. In summary, this means that securitisation exposures backed by retail pools can be considered to generally attract less capital than those backed by big ticket transactions.

The SF is a complex methodology for non-rated exposures, which is clearly defined in the framework. Certain simplifications can be made depending on the underlying portfolio of assets. It is based upon five inputs obligatory to be supplied by the originator:

- The IRB capital charged, given that the underlying exposures had not been securitised;
- The tranche's credit enhancement level;
- The tranche's thickness;
- The pool's effective number of exposures;
- The pool's exposure-weighted average loss given default.

Given the complexity of the SF, we expect a number of credit institutions to adopt full capital deduction for their non-rated exposures rather than to apply the formula and obtain all the data necessary for its calculation. Also, it is unlikely that an originating credit institution will share some of the aforementioned input data with an investing credit institution. Therefore, an investing credit institution will still most likely deduct its exposure from the capital base.

The IAA is limited to exposures arising from ABCP programmes and it is subjected to a number of operational requirements. By using this approach, a credit institution has to map its internal assessments of exposures provided to ABCP programmes to equivalent external ratings of an eligible External Credit Assessment Institution (ECAI).

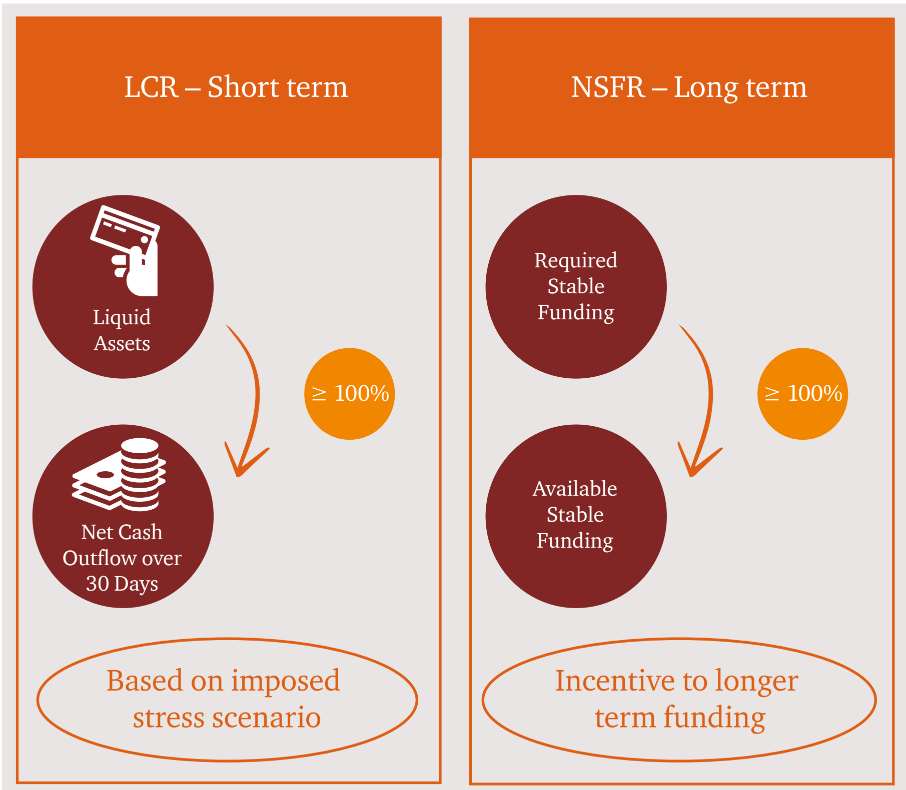
Before credit institutions (the same applies via Solvency II for insurance companies) become exposed to the risks of securitisation exposure, they shall be able to demonstrate having a comprehensive and thorough understanding of their investments in securitised positions and having implemented formal policies and appropriate procedures.

Furthermore, credit institutions (also applicable for insurance companies through Solvency II) shall be exposed to the credit risk of securitisation exposure only if the originator, sponsor or original lender has explicitly disclosed that it will retain, on an ongoing basis, a material net economic interest not less than 5%.

Liquidity and securitisation

The intent of the **Liquidity Coverage Ratio** (LCR) is for available high-quality liquid assets to exceed the net cash outflows of the next 30 days. With the Net **Stable Funding Ratio** (NSFR), long-term financial resources will exceed long-term commitments. Securitisation cash flows have to be included in the computations of these ratios; securitisation positions do qualify – under certain conditions – as high-quality liquid assets.

Figure 21: LCR and NSFR



Disclosure requirements for securitisation

As securitisation exposures form part of the risk-weighted assets, credit institutions have to disclose inter alia information regarding:

- A description of the institution's objectives in relation to securitisation activity;
- The nature of other risks, including liquidity risk inherent in securitised assets;
- The type of risks in terms of seniority of underlying securitisation positions and in terms of assets underlying the securitisation positions assumed and retained with re-securitisation activity;
- The different roles played by the institution in the securitisation process;
- A description of the processes in place to monitor changes in the credit and market risk of securitisation exposures, including how the behaviour of the underlying assets impacts securitisation;
- A description of the institution's policy governing the use of hedging and unfunded protection to mitigate the risks of retained securitisation exposures, including identifying material hedge counterparties by the relevant type of risk exposure;
- The approaches to calculating risk-weighted exposure amounts that the institution follows for its securitisation activities, including the types of securitisation exposures to which each approach applies;
- The types of vehicles that the institution, as sponsor, uses to securitise third-party exposures, as well as a list of the entities that the institution manages or advises and that invest in either the securitisation positions that the institution has securitised or in vehicles that the institution sponsors;

- A summary of the institution's accounting policies for securitisation activities;
- The names of the ECAIs used for securitisations and the types of exposure; and
- The total amount of outstanding exposures securitised by the institution, separately for traditional and synthetic securitisations and securitisations for which the institution acts only as sponsor.

Supervisory review process for securitisation

This area defines the risk management and supervision for securitisations and can certainly be considered as a complement to the operational requirements. In summary, this area provides the necessary support for supervisory authorities to modify or refine the calculation of capital requirements in order to take into account the specifics of each securitisation transaction, and any factors which have not been directly dealt with by the existing framework.

Conclusion and outlook

Using the CRD IV framework, the supervisory authorities provide a comprehensive set of rules and regulations to take into account the wide range of different securitisation schemes and the various roles of the credit institutions concerned. Designed to reflect the differing levels of knowledge and experience in performing securitisation transactions, these rules have been tailored to the needs of all credit institutions.

However, the Basel Committee is planning to publish a revised securitisation framework coming into effect in January 2018. The aim of this framework is to overcome certain shortcomings in the current framework to strengthen the capital standards for securitisation exposures held in the banking book. The main changes relate to the hierarchy of approaches with the Internal Ratings-Based Approach at the top, followed by the External Ratings-Based Approach and the Standardised Approach. Furthermore, certain risk drivers will be introduced to avoid an under-capitalisation of securitisation exposures.

4.5 Solvency II

Since the Solvency II Directive and its delegated acts entered into force as of 1 January 2016, this new regulatory environment may make Luxembourg securitisation vehicles even more attractive for insurers and re-insurers. All insurers and re-insurers have to apply the Solvency II requirements, especially those assessing the required amount of underlying capital on a product-by-product basis.

Though there is no clear black or whiteit is's not yet clear enough, it could well be that some equity-type investments – especially in the alternative sector – could appear less attractive compared to debt products with the same underlying, as this could lead to a lower amount of underlying-required capital at the insurers' level. So the use of securitisation vehicles instead of mere fund structures could be an even more attractive choice and should definitely be considered more often.

As for debt instruments, e.g. securities issued by a securitisation vehicle, the question of a good external rating becomes a significant factor in determining the stress factor of an investment, and thus ultimately the amount of underlying-required capital.

Avoiding a "look through approach" is another crucial factor. The most appropriate form for the structure would be that of a financial institution or investment firm as defined in the Solvency II Regulations, which is not a UCITS or AIF, so that the structure would not be in a position to be considered an "investment packaged as a fund", thus avoiding a "look through approach" to the underlying assets. According to Art. 84 of the Commission Delegated Regulation, the securitisation vehicle has to be set up in such a way in order to avoid the criteria for such a "look through".

Art. 84 Sec. 1 of the Commission Delegated Regulation states:

"The Solvency Capital Requirement shall be calculated on the basis of each of the underlying assets of collective investment undertakings and other investments packaged as funds (look-through approach)."

Although there is no regulatory or other official guidance, we believe that the Luxembourg securitisation vehicles can be structured so that it does not meet this definition.

If the securitisation vehicle's securities are to avoid any "look-through" obligation, the entity necessarily needs to be none of the following:

a) a "collective investment undertaking";

b) an "other investment packaged as a fund"; or

c) a "securitisation".

A "collective investment undertaking" is defined to be either a UCITS or an

AIF. While the securitisation vehicle will clearly not constitute a UCITS, it could amount to an AIF. The definition of an AIF can in theory be met by a Luxembourg securitisation vehicle; however under Article 2(3)(g) of the AIFMD, a "securitisation special purpose entity" will not be considered as an AIF. We understand that the securitisation vehicle will be established in such a way that it meets the requisite criteria and therefore will not be an AIF and will accordingly be exempt from the scope of the AIFMD.

Although there is no guidance on the meaning of "other investment packaged as a fund", a securitisation vehicle that is not a UCITS "fund" or an AIF "fund" or a "fund" cannot be in any regulatory sense an "investment" (or any other structure) packaged as a fund.

Notwithstanding the fact that we are confident that the securitisation vehicle is not a "fund", it will also be important to be assured that this entity is not a "securitisation" under Solvency II. Although the securitisation vehicle will be established under the Luxembourg Securitisation Law, we are satisfied that the securitisation vehicle is not a "securitisation" for the purposes of Solvency II, for the reasons set out below.

Article 4(1)(61) of CRR, from which Solvency II takes its definition of a securitisation, reads:

"Securitisation" means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics:

a) Payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures;

b) The subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

A securitisation vehicle set up according to the Luxembourg Securitisation Law can be structured without tranches. Hence, it would be possible to avoid the above characteristic and therefore the securitisation vehicle should not be considered a "securitisation" under Solvency II and no "look through" should apply.

However, due to the ambiguity of Solvency II in general, and of Article 84 in particular, especially the expression "investment packaged as a fund", we highly recommend to give the securitisation vehicle "substance". The Board should take appropriate management and investment decisions on behalf of the securitisation vehicle. The Board can be advised by an external service provider pursuant to a service support agreement, together with discretionary investment management agreements with a limited number of managers. The latter may also be responsible for ensuring that the securitisation vehicle has the required resources to carry out its business and to implement its investment objectives and policy.

In conclusion, we believe that a Luxembourg securitisation vehicle can become even more attractive to European insurers under Solvency II. Properly structured to avoid a "look through" on the underlying and with a good external rating, it could ultimately lead to a lower amount of underlying required capital at the insurers' level.

4.6 Distribution and listing – from market segment to prospectus requirement

4.6.1 Listing in Luxembourg

The Luxembourg Stock Exchange ("LuxSE") offers two market segments for listing of securities issued by securitisation vehicles: (1) the EU-regulated market, the "Bourse de Luxembourg market", and (2) the exchange-regulated market "Euro MTF".

The exchange-regulated market Euro MTF meets the financing needs of issuers who are looking for a sound regulatory framework but do not require a European passport as defined in the Prospectus Directive[14]. This market is outside the scope of the Prospectus and the Transparency Directive[15], both leading to specific disclosure requirements for the issuing entity. There are no restrictions on the type of securities to be listed on both the main and exchange-regulated market. However, issuers will need to comply with different requirements according to the chosen market. Official listing requirements are applicable to both markets.

Furthermore, disclosure required in the annual accounts will differ. Entities having securities listed on an EU-regulated market will always have to publish a management report and a corporate governance statement. While consolidated accounts (normally not the case for securitisation vehicles) would have to be drawn up under IFRS, stand-alone accounts can still be published under local GAAP[16]. Nevertheless, they should be accompanied by a cash flow statement.

[14, 15] Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC.

[16] Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC.

The following table summarises the main benefits and constraints of the two markets:

	EU regulated market: Bourse de Luxembourg	Exchange regulated market: Euro MTF
Main benefits	European passport for the documentation when offering securities in more than one EU Member State.	Less costly and less stringent requirements for financial reporting (disclosure and deadlines) being outside of the scope of some EU regulations including the IAS Regulation, the Prospectus and the Transparency Directive and their transformation in Luxembourg Law.
	Higher degree of eligibility (e.g. as ECB collateral according to national legislation of the different EU Member States.	
	Easier accessibility to non-sophisticated investors and retail investors.	Nevertheless, a Multilateral Trading Facility in accordance with the MiFID Directive.
		A more swift application, reviewing, approval and listing process.
		Supervision by the LuxSE in compliance with its rules and regulations.
Main constraints	More demanding financial reporting requirements in terms of content and ongoing information to be published by the issuer to satisfy the Transparency and the Prospectus Law requirements.	No EU passporting for the documentation.
	More time-consuming listing and prospectus-approval process.	Low liquidity on the secondary market.

[17] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

4.6.2 When is a prospectus required?

Once a securitisation transaction has been structured, questions regarding the distribution of the securities issued may arise. Whether a prospectus will need to be published will depend on the distribution structure used (i.e. who the potential investors are, whether they are institutional or retail, in which and how many countries the securities should be sold, and whether or not a listing on a regulated market is demanded).

The requirements governing the publication of a prospectus when securities (debt and equity securities) are offered to the public or admitted to trading, are laid down in Prospectus Directive and transposed into Luxembourg legislation by the Law of 10 July 2005 on the prospectus of securities ("Prospectus Law"), both having been amended from time to time.

The Prospectus Directive was adopted to respond to the following main objectives:

- Defining and harmonising the disclosure requirements to obtain a single EU passport. Thus, a prospectus approved by the authority of one Member State is valid within other Member States;
- Improving the quality of information provided to investors by companies wishing to raise capital in the EU;
- Lowering the cost of capital;
- Setting out the conditions to be met by issuers when offering securities to the public in the EU;
- Specifying minimum disclosure requirements for different products and according the type of targeted investors;
- Ensuring that interested parties have access to prospectuses.

The Prospectus Law differentiates three different prospectus regimes: a "public offer of securities" and/or a "listing of securities on an EU-regulated market" and "private placements". Before having a deeper look at the regimes, "public offering" should be further defined. Under the Prospectus Law, essentially any offer of securities to more than one person within the scope of the Prospectus Law will constitute a "public offer" and, consequently, require a prospectus to be published. The same applies to securities listed on an EU-regulated market.

However, according to article 5 (2), the obligation to publish a prospectus does not have to be met for the following distribution forms:

- Offers to qualified investors only, and/or;
- Offers to less than 150 individuals or legal entities per EU or EEA Member State other than qualified investors, and/or;
- Offers to investors who subscribe at least EUR 100,000 per investor, and/or;
- Offers where each security has a nominal value of at least EUR 100,000, and/or;
- Offers where the total amount issued is less than EUR 100,000.

In the following, such offers will be referred to as "private placements". Placements of securities through one financial intermediary would also require a prospectus to be published if none of the aforementioned criteria are met. In connection with private placements, there are no further requirements described in the Prospectus Law. Concerning the information required to be made available to potential investors within private placements, the Prospectus Law only states that all material information should be provided to them. However, it does not explicitly determine what information qualifies as "material". Because of the liability attached to a prospectus, the private placement memorandum should include any material information necessary for investors to make an informed assessment of the securities offered.

Contrary to private placements, any entity intending to make a public offer of securities in Luxembourg must notify the CSSF in advance and must publish a prospectus (or, as the case may be, a simplified prospectus), which must be approved by the CSSF. The Prospectus Law distinguishes three regimes:

(i) The first regime applies to "public offers" of securities within the scope of the Prospectus Directive and offering to the public or admission to trading on an EU-regulated market by corporate issuers, which, in Luxembourg, is the Bourse de Luxembourg market segment of the LuxSE. In this case, the CSSF is the competent authority to ensure that the provisions of the Prospectus Law are enforced, i.e. that the prospectuses and any related supplement to them are approved where Luxembourg is the issuer's home Member State. The filings of documents and notices are also within the supervision of the CSSF. If a listing on another EU-regulated market is also required, the CSSF is also the competent authority to approve the prospectus ("European passport") as home member state authority.

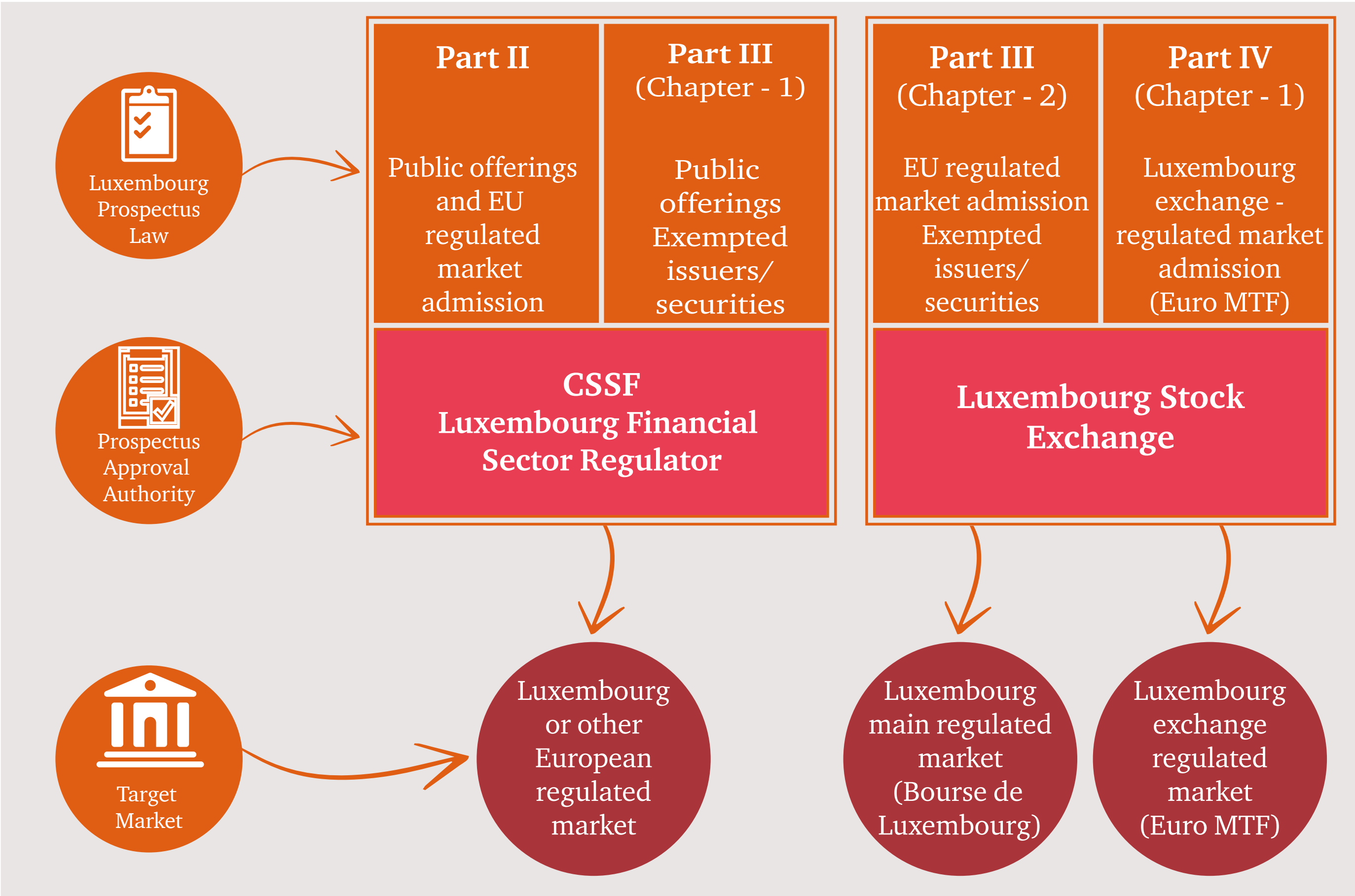
The prospectus must include all the necessary information on the particular nature of the issuer and the securities offered to the public, according to the Commission Regulation (EC) No 809/2004 as regards the information contained in prospectuses, format incorporation by reference and publication of such prospectuses. This enables investors to make informed assessments of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, as well as of the rights attaching to such securities. The information shall be provided in a format that is easy to analyse and understand. Such a prospectus will also need to contain a summary conveying the essential characteristics and risks associated with the issuer, any guarantor and the securities, unless the securities offered are wholesale debt securities (securities issued with a minimum denomination of EUR 100,000 deemed to be issued to "sophisticated" or "professional investors"). In the case of a simplified prospectus, which is described below, a summary is not required.

(ii) The second regime applies to "public offers" of securities and other comparable instruments outside the scope of the Prospectus Directive; for these securities, simplified prospectuses have to be drawn up. These securities mainly include: (a) securities issued by EU Member States, their regional or local authorities or related entities; (b) "small" issues (less than EUR 2.5 million) and certain debt securities issued by credit institutions for a total amount of less than EUR 50 million; and (c) money market instruments with a maturity at issue of less than 12 months. As with the first regime, the CSSF is the competent authority for approving of simplified prospectuses and any related supplement to the prospectuses.

Simplified prospectuses, however, do not benefit from the European passport. According to the provisions of the Prospectus Law, the LuxSE is the competent authority for approving of prospectuses, as well as admitting these securities for trading on an EU-regulated market that it operates. The simplified prospectus must also include all information necessary to enable investors to make an informed assessment of their investments, e.g. annual financial statements and the corporate structure details.

(iii) The third regime deals with admitting securities for trading on a market not set out on the list of EU-regulated markets published by the EC. For admission to the Euro MTF market, the LuxSE is the competent authority and its Rules and Regulations apply. However, they may not be more restrictive than those applicable on an EU-regulated market. For example, an issuer would have to provide a documentation containing the characteristics of the notes (maturity, rank of subordination, interests/coupons, description of the activity of the issuer, etc.).

Figure 22: Prospectus Law requirements



4.7 AIFMD

Following the financial crisis, the financial sector faces a wave of regulations. The AIFMD, the Alternative Investment Fund Managers Directive, represents one part of this development and is a key element of the current European regulatory framework. The AIFMD aims to provide a harmonised regulatory and supervisory framework within the EU, as well as a single EU market for managers of Alternative Investment Funds ("AIF"). It sets rules regarding the marketing of AIF and the substance and organisation of their managers. In Luxembourg the AIFMD was transposed into the national Law of 12 July 2013 on alternative investment fund managers.

As the AIFM Law does not generally apply to "securitisation special purpose vehicles", the question was raised as to whether Luxembourg securitisation vehicles fall within the scope of the AIFM Law and thus qualify as an AIF. The response of the CSSF has clarified this question in their Q&A on securitisations.

The issue was that the AIFM Law refers to entities whose sole purpose is to carry out a securitisation within the meaning of Article 1 (2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30). Compared to the Luxembourg Securitisation Law, this EC regulation provides a much narrower definition of securitisation.

The CSSF has published three criteria to define whether a securitisation vehicle is qualified as an AIF or not:

1. Securitisation vehicles falling within the definition of "securitisation special purpose entities" (structures de titrisation ad hoc) within the meaning of the AIFM Law may not be considered as AIFs within the meaning of the AIFM Law, as article 2(2)(g) of the AIFM Law provides that securitisation special purpose entities are excluded from the scope of the AIFM Law.

   Securitisation special purpose entities are defined as entities whose sole object is to carry out one or more securitisation transactions within the meaning of the aforementioned ECB regulation. The latter defines "securitisation" as *"a transaction or scheme whereby an asset or pool of assets is transferred to an entity that is separate from the originator and is created for or serves the purpose of the securitisation and/or the credit risk of an asset, or pool of assets, or part thereof, is transferred to the investors in the securities, securitisation fund units, other debt instruments and/or financial derivatives issued by an entity that is separate from the originator and is created for or serves the purpose of the securitisation, and:*

   (a) in case of transfer of credit risk, the transfer is achieved by:

   - *the economic transfer of the assets being securitised to an entity separate from the originator created for or serving the purpose of the securitisation. This is accomplished by the transfer of ownership of the securitised assets from the originator or through sub-participation, or*
   - *the use of credit derivatives, guarantees or any similar mechanism;*

   and

   (b) where such securities, securitisation fund units, debt instruments and/or financial derivatives are issued, they do not represent the originator's payment obligations".

2. Whether or not they fall within the definition of securitisation special-purpose entities pursuant to the AIFM Law, securitisation vehicles that issue only debt instruments shall not qualify as AIFs. It seems that it was not the EU lawmakers' intention to qualify undertakings issuing debt instruments as AIFs.

3. Whether or not they fall within the definition of securitisation special-purpose entities pursuant to the AIFM Law, securitisation undertakings that are not managed in accordance with a defined investment policy pursuant to article 4 (1)(a) of the AIFMD shall not qualify as AIFs. Subject to criteria set out in the ESMA guidelines, securitisation undertakings that issue structured products offering synthetic exposure to assets (equities, commodities or indices thereof), as well as acquire underlying assets and/or enter into swaps with the sole purpose of hedging the payment obligations arising from the issued structured products, shall not be considered to be managed in accordance with a defined investment policy.

It should be noted that securitisation undertakings are required to carry out a self-assessment to determine whether they qualify as an AIF.

Consequently, Luxembourg securitisation vehicles which

a. securitise credit risk, or

b. issue only debt instruments, or

c. are not managed in accordance with a defined investment policy do not qualify as AIF.

Therefore, the vast majority of securitisation vehicles established in Luxembourg are outside the scope of the AIFM Law. In particular, the majority of the authorised Luxembourg securitisation companies established as platforms issuing structured products through many compartments do not fall within the scope of the AIFM Law.

4.8 Responsibilities and liabilities of the Board of Directors

The Luxembourg Securitisation Law does not define specific duties or responsibilities for the members of the Board of Directors (or Board of Managers for a S.à r.l.) of the securitisation companies or management companies of securitisation funds. Therefore, their responsibilities are governed by general rules, mostly defined by commercial company law, commercial and civil law and, of course, the statutes of the relevant companies.

The core responsibility of directors is to take any action necessary or useful to realise corporate objectives, within the powers vested by law and by the individual company's articles of incorporation. In addition, the company will be represented relating to third parties and in legal proceedings by the directors. Regarding the day-to-day management of the business of the company and the power to represent the company, one or more directors (or officers, managers or other agents) may have the right to act either alone or jointly. Some tasks may also be delegated to other transaction parties, e.g. the paying agent. Regarding transaction management, the directors usually approve and sign all transaction documents. Thus, they need to understand the structure, the expected cash flow of the securitisation vehicle and the underlying transaction documents to ensure that the securitisation vehicle's operations comply with the transaction documents. To ensure this, they liaise closely with the arranger, trustees and lawyers involved. The Board of Directors is also responsible for the proper preparation of the annual accounts and any other reporting (BCL, CSSF, interim accounts), including an appropriate assessment of the valuation of the underlying assets. To prepare the company's annual accounts, the directors need to have a broad knowledge of the different accounting principles used, like IFRS and Luxembourg GAAP, but sometimes also US or UK GAAP.

As such, the directors are exposed to several liabilities. They are jointly liable for all damages adversely affecting the company and third parties resulting from breaching the Commercial Company Law or the Articles. In addition, directors are liable for all possible avoidable administrative mistakes and/or failures made by management.

Of course, the Board of Directors can delegate certain tasks like accounting, asset servicing or valuation to third parties. However, the responsibility always remains with the directors.

Similarly, the independent auditor cannot limit their work to the level of the legal entity but needs to look beyond in cases where third party information is used to prepare significant elements of the company's annual accounts. Specifically, the International Standards on Auditing ("ISA") lay out the auditor's responsibilities for audits of annual accounts for which information provided by so-called "service organisations" (ISA 402) and "management's experts" (ISA 500) is used.

Let's assume a Luxembourg vehicle (the "SPV") is domiciled with the service provider ABC S.A., which also takes over the vehicle's accounting functions and prepares its annual accounts. The directors of the SPV may at the same time be employees of ABC S.A. The SPV's business purpose may be the investment in a portfolio of non-performing loans in the UK. Those loans are serviced by XYZ Ltd., a company specialised in loan servicing. XYZ Ltd. prepares a monthly report on principal and interest collections and receives a fixed fee for its service. In addition, SPV enters into a performance swap agreement with the renowned financial institution BANK AG. Under this swap agreement, SPV pays a fixed amount (part of the interest received from the loan portfolio) and receives the performance of the German stock index DAX. The valuation of that swap is provided by the swap counterparty BANK AG.

At financial year-end, information from all these players will be used to prepare the annual accounts and will most likely be a significant part of it. The directors will approve the accounts and remain personally liable for the information included. However, the preparation itself, including all accounting records and journal entries, will be provided by ABC S.A.. In order to do so, they will normally use the reports received from XYZ Ltd. on the loan portfolio, including principal repayments and interest received, as well as the fair valuation of the performance swap provided by BANK AG. In the end, the Board of Directors signs off (and remains responsible for) annual accounts significantly made up of information prepared by ABC S.A., XYZ Ltd. and BANK AG. Similarly, the auditor is responsible for the annual accounts as a whole, regardless of where the information comes from.

Therefore, both the auditor and the Board of Directors, have a genuine interest and duty to gain sufficient understanding of and familiarity with the information obtained from third parties. This may include obtaining controls reports on the third party's processes (often so-called ISAE 3402 reports), procedure manuals, internal audit reports, on-site visits etc. Furthermore, plausibility checks on the appropriateness of the information received should be made, e.g. back-testing and variation analysis of third-party valuations. In substance, the Board of Directors and the auditors should make no differentiation as to whether information is prepared by the department of a company (as is usually the case for a bank or commercial company) or by a third party (as mostly occurs for securitisation vehicles).

4.9 Other structures

As mentioned in chapter 2.1, in the Luxembourg market, some securitisation transactions are not carried out through securitisation vehicles under the Law of March 2004 but through other types of vehicles. The main ones are the following:

- UCIs Part II;
- Specialised Investment Funds ("SIF");
- Société d'Investissement en Capital à Risque ("SICAR").

The possibility to use other types of structures provides Luxembourg with a fertile environment for product development and gives managers the option to choose between a fund type product and products outside the fund regimes.

The following schedule summarises the main characteristics of these other type of structures used in Luxembourg.

	UCIs Part II	Specialised Investment Funds	SICAR
Background	Undertakings for Collective "Investments" (UCIs) under the so-called "Part II" of the Law of 17 December 2010 offer a wide range of investment possibilities, and can be considered as the classic type of regulated fund vehicle publicly distributed in Luxembourg.	In February 2007, the Luxembourg parliament adopted a law (the "SIF Law"), to replace the 1991 Law on UCIs dedicated to institutional investors, so formalising the concept of Specialised Investment Funds (SIFs). The main change compared to previous regulation concerns the scope of eligible investors, which has been broadened to include not only institutional investors, but also professional and sophisticated investors. The SIF Law has been amended by the Law of 26 March 2012.	The SICAR Law of 15 June 2004 introduced the SICAR form of investment vehicle, which has enjoyed some popularity as a vehicle exclusively dedicated to investments in risk capital, and only available to well-informed investors.
Withholding tax	Distributions by a Luxembourg Part II UCI, whether paid to resident or non-resident investors, are not subject to any Luxembourg withholding tax. Some payments may, however, be subject to withholding tax as a result of the application of the European Savings Tax Directive.	Distributions by a Luxembourg SIF, whether paid to resident or non-resident investors, are not subject to any Luxembourg withholding tax. Some payments may however be subject to withholding tax as a result of application of the European Savings Tax Directive.	Distributions by a SICAR, whether paid to resident or non-resident investors, are not subject to any Luxembourg withholding tax. Some payments may however be subject to withholding tax as a result of the application of the EU Savings Directive.
Investment restrictions	The investment restrictions are not onerous. Some risk diversification is required; consequently a maximum of 20% of the assets can be invested in a single investment. However, all types of investors are allowed to participate.	The investment restrictions are not onerous. Some risk diversification is required, and consequently a maximum of 30% of the assets can be invested in a single investment. Participation in a SIF is only open to "well-informed investors", i.e. institutional, professional investors or high-net-worth individual investors who are investing at least EUR 125,000 or who can provide a bank confirmation of suitable experience, and confirmed in writing that he/she adheres to the status of well-informed investor.	SICARs are, by definition, exclusively dedicated to investments in risk capital. As a result, a SICAR does not have to comply with any kind of risk diversification requirement. A SICAR may, in principle, invest 100% of its assets in only one target investment.
Legal form	The regulatory shell which publicly distributed UCIs may choose are as follows: • *A Fonds Commun de Placement* (FCP); • *A Société d'Investissement à Capital Variable* (SICAV) ; • *A Société d'Investissement à Capital Fixe* (SICAF).	A SIF is in essence a special regulatory regime for non-retail funds. The SIF regime is available for FCPs with a management company; for SICAVs and for SICAFs. Both the SICAV and the SICAF may choose from a number of legal forms - the limited liability company (*Société à responsabilité limitée* – S.à r.l.) the public limited company (S.A.), the (commonly used) partnership limited by shares (S.C.A.), or the cooperative in a form of a public limited company (*Société coopérative organisée sous forme de société anonyme* – S.C.S.A.).	A SICAR is an investment company in risk capital for private equity and venture capital funds. A SICAR can be set up under the legal form of a partnership, or of a corporation. Various legal forms are available: • A public limited company (S.A.). • A limited liability company (S.à r.l.). • A cooperative in the form of a public limited company (S.C.S.A.) (rarely used) • Partnership limited by shares (S.C.A.). • A limited partnership (*Société en Commandite Simple* – S.C.S.) (rarely used).
Other taxes	Subscription tax (*taxe d'abonnement*) at a rate of 0.01% or 0.05% per annum is levied, depending on the investments made and the investor base, on the net asset value at the end of each quarter. There is no net wealth tax. UCIs are regarded as VAT taxable persons performing VAT-exempt activities and are in principle not entitled to recover the input VAT incurred on their costs, except in specific cases.	Subscription tax (*taxe d'abonnement*) at a rate of 0.01% yearly is levied on the net asset value at the end of each quarter. There is no net wealth tax. SIFs are regarded as VAT taxable persons performing VAT-exempt activities and are in principle not entitled to recover the input VAT incurred on their costs, except in specific cases.	A SICAR is not subject to annual subscription tax. There is no net wealth tax. SICARs are regarded as VAT taxable persons performing VAT-exempt activities and are in principle not entitled to recover the input VAT incurred on their costs, except in specific cases.

	UCIs Part II	Specialised Investment Funds	SICAR
Minimum capital requirements	The minimum asset base of a UCI is EUR 1.25 million. This amount has to be reached within six months of authorisation by the CSSF. Publicly distributed UCIs may have various subfunds and can issue different classes of shares.	The minimum asset base of a SIF is EUR 1.25 million. This amount has to be reached within the 12 months following SIF authorisation. SIFs can have various sub-funds, and can issue different classes of shares. Units or shares issued by each of the sub-funds may have different values, representing specific pools of assets and liabilities.	The subscribed share capital must be not less than EUR 1 million, and must be reached within the 12 months following CSSF authorisation.
Tax treatment at entity level	The UCI vehicle is tax-exempt. Dividends received, capital gains realised and other income received are outside the scope of taxation.	The SIF vehicle is tax-exempt, irrespective of its legal form. Dividends received, capital gains realised and other income received are outside the scope of taxation.	The limited partnership is transparent for tax purposes; consequently, there is no taxation at the level of the fund. The other legal forms are fully taxable, although the income (including interest), which is connected with investments in risk bearing capital, is tax-exempt. All other income is subject to corporate income tax and municipal tax.
Treaty status	For the FCP form there is no access to the double tax treaty network. SICAVs and SICAFs should have access to Luxembourg double tax treaties with 37 countries. For all of the legal forms, there is no access to the EU Parent-Subsidiary Directive.	For the FCP form, there is no access to the double tax treaty network. SICAVs and SICAFs should have access to Luxembourg double tax treaties with 37 countries. For all of the legal forms, there is no access to the EU Parent-Subsidiary Directive.	SICARs having the form of S.A., S.à r.l., S.C.A., or S.C.S.A., should generally be entitled to tax treaty benefits; however, this has to be reviewed on a case-by-case basis as some countries may challenge treaty access. There is no access to most tax treaties for partnerships, and SCS-type SICARs are not differentiated.
Treatment of investors	The tax treatment of investors depends on the rules applicable in their country of residence. Some jurisdictions may treat the FCP form as tax-transparent.	The tax treatment of investors depends on the rules applicable in their country of residence. Some jurisdictions may treat the FCP form as tax-transparent.	Investors in an SCS-type SICAR are deemed to receive their income pro rata to their participations in the fund; the tax treatment of investments via SICARs in other legal forms depends on the rules applicable in the country of their residence.
Regulation	UCIs fall under the supervision of the CSSF.	The regulatory authority is the CSSF.	A SICAR is subject to a light degree of regulation by the CSSF.

The new "Reserved Alternative Investment Fund" (RAIF), that will be probably voted in Q3/2016, will complement the structures mentioned above.

This new vehicle is very flexible and will not be supervised by the CSSF but will be regulated through its relevant manager under the AIFMD. The RAIF can be set up in the legal structure of a SICAV, FCP, or SICAF.

SICAV and SICAF may opt for the various legal forms provided for in the Luxembourg Commercial Law.

The RAIF is based on SIF and SICAR regimes. As it is managed by an authorised AIFM, the RAIF also benefits from all passporting advantages. Similar to SIF and SICAR, a RAIF is available to institutional investors, professional investors and well informed investors.

The RAIF, in addition to be managed by an authorised AIFM, needs to have some mandatory services providers: a depository fully compliant with the AIFMD, a central administration and a Luxembourg independent auditor.

Depending on the regime followed, RAIF will accordingly follow either the SIF or the SICAR tax regime.

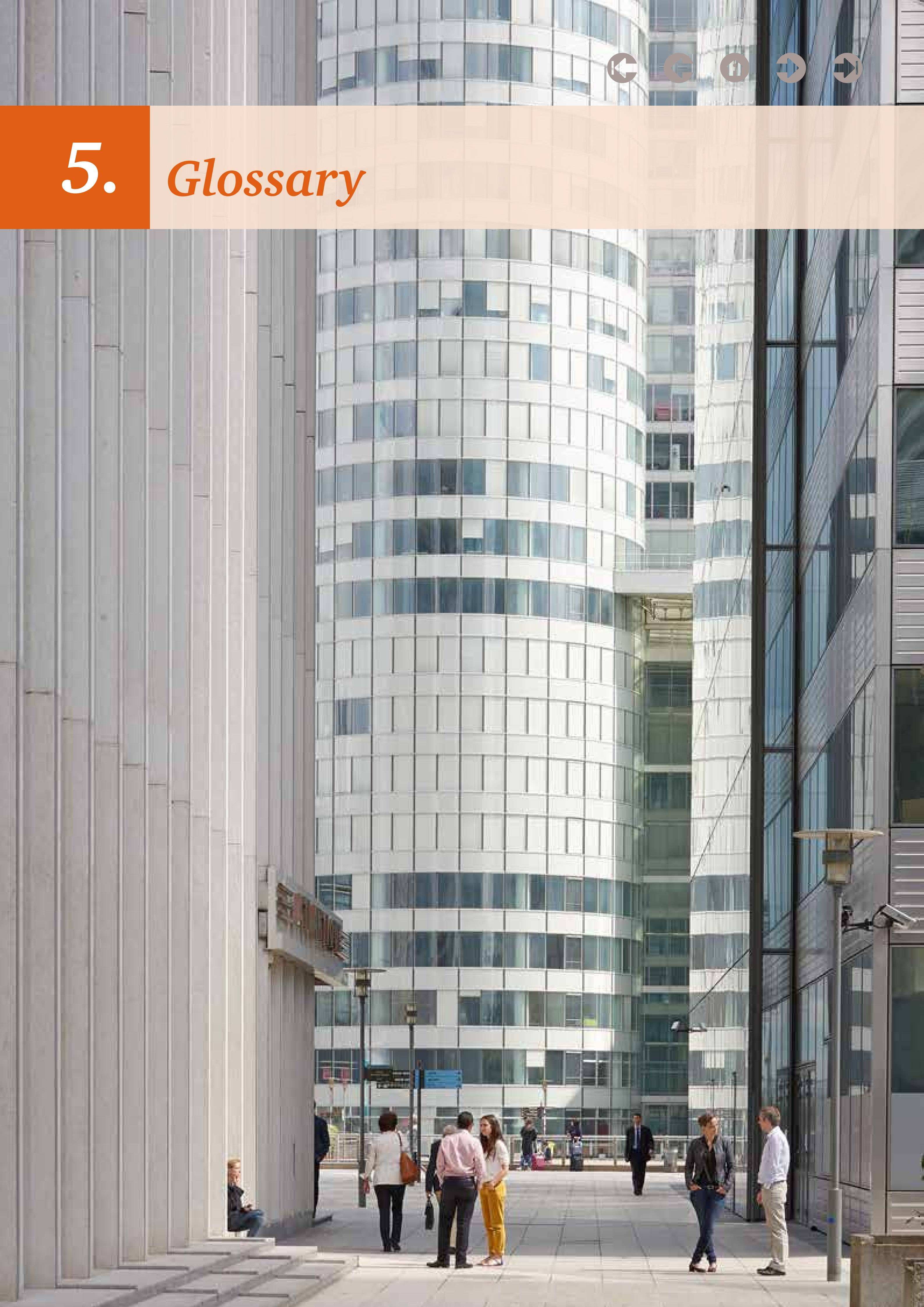
4.10 Reporting standardisation

Within the financial crisis the securitisation market came under substantial criticism as securitised products played a major role in the financial difficulties. Badly structured products, obscure structures and over-leveraged issuances performed very poorly and weakened the global financial system.

A couple of years later, the vast majority of European securitisations have demonstrated incredible credit resilience and strong price performance. They show that simple, transparent, and high quality securitisations are a healthy and robust part of the financial architecture. Therefore, some initiatives have been set up in order to define and promote standards of "best practice" in the asset backed market: standards of quality, transparency, simplicity, and liquidity.

In the UK, the PCS ("Prime Collateralised Securities") initiative grants the PCS label for securitisation fulfilling certain eligibility criteria. In Germany, the True Sale Initiative (TSI) grants a certificate "CERTIFIED BY TSI – DEUTSCHER VERBRIEFUNGSSTANDARD". This label is also founded on clearly defined rules for transparency and disclosure. Both labels have in common that only some asset classes, like auto loans or consumer loans, are eligible and that loan level data and other information must be provided by the originator. The way to more simple and transparent securitisation structures can now also been seen in the STS-Regulation described in chapter 4.3.2.

5. *Glossary*



Arbitrage transactions:	Securitisation transactions whereby assets are acquired from various originators, or from the market, and are securitised with the intention of making an arbitrage profit resulting from the difference between the average return of the assets and the average coupon on the liabilities.
Asset-Backed Commercial Paper (ABCP):	Transactions, where normally short-term receivables (e.g. trade receivables) are pooled into a Special Purpose Vehicle (SPV). The SPV in turn issues Commercial Papers (normally with 90 to 180 days remaining until maturity), which are called Asset-Backed Commercial Papers. The SPV may be established for a single seller of short-term receivables or for a pool of sellers (multi-seller ABCP conduit).
Asset-Backed Securities (ABS):	Securities generally issued by an SPV, which are backed by assets rather than by a payment obligation. Securitised instruments are Asset-Backed Securities.
Backup servicer:	Normally, the originator of a securitisation transaction continues to service the original transaction. In pre-agreed circumstances the SPV can, however, obtain the authority to bring in a backup servicer to replace the originator as servicer.
Bankruptcy-Remote:	This term applies to an entity that is not likely to have an incentive to commence insolvency proceedings voluntarily and is not likely to have an involuntary insolvency proceeding brought against it by third-party creditors.
Beneficial interest:	In contrast to legal interest, beneficial interest means the right to stand to benefit, short of legal title. In a securitisation transaction, the receivables/cash flow or security interest thereon are legally held by the SPV or trust, for the benefit of the investors; that means the investors are beneficiaries and their interest is the beneficial interest.
Cash collateral:	In a securitisation transaction, the originator may deposit some cash in the SPV to enhance creditworthiness for the investors. The cash deposit is not normally used by the SPV to acquire receivables from the originator.
Cash Collateral Account (CCA):	A reserve fund that provides credit support to a transaction. Funds in a CCA are lent to the issuer by a third party, typically a letter of credit from a bank, pursuant to a loan agreement.
Cash flow waterfall:	The rules by which the cash flow available to an issuer, after covering all expenses, is allocated to the debt service owed to holders of the various classes of securities issued in connection with a transaction.
Clean up buyback or call:	An option giving the originator the right to buy back the outstanding securitised assets when the principal outstanding has been substantially amortised. The option is usually exercised when the outstanding principal is less than 10% of the original principal.
Collateral:	Is the underlying security, mortgage or asset for the purposes of securitisation or borrowing and lending activities. In respect of securitisation transactions, it means the underlying cash flow.
Collateral manager:	The collateral manager manages the collateral that is purchased and sold by the SPV regularly (used especially in arbitrage transactions).
Collateralised Bond Obligations (CBO):	Obligations, usually structured obligations, issued which are collateralised by a portfolio of bonds, transferred by an originator or purchased from the market with the intention to securitise them.
Collateralised Debt Obligations (CDO):	A common name for Collateralised Bond Obligations and Collateralised Loan Obligations.
Collateralised Fund Obligations (CFO):	Obligations, usually structured obligations, issued which are collateralised by a portfolio of hedge funds or equity fund investments, transferred by an originator or purchased from the market with the intention to securitise them.
Collateralised Loan Obligations (CLO):	Obligations, usually structured obligations, issued which are collateralised by a portfolio of loans, transferred by an originator or purchased from the market with the intention to securitise them.

Collateralised Mortgage Obligations (CMO):	A securitisation transaction where the SPV's cash inflows are divided into different tranches. The tranches, having different payback periods and priority profiles, repay the bonds issued by the SPV in line with the pre-determined payback periods and priority profiles of the bonds. On issue, the bonds are usually structured and served in accordance with investo rs' objectives and risk profiles.
Co-mingling:	When the originator in a securitisation acts at the same time as the servicer, the cash flows collected by the originator may sometimes co-mingle, or may intentionally be mixed up with that of the originator him/herself. Thus, it is no longer possibly to clearly identify the cash flow collected on behalf of the SPV. This is called co-mingling.
Commercial Mortgage-Backed Securities (CMBS):	A part of Mortgage-Backed Securities. The expression is used to avoid confusion with the term Residential Mortgage-Backed Securities (RMBS). Commercial mortgages represent mortgage loans for commercial properties, such as multi-family dwellings, shops, restaurants, showrooms, etc.
Conduit:	A securitisation vehicle that is normally used by third parties as a ready-to-use medium for securitisation, usually for assets with multiple originators. Conduits are mostly used in cases of Asset-Backed Commercial Paper, CMBS etc. There are two types, the single seller conduit and the multiseller conduit.
Covenant:	In terms of legal documents, a covenant is a promise to do or not to do something stipulated in the related agreement.
Credit Default Swap (CDS):	If there are predefined credit events that indicate credit default by a reference obligor, a credit derivative deal is executed, which means that either a specific obligation of the obligor will be swapped between the counterparties against cash or one party will pay compensation to the other.
Credit enhancement:	General term for measures taken by the originator in a securitisation structure to enhance the securitised instrument's security, credit or rating. These measures include cash collateral, profit retention and third-party guarantees. Credit-enhancement devices can be differentiated as structural credit enhancement, originator credit enhancement and third-party credit enhancement.
Credit derivative:	A derivative contract whereby one party tries to transfer the credit risk, or variation in returns on an asset, to another. Common types are credit default swaps, credit linked notes and synthetic assets.
Credit Linked Note (CLN):	A note or debt security which allows the issuer to set off the claims under an embedded credit derivative contract from the interest, principal or both, payable to the investor in such a note.
Credit enhancer:	A party who agrees to elevate the credit quality of another party or a pool of assets by making payments usually up to a specified amount, in the event that the other party defaults on their payment obligations or the cash flow produced by the pool of assets is less than the amount(s) contractually required because of defaults by the underlying obligors.
Default:	A failure by one party to a contractual agreement to live up to their obligations under the agreement; a breach of a contractual agreement.
Deferred purchase price:	A type of credit enhancement where a portion of the purchase price of the assets is reserved by the SPV to serve as cash collateral.
Derecognition:	The action of removing an asset or liability from the balance sheet. In securitisation transactions, the term refers to derecognition of assets securitised by the originator when they are sold for securitisation. Before derecognition is permitted, certain conditions, stated in the accounting standards, have to be fulfilled.
Eligibility criteria:	The choice of receivables that the originator assigns to the SPV. The eligibility criteria are usually stated in the receivables sale agreement with a provision that a breach of the criteria would amount to breach of warranties by the originator, obliging the originator to buy back the receivables.
Event risk:	The risk that an issuer's ability to make debt-service payments will change because of dramatic unanticipated changes in the market environment, such as a natural disaster, an industrial accident, a major shift in regulation, a takeover or corporate restructuring.
Excess spread:	The excess of the proceeds inherent in the SPV's asset portfolio, over the interests payable to the investors and the expenses of the transaction.

Expected maturity:	The time period within which the securities are expected to be fully paid back. However, the expected maturity is not the legal final maturity, as the transaction's rating is not based on repayment by the expected maturity.
Extension Risk:	The possibility that prepayments will be slower than an anticipated rate, causing later-than-expected return of principal. This usually occurs during times of rising interest rates. Opposite of prepayment risk.
External credit enhancement:	Credit support provided to a securitisation by a highly rated third party.
First-loss risk:	When the risks in the SPV's asset portfolio are segregated into several tranches, the first-loss risk, to a certain extent, is borne by a particular class before it can affect the other classes. The first-loss class must fully cover the loss before it affects the other classes. The first-loss class can be compared to the equity of an entity and provides credit enhancement to the other classes.
Future flows securitisation:	The securitisation of receivables which only arise in future periods.
Guaranteed investment contract:	A contract in which a particular rate of return on investments is guaranteed.
Issuer:	Within the framework of securitisations, the issuer is the SPV which issues the securities to the investors.
Internal credit enhancement:	Structural mechanism or mechanisms built into a securitisation to improve the credit quality of the senior classes of securities issued in connection with the transaction, usually based on channelling asset cash flow in ways that protect those securities from experiencing shortfalls.
Investment grade:	With respect to Standard & Poor's ratings, a long-term credit rating of BBB- or higher. With respect to Moody's ratings, a long-term credit rating of BBB3 or higher.
Junior bonds:	Bonds that rank below senior bonds.
Legal final maturity:	The final maturity by which a security must be repaid to avoid the contractual obligation defaulting. Typically, in securitisation transactions, the legal maturity is set at a few months after the expected maturity, to allow for delinquent assets to pay off and to avoid contractual default which can lead to the winding up of the transaction.
Letter of credit:	An agreement between a bank and another party under which the bank agrees to make funds available to or upon the order of the other party upon receiving notification.
Limited recourse:	The right of recourse limited to a particular amount or extent. For example, in a securitisation transaction, the right of recourse being limited to the over-collateralisation or cash collateral placed by the originator is a case of a limited recourse.
Liquidity facility:	A short-term liquidity or overdraft facility provided by a bank or the originator of the SPV to meet the short-term funding gaps and pay off its securities. Liquidity facilities can sometimes be substantial and the only way to redeem securities – for example, in the case of ABCP conduits.
Liquidity provider:	The provider of a facility that ensures a source of cash with which to make timely payments of interest and principal on securities if there is a temporary shortfall in the cash flow being generated by the underlying assets.
Mezzanine bonds:	Bonds that rank in priority below senior bonds, but above junior bonds.
Mortgage-Backed Securities (MBS):	Securities backed by cash flow resulting from mortgage loans. MBSs can be divided into residential mortgage-backed securities and commercial mortgage-backed securities.
Non-petition undertaking:	A legal provision meaning that investors and creditors may waive their rights to initiate a bankruptcy proceeding against the securitisation vehicle. This clause protects the vehicle against the actions of individual investors who may, for example, have an interest in a bankruptcy proceeding against the vehicle.
Obligor:	The debtor from whom the originator has right to receivables.

Offering circular:	A disclosure document used in marketing a new security's issuance to prospective investors.
Originator:	The entity assigning assets in a securitisation transaction.
Originator advance:	A liquidity facility provided by an originator to a securitisation transaction, whereby the originator pays the expected collections of one or more months by way of an advance and later appropriates the actual collections to reimburse them.
Originator credit enhancement:	Credit enhancement granted by the originator, like cash collateral, over-collateralisation, etc.
Orphan company:	A company without identifiable shareholders, e.g. an SPV owned by a charitable trust or a "Stichting". Such a company is often used to avoid consolidating the SPV with any other entity.
Over-collateralisation:	A type of credit enhancement in a securitisation transaction where the originator transfers additional collateral to the SPV to serve as security in the event of delinquencies, etc.
Pass through:	A special payment method whereby the payments made by the SPV to the investors take place in the same time periods and are subject to the same fluctuations as the receivables. This means that the cash flow collected every month is passed through to investors, after deducting fees and expenses.
Paying agent:	A bank of international standing and reputation that has agreed to be responsible for making payments on securities to investors.
Pay through:	A special payment method whereby the payments made by the SPV to the investors take place according to a predetermined pattern and maturity, and do not reflect the payback behaviour of the receivables. During the intervening periods, the SPV reinvests the receivables, mainly in passive and predefined investments.
Pfandbrief:	A German traditional secondary market mortgage product whereby the investor is granted rights against the issuer and also against the underlying mortgage.
Prepayment risk:	The possibility that prepayments will be faster than anticipated rates. This can lead to a loss of interest. The SPV can pass through the prepaid amounts to investors, thus resulting in earlier payment of principal than expected and reduced income over time. Alternatively, if the SPV reinvests the prepayments, the reinvestment's rate of return will be lower than that of the underlying receivables.
Protection buyer:	In a transaction such as a credit default swap, the party transferring the credit risk associated with certain assets to another party in return for the payment of what is typically an upfront premium.
Protection seller:	In a transaction such as a credit-default swap, the protection seller is party that accepts the credit risk associated with certain assets. To the extent that losses are incurred on the assets in excess of a specified amount, the protection seller makes credit protection payments to the protection buyer.
Recourse:	The ability of an investor/purchaser to seek payment against an investment to the originator of the investment. For example, in a securitisation transaction, the right of the investor to seek payment from the originator.
Regulatory arbitrage:	The possibility for banks to reduce their regulatory capital requirements of a portfolio of assets without any substantial reduction in the real risks inherent in the assets. For instance, this is the case of a securitisation transaction where the economic risks of the assets securitised have been substantively retained.
Reserve account:	A funded account available for use by an SPV for one or more specified purposes. A reserve account is often used as a form of credit enhancement.
Residential Mortgage-Backed Securities (RMBS):	RMBS are the most fundamental type of securitisations. These securities involve the issuance of debt, secured by a homogenous pool of mortgage loans that have been secured on residential properties.
Retained interest:	Any risks/rewards retained by the originator in a securitisation transaction – for example service fees, any retailed interest strip, etc.

Securitisation:	A securitisation is a type of structured finance in which a pool of financial assets is transferred to a Special Purpose Vehicle which then issues securities solely backed by those assets transferred and the payments derived by those assets.
Senior:	Bonds that rank before junior bonds. These bonds or tranches of securities issued by an SPV have high or the highest claim against the SPV.
Sequential payment structure:	A payment structure whereby the cash flow collected by the SPV is paid in sequence to the various classes. This means the cash flow is first used for the full payment to the investors of the most senior class, and then for the full payment of the second class, and so on.
Servicer:	The entity that collects principal and interest payments from obligors and administers the portfolio after the transaction has closed. It is very common in securitisation transactions for the originators to act as servicers, although this is not always the case. See also "backup servicer".
SIC 12:	An accounting interpretation by the International Accounting Standards Board whereby SPVs which are supported or credit-enhanced by the originator are to be treated as quasi-subsidiaries of the originator, and therefore consolidated with the originator.
Special Purpose Vehicle:	The legal entity established – especially in securitisation transactions – with the purpose of acquiring and holding certain assets for the benefit of investors of the securities issued by the SPV. Therefore, the investors have acquired nothing but the specific assets. The vehicle holds no other assets and has no other obligations.
Structural credit enhancement:	A type of credit enhancement. It involves creating senior and junior securities, thereby enhancing the credit rating of the senior securities.
Subordination:	The technique of subordinating the payment rights of investors and creditors to the prior payment of other securities or debts by the securitisation vehicle.
Synthetic transaction:	In a synthetic securitisation transaction, instead of selling an asset pool to the SPV, the originator buys protection through a series of credit derivatives. Such transactions do not provide the originator with funding. These transactions are typically undertaken to transfer credit risk and to reduce regulatory-capital requirements.
Synthetic CDO:	A CDO-transaction in which the transfer of risk is affected through the use of a credit derivative as opposed to a true sale of the assets.
Tax-transparent entity:	An entity that is not subject to tax itself in principle. The shareholders/partners of the entity will be taxed directly.
Third-party credit enhancement:	A credit enhancement provided in a securitisation transaction by third-party guarantees, i.e. insurance contracts or a bank letter of credit.
Tranche:	A piece, fragment or slice of a deal or structured financing. The risks distributed on different tranches concerning losses, sequential payment of the cash flow, etc. are different. This is why the coupon on different tranches is also different.
True sale:	In a true sale structure, the originator sells a pool of assets to a Special Purpose Vehicle, which funds the purchase through the issue of tranches of securities. If the sale is structured in a way that it will be considered as a sale for legal or tax purposes, it is defined as a true sale.
Trustee:	A third party, often a specialist trust corporation or part of a bank, appointed to act on behalf of investors.
Underwriter:	Any party that takes on risk. In the context of the capital markets, a securities dealer who commits to purchasing all or part of a securities issuance at a specified price.

6. *How we can help*

We consider one of our roles to be a key driver in promoting a better understanding of the securitisation and structured-finance industry, emphasising both the benefits and the potential pitfalls, as well as developing ideas for the future direction of the industry.

To meet this challenge, PwC Luxembourg is part of the Global Structured Finance Group (SFG), which is composed of experts and professionals with extensive knowledge of securitisation and structured finance in all the main jurisdictions around the world. Many PwC professionals across Europe, the US and Asia provide clients with advice, in-depth market insight and pre-eminent transaction support in securitisation and structured-finance deals.

We provide services in the following arenas:

Audit services

Our global presence allows us to provide all audit services for special purpose entities used for securitisations and structured finance transactions.

Tax strategies and structuring

We can provide tax advice in connection with all aspects of your securitisation, from deal structuring to implementation and monitoring. Through our network of securitisation tax specialists within PwC's global network, we are able to deliver quality tax advice in all major territories. We ensure our clients get answers with respect to tax opinions and tax advice relating to securitisations quickly.

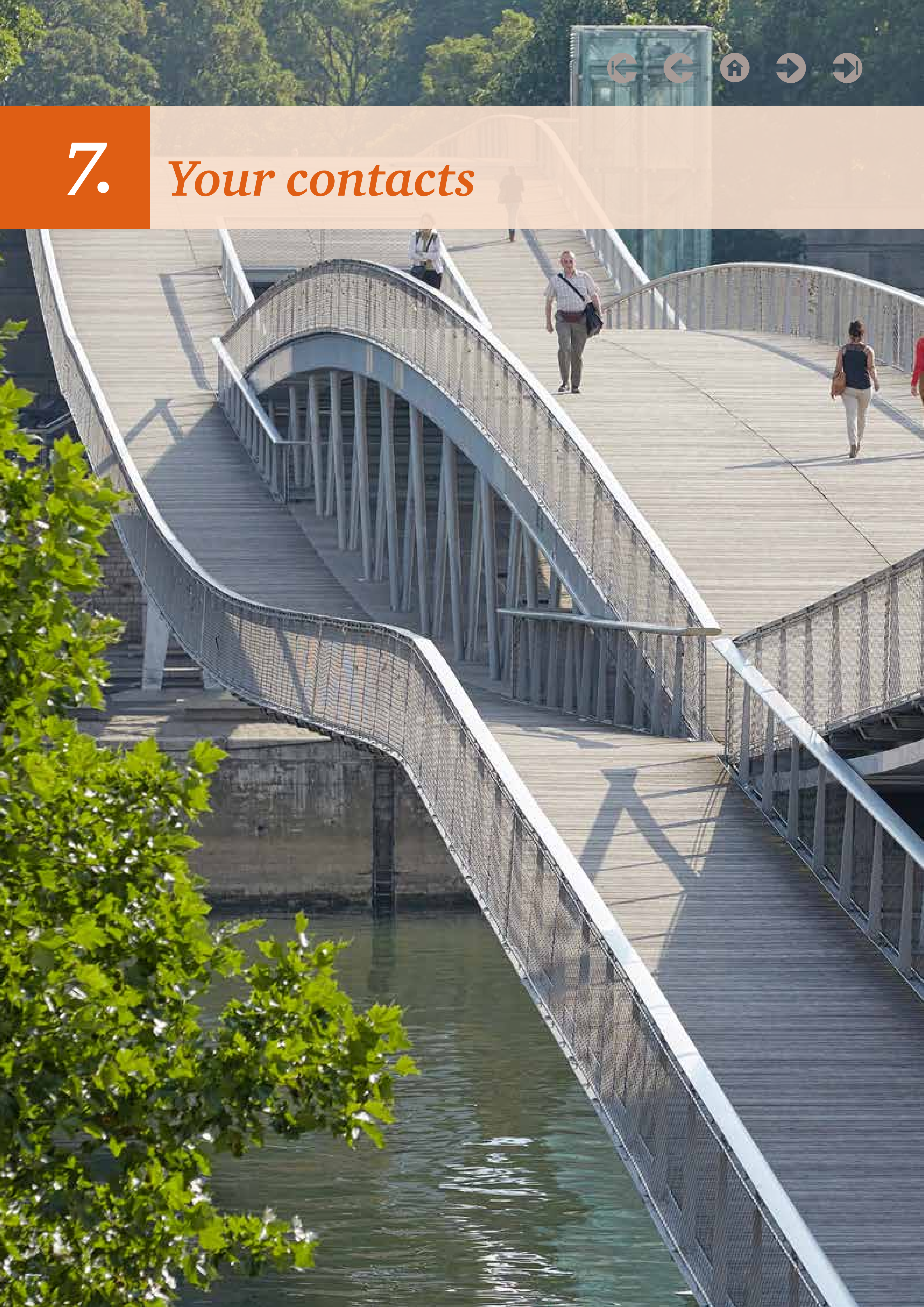
Accounting and regulatory advice

We provide advice on the accounting treatment of securitisation and structured finance structures under IFRS & Luxembourg GAAP and other accounting frameworks. We can help you comply with applicable regulations through regulatory advice and guidance on the latest developments in accounting and regulatory rules and their impact on structures.

Education & training

Provided through PwC's Academy, we run tailored training courses to educate and train clients new to the securitisation and structured-finance market.

7. *Your contacts*



Should you have any questions, please do not hesitate to contact one of our following experts:

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