Securitisation in Luxembourg

A comprehensive guide

June 2025

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Preface

We are pleased to present the 14th edition of our brochure, “Securitisation in Luxembourg – A Comprehensive Guide”, as part of our ongoing series of publications on securitisation in Luxembourg. We sincerely thank you for your comments and suggestions over the years, which have helped make this publication the preferred reference guide for securitisation in Luxembourg.

We also greatly appreciate your positive feedback on our brief video tutorials aimed at demystifying securitisation. These videos, which introduce a new topic every four to six weeks, are available on our website and LinkedIn. Your continued support of our work, publications, and videos is what makes it all worthwhile—thank you!

In this year’s edition of the Comprehensive Guide, we have primarily updated Chapter 5 on taxation. Notably, we have included commentary on the impact of certain amendments to the Pillar 2 Law and the introduction of the “single entity group” concept for applying interest limitation rules. This new concept has significantly reduced the uncertainty around the interest limitation rules under the Anti-Tax Avoidance Directive 1 (ATAD 1). Our 2025 Market Survey confirms this positive shift, with the issue dropping from the most problematic to the fourth position in our question on the key obstacles for securitisation in Luxembourg.

As a result, Luxembourg continues to be one of the two leading jurisdictions for establishing issuing vehicles. In 2024, over 190 new Luxembourg securitisation vehicles were created, while 110 were liquidated, resulting in a net growth of 80. By the end of March 2025, approximately 1,590 vehicles were active in Luxembourg, approximately representing 7,000 to 8,000 compartments and transactions. We anticipate continued growth in the coming years, driven by arrangers increasingly leveraging the modernised Securitisation Law—such as 100% loan financing, partnerships as legal forms, and the resolution of ATAD I uncertainties.

Moreover, we understand that European policymakers remain committed to securitisation as a key instrument in achieving the goals of the Savings and Investments Union (SIU)—formerly known as the Capital Markets Union (CMU). The new initiative reflects a reinforced focus on mobilising savings and channeling investments more effectively across Europe. While the name has changed, the core objectives remain: strengthening European capital markets and fostering economic growth. And securitisation has been identified as key contributor to these objectives.

As in previous years, we are publishing this brochure in electronic format only, to enhance accessibility and align with our corporate objective of reducing our carbon footprint. However, if you would like to receive a printed copy, please let us know.

We hope you enjoy reading the 2025 update of our brochure and that it provides valuable insights into the securitisation market and best practices in Luxembourg.

Finally, I would like to thank everyone who contributed to this publication for their time and dedication. It would not be possible without our team of committed securitisation professionals, who are always happy to assist you with any questions you may have.

Holger von Keutz
Securitisation Leader

Markus Zenz
Securitisation Partner

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01

Securitisation market and trends

Securitisation market and trends

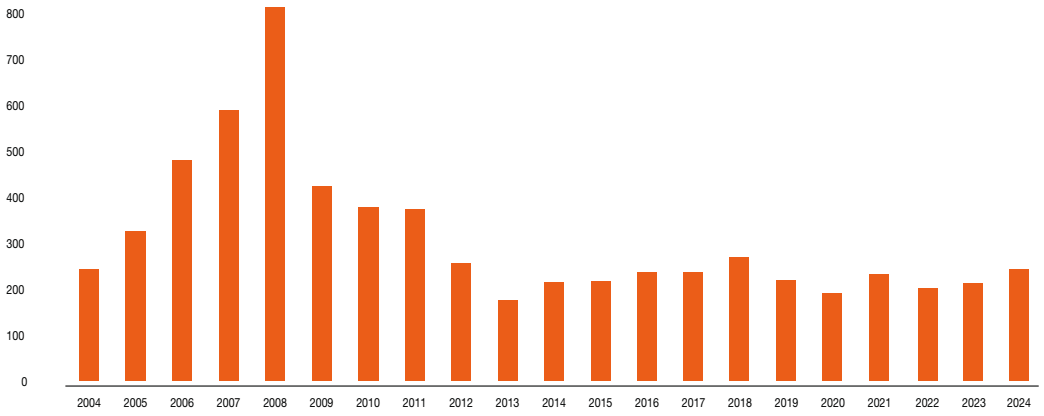
1.1 European market overview

The development of the securitisation market in Europe can be analysed from two different angles: either considering transactions with the issuing vehicle domiciled in Europe, or looking at those with European collateral/underlying investment. For the domicile, we refer to the statistics published by the European Central Bank ("ECB") for the Euro area and discuss this further in the next section. An analysis of the European market by collateral country and type is performed by the Association for Financial Markets in Europe ("AFME") in cooperation with the Securities Industry and Financial Markets Association ("SIFMA") on a quarterly basis and is presented hereafter.

The graph in Figure 1 illustrates that following the drop after the financial crisis in 2008 the yearly issuance volume in Europe have finally stabilised since 2014 with the strongest year in 2018 with EUR 269.7 billion.

In the last three years issuances constantly increased from EUR 202.8 billion in 2022 through EUR 213.3 billion (+5,2%) in 2023 to EUR 244.9 billion (+14.8%) in 2024, marking the highest issuance volume since 2018.

Figure 1: European securitisation issuance (in billion EUR)



Source: AFME Securitisation Data Reports

With regards to the type of underlying assets, and as illustrated in Figure 2, Residential Mortgage-Backed Securities ("RMBS") continued to dominate the market in 2024, representing approximately 49% of the total issuance. While RMBS issuance slightly decreased from EUR 121.59 billion in 2023 to EUR 120.4 billion in 2024, it remains the leading asset class in European securitisation.

Other Asset-Backed Securities ("ABS") maintained their strong position, increasing from EUR 58.1 billion in 2023 to EUR 62.7 billion in 2024, bringing their market share to approximately 26%. This suggests continued investor confidence in ABS products.

Collateralised Debt or Loan Obligations ("CDO/CLO") saw a significant increase, rising from EUR 26.2 billion in 2023 to EUR 49.2 billion in 2024, marking a notable resurgence in investor interest in this asset class. On the other hand, Small and medium-sized entities ("SME/Corporate") financing experienced a recovery, increasing from EUR 4.0 billion in 2023 to EUR 9.8 billion in 2024, though still far below its 2022 level of EUR 29.3 billion.

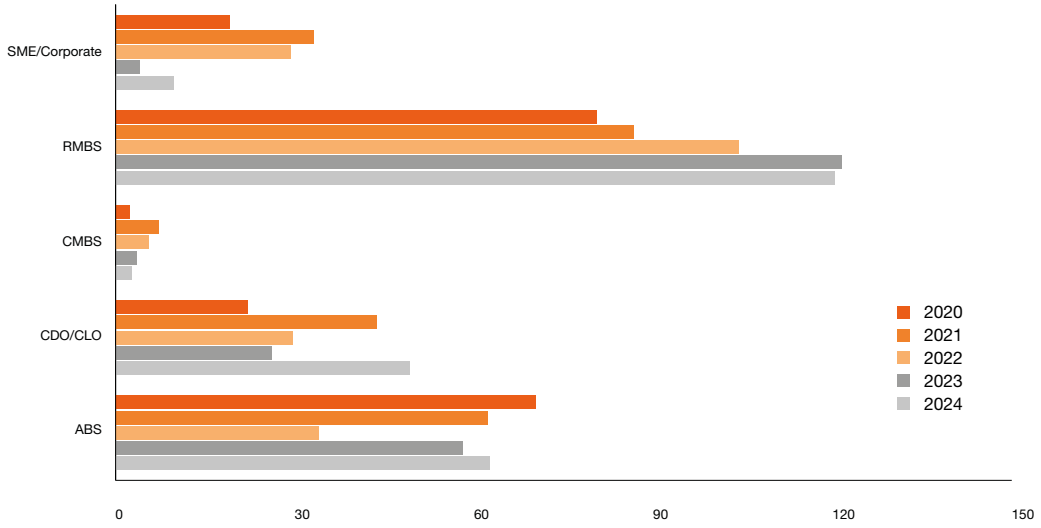
Commercial Mortgage-Backed Securities (CMBS) continued their downward trend, with issuance volume declining from EUR 3.5 billion in 2023 to EUR 2.8 billion in 2024, reflecting weaker investor demand in this segment.

Overall, total issuance in 2024 surged to EUR 244.9 billion from EUR 213.4 billion in 2023, representing a solid growth trajectory for the European securitisation market. The data reflects a dynamic landscape with shifting investor priorities, reinforcing the dominant role of RMBS and ABS. The total outstanding European securitisations (as compared to new issuances described above) remain heavily concentrated in RMBS, which continues to account for nearly half of the total volume, while ABS—including auto and consumer loans—make up about one-quarter.

These figures indicate that European securitisation has not only stabilised in the last decade but has also experienced renewed growth in 2024. However, when compared to the US securitisation market, Europe still operates at a lower volume. This difference is largely due to the European economy's reliance on bank loans, whereas the US economy is more capital-market-driven. Additionally, the US benefits from active government-sponsored agencies supporting securitisation, a structure that does not exist in Europe.

To address this gap, the European Commission has advanced its Savings and Investments Union ("SIU") initiative (former Capital Markets Union ("CMU")), aiming to create a single capital market across the EU and facilitate increased funding for economic growth. Securitisation remains a critical tool in the SIU's strategy, and ongoing policy efforts suggest a promising outlook for the future development of the European securitisation market.

Figure 2: European securitisation issuance by collateral type (in billion EUR)



Source: AFME Securitisation Data Reports

1.2 Luxembourg market overview

Development of the Luxembourg securitisation market

Despite the ongoing challenging economic environment, the Luxembourg securitisation market continues to show a positive trend, with a total of 1,590 securitisation vehicles (companies and funds) in operation at the end of 2024, up from 1,507 at the end of 2023 (2022: 1,442). By the end of Q1 2025, the number decreased slightly to 1,563 due to some liquidations. This steady growth over the years, despite occasional liquidations, proves once again that Luxembourg remains a prime location for securitisation transactions in Europe.

Our figures are based on in-depth research on the Registre de Commerce et des Sociétés portal, the company list published by the Luxembourg Trade and Companies register ("Recueil électronique des sociétés et associations" or "RESA"), the ECB reporting on Financial Vehicle Corporations ("FVC") and other sources. As such, it remains an estimation and not an exact science, even though we thrive to make our list as complete as possible. During our regular quality checks, we may also have to adjust historical figures.

Our research goes further than the statistics of the ECB, which are sometimes used to quantify the Luxembourg securitisation market, since we focus on Luxembourg undertakings incorporated under the Luxembourg Securitisation Law regardless of their size. In fact, the FVC reporting of the ECB does not include each Luxembourg securitisation undertaking, and some Luxembourg FVCs are not subject to the Luxembourg Securitisation Law. This is due to the different definitions and reporting thresholds: e.g. an FVC is any entity that carries out securitisation transactions and issues securities (which does not have to be under the Luxembourg Securitisation Law); on the other hand, even though each Luxembourg securitisation vehicle shall be deemed FVC (as per the interpretation of the Banque Centrale du Luxembourg ("BCL")), not all would be included in the regular reporting having a reporting threshold of EUR 70.0 million.

We have illustrated the development over time in Figure 3, which shows 1,590 active securitisation undertakings at the end of 2024 (2023: 1,507). The gross number of creations increased in 2024 to 193 (2023: 162), while liquidations also rose to 110 in 2024 (2023: 97), resulting in a net positive growth for the year. In Q1 2025, 29 new creations and 56 liquidations occurred, leaving a slightly reduced net growth to 1,563. Despite the rise in liquidations, the number of creations in 2024 and Q1 2025 was higher than in 2023 and remained consistent throughout the year, with an average of 48 creations per quarter in 2024.

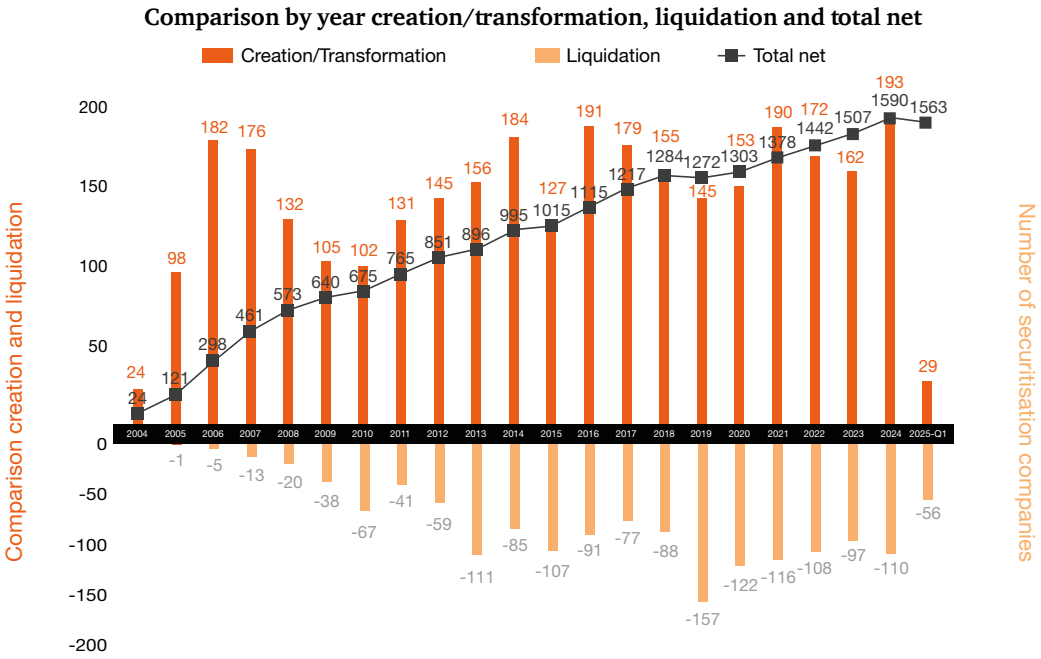
We have also broken down our analysis by type of entity (securitisation company, fund and management company).

Regarding the corporate securitisation vehicles, the majority, 58% of the active vehicles at the end of 2024 are created in the form of a SARL (2023: 52%), followed by SA 28% (2023: 37%). The trend that the majority of newly created securitisation companies are formed as SARL started in 2017 leading to around 71% of the new creations being SARL in 2024 due to the reform of the Luxembourg Law of 10 August 1915 on commercial companies (the "Commercial Law"), which permits public bond issuances of SARL since mid-2016.

On the other hand, we estimate to have around 101 securitisation management companies active in Luxembourg (2023: 102), which are managing a total number of around 113 securitisation funds (2023: 108). This means that still only around 7% of the total number of active undertakings under the Luxembourg Securitisation Law are set up as funds. We also saw a few new securitisation vehicles created in the form of a partnership. For the year 2024, we have identified 8 special limited partnerships ("SCSp") (2023: 5) and 3 common limited partnerships ("SCS") (2023: 3), making the newly authorised legal forms a welcomed and used alternative but at a relatively low level.

As already highlighted in the past, the number of securitisation undertakings itself is not representative of the extent of securitisation transactions in Luxembourg. With the specificity of the Luxembourg Securitisation Law allowing for the creation of compartments (ring-fenced sub-divisions of the securitisation undertaking) it is easily, quickly, and cost-efficiently possible to have several securitisation transactions within one legal entity. In our PwC Market Survey 2025, Luxembourg market participants have confirmed that the vast majority (>90%) of the observed vehicles have multiple compartments. We estimate that between 6,000 and 8,000 transactions are executed in the currently active securitisation undertakings.

Figure 3: Yearly evolution of Luxembourg securitisation vehicles



Source: PwC Analysis based on Luxembourg trade register, ECB statistics and CSSF figures

It is also worth mentioning that Luxembourg offers special investor protection for securitisation undertakings issuing securities to the public on a continuous basis. Such securitisation undertakings need to be supervised by the Commission de Surveillance du Secteur Financier ("CSSF"). As of 31 December 2024, a number of 28 (2023: 28) undertakings are supervised and have around EUR 44.4 billion securitised assets (2023: EUR 29.6 billion), i.e. an increase decrease of 50% or EUR 14.8 billion. In addition, there are EUR 2.3 billion (2023: EUR 1.5 billion) securitised in fiduciary estates and shown off-balance. It is interesting to see that those supervised entities make up only around 1.9% (2023: 1.9%) of the FVCs registered in Luxembourg but represent around 7% (2023: 7%) of the total assets. The supervised securitisation companies have mostly created several compartments in order to issue certificates as investment products for retail investors (so called "structured products", paying the performance of an index or similar underlying synthetically received via a total return swap).

Luxembourg's position in Europe

A look at the ECB statistics for international comparison (Euro area), clearly confirms that Luxembourg remains one of the leading centres for securitisation and structured finance vehicles. In fact, 1,538 FVCs or 30.1% of all Euro area FVCs were incorporated in Luxembourg (2023: 1,512 or 28.6%).Luxembourg is slightly behind Ireland (2024: 1,563 or 30.6%; 2023: 1,677 or 31.7%). Italy is ranked third with significantly less FVCs incorporated (2024: 915 or 17.9%; 2023: 1,002 or 18.9%) but double the number of the fourth (see Figures 4 and 5).

With regards to the amount of securitised assets, Luxembourg ranked again third after Ireland and Italy. Furthermore, the FVC statistics offer insights on the number of "series" of securities issued, which can be seen as an approximation for the number of transactions, compartments, or silos within the entities. With 7,132 "series" (2023: 6,960), Luxembourg shared its leading position with to Ireland with 9,257 "series" (2023: 9,740). However, we could see in the past years that for both Luxembourg and Ireland these figures are fluctuating between 6,000 and 9,000. It should also be noted that these historic figures are regularly restated by the ECB and the numbers or rankings may change retrospectively. A complete overview of the Euro countries for securitisation in the Euro area can be found in Figure 4. Obviously, these statistics for the Euro area do not include the UK, which is also one of the major players in the European securitisation market.

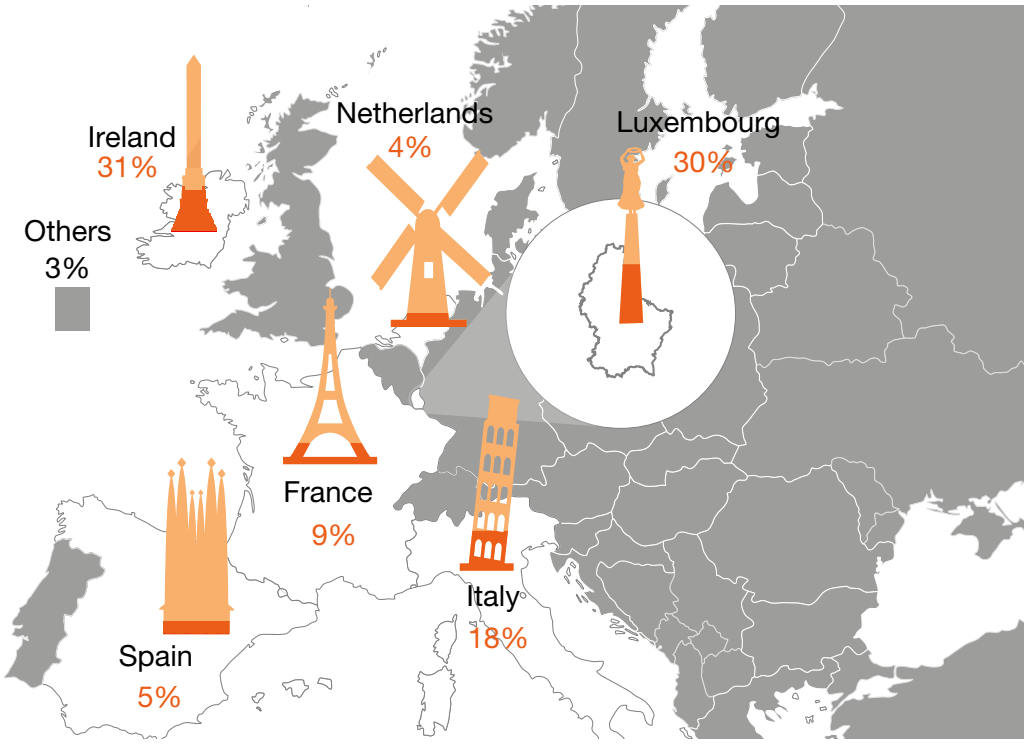
Figure 4: Euro area countries for securitisation

	Number of FVC		"Series"		Total Assets (in billion EUR)	
	2024	2023	2024	2023	2024	2023
Grand Total	5,109	5,294	30,342	30,827	2,485	2,354
Luxembourg	1,538	1,512	7,132	6,960	490	437
Ireland	1,563	1,677	9,257	9,740	662	624
Italy	915	1,002	3,229	3,388	504	508
France	476	460	647	633	389	344
Netherlands	194	224	234	266	161	160
Spain	246	252	793	806	130	142
Latvia	70	57	8,510	8,497	-	-
Other	107	110	540	537	150	138

Asset types and financing in Luxembourg and Europe

When looking closer at the top three Euro area securitisation countries, the ECB statistics allow for a closer look into asset types (high level) and ways of financing. Luxembourg FVCs securitise mainly loans (38%, 2023: 38%) and debt securities (31%, 2023: 34%), but a significant portion is also invested in equity and funds (14%, 2023: 10%). Italian FVCs are also mainly investing in loans securities with 74% in 2024 whereas Irish FVCs are balanced between holdings of debt securities and loans of securities for respectively 49% and 15% while only a minority holds funds or other equity interests (Ireland: 4%; Italy: 0%) which is almost unchanged to prior year. On the other hand, Ireland is also active with the securitisation of deposits for 15% (Luxembourg: 9%; Italy: 5%).

Figure 5: Market share of FVCs per country (in Euro area, as at 31 December 2024)



On the financing side, the statistics show that, as in prior year, the vast majority of Luxembourgish and Irish FVCs are financed by the issuance of debt securities (Luxembourg: 82%; Ireland: 79%; Italy: 43%) while Italian FVCs are mainly financed by other liabilities (55%). Interestingly, only Luxembourg FVCs are partly financed by equity (Luxembourg: 4%, Ireland and Italy: 0%), probably due to the flexibility in the Luxembourg Securitisation Law and favourable tax regime. On the other hand, a significant portion of Irish vehicles are loan financed (11%), which remains relatively low for Luxembourg securitisation undertakings (Luxembourg: 6%, Italy: 2%) since loan financing was only allowed under certain conditions under the Luxembourg Securitisation Law in the past. Since the modernisation of the Luxembourg Securitisation Law, 100% loan financing is now also possible for Luxembourg vehicles.

Check out our latest Securitisation in Luxembourg - PwC Market Survey

Based on our observations and confirmed by our PwC Market Survey 2025, the Luxembourg securitisation market's main asset classes are trade receivables and repackage transactions, followed by real estate and mortgages as well as lease receivables. Another important transaction type observed in Luxembourg are structured products. Securitisation undertakings are also regularly used as structuring alternatives or investment products for real estate or private equity groups. Insurance companies and pension funds, investment funds and banks remain the main investor groups.

Outlook

We remain confident about the further growth of the Luxembourg securitisation market. We observe again an increase in the creation of new securitisation vehicles. And Luxembourg fulfils all preconditions to accommodate for further growth: (i) a proven, robust but still flexible legal environment, (ii) amended tax rules for interest limitation rules (iii) possibility to securitise numerous asset classes, (iv) compliance with EU securitisation requirements or remaining outside, (v) provide a cost and time efficient framework through compartments, (vi) allow active management of debt instruments and direct lending, and, last but not least, (vii) a network of experienced service providers.

02

Securitisation basics

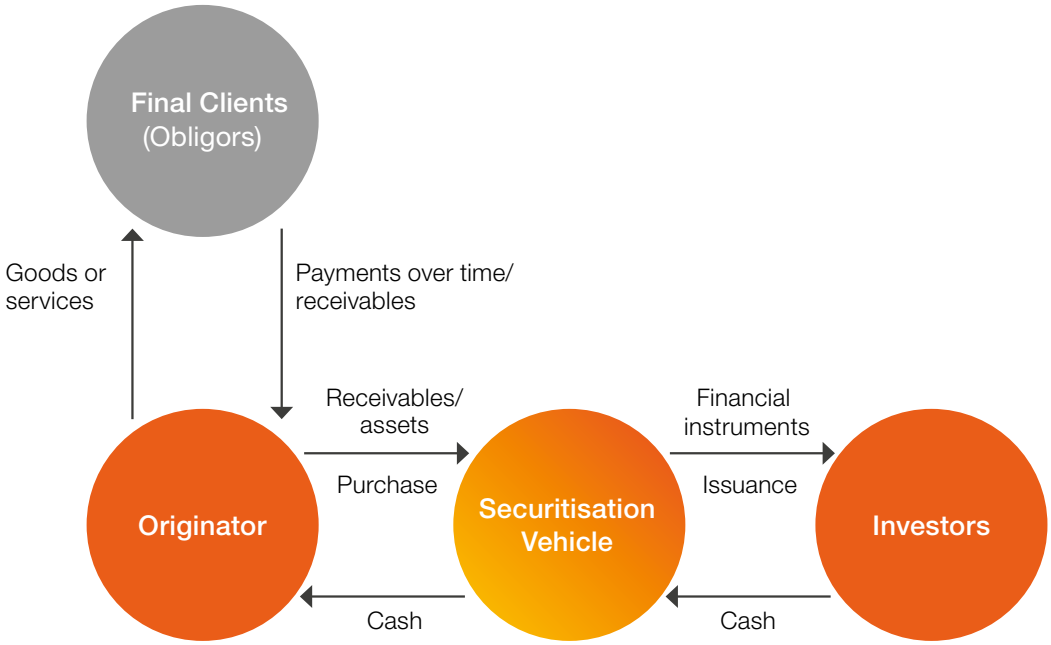
Securitisation basics

2.1 What is "securitisation"?

In a nutshell, securitisation is the pooling of various assets and the financing of the acquisition of these pooled assets by the issuance of securities or more broadly speaking of financial instruments. The first asset securitisation transactions took place in the 1970s in the form of structured financing of mortgage pools. 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, rents as well as auto loans, credit card receivables, and consumer loans. Nowadays, securitisation is recognised more and more as an efficient tool to provide funding to the market. Securitisation plays a crucial role for the implementation of the EU Capital Markets Union by improving the financing of the EU economy and remains high on the EU policymakers agenda. Through securitising assets, financial institutions can create tradable securities backed by these assets. 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 (and illustrated in a simplified way in Figure 6), a pool of cash generating assets is transferred from a so-called "Originator" to a Special Purpose Vehicle ("SPV") or Securitisation Vehicle ("SV"). The SV finances the acquisition of these assets by the issuance of financial instruments, whose interest and principal payments depend on – and are backed by – the assets transferred.

Figure 6: Securitisation process



SVs may also assume a risk without the acquisition of the reference assets (transferring the performance through derivatives instead). From an originator's perspective, the securitisation transaction:

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

Further benefits are described in chapter 2.3 below.

The “structuring” process is one of the central elements of a securitisation transaction. Securitisation typically splits the credit risk into several contractually subordinated tranches with different risk profiles. This allows the issuer to attract a wide range of investors with different risk and reward appetite. The most senior tranche is usually highly rated and is protected from credit losses (up to a certain amount) by having priority on the cash flow received from the assets. The lower tranches are consequently rated lower and designed to absorb first credit losses. These tranches have higher margins to compensate for the additional risk.

The first-loss tranche (or “first-loss piece”) is often held by the originator itself and offers a high risk and-reward profile. This may also be required by regulation as “risk retention” to ensure that the originator keeps a “skin-in-the-game” - the most probable credit losses of a securitisation transaction are concentrated on 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. As remuneration, the first-loss tranche typically receives the remaining portfolio cash flow after all prior claims (transaction related fees, senior principal, senior interest, etc.) have been settled.

The payment sequence follows the structuring concept and is called a “waterfall”. It shows similarities to the well-known champagne waterfall we see at weddings, with various levels of glasses balanced on one another. The champagne waterfall may be translated to securitisation as illustrated in Figure 7

The waterfall shows the order of use of the cash return from the assets, which serves to pay interest, transaction-related fees 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 lower-ranked tranches (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 normally receive all 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 7: The “waterfall” payment sequence (example)

2.2 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 and should make their purpose easier to understand.

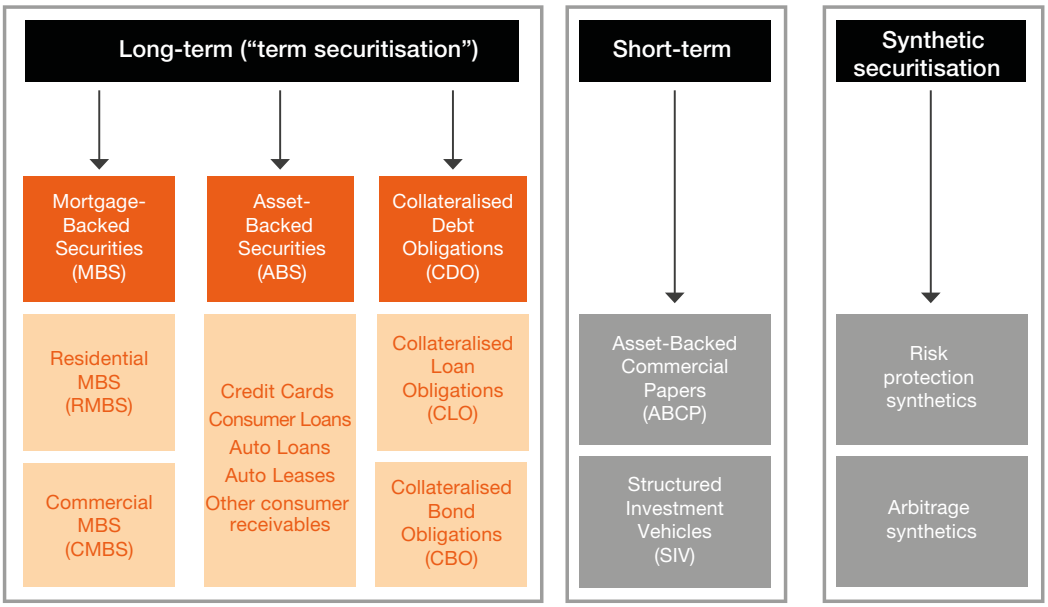
An overview is given in Figure 8.

Term securitisation vs. securitisation via 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. Term securitisations are usually classified by asset type as outlined below.

Securitisations issued via 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. A typical example is the revolving securitisation of trade receivables with a roll-over refinancing. Other short-term securitisations are Structured Investment Vehicles ("SIV"), refinancing long-term assets with short-term liabilities in order to benefit from credit spread differences.

Figure 8: Transaction types according to maturity and underlying risk



Source: European Commission

Transaction types 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"), Collateralised Debt Obligations ("CDO"), and other Asset-Backed Securities ("ABS").

Mortgage-Backed Securities ("MBS") are types of asset backed securities collateralised by a pool of mortgages. Securities issued by the SV are backed by the principal and interest of mortgage loans and, ultimately, the property serving as security for the loan. Investors receive payments of interest and principal derived from payments which are received on the underlying mortgage loans. 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 common.

Collateralised Debt Obligations ("CDO") pool cash flow generating assets, such as bonds, loans 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 replaced, irrespective of the performance of a single credit risk in the underlying portfolio. The underlying assets will only be substituted in the event of full repayments or defaults, but sub-performing assets are typically not replaced. In dynamic or actively managed transactions, which are more common, the asset manager can replace one or more underlying assets to decrease the credit risks or to use market opportunities to increase the performance of the asset pool. This means that the assets pool will be exchanged regularly.

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

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

A true-sale transaction is the traditional form of a securitisation. The SV acquires cash flow generating assets of an originator who legally transfers the assets to the SV. Usually, the assets are then removed from the balance sheet of the originator. The SV finances the purchase of these assets by issuing financial instruments, which are often rated by a rating agency. The rating would be independent of the rating of the originator and reflects the fact that the SV is isolated from any credit risk of the originator and the level of credit enhancement. Therefore, the originator transfers both the legal and beneficial interest in the assets to the SV.

(ii) Synthetic transactions

In a synthetic securitisation, the originator buys protection, for example through a series of credit derivatives, instead of legally selling the asset pool to the SV. Such transactions 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 party (the "Protection Seller"). Although the credit risk of the Reference Portfolio is transferred, its legal ownership remains with the Protection Buyer.

Credit risk may be transferred in a number of ways:

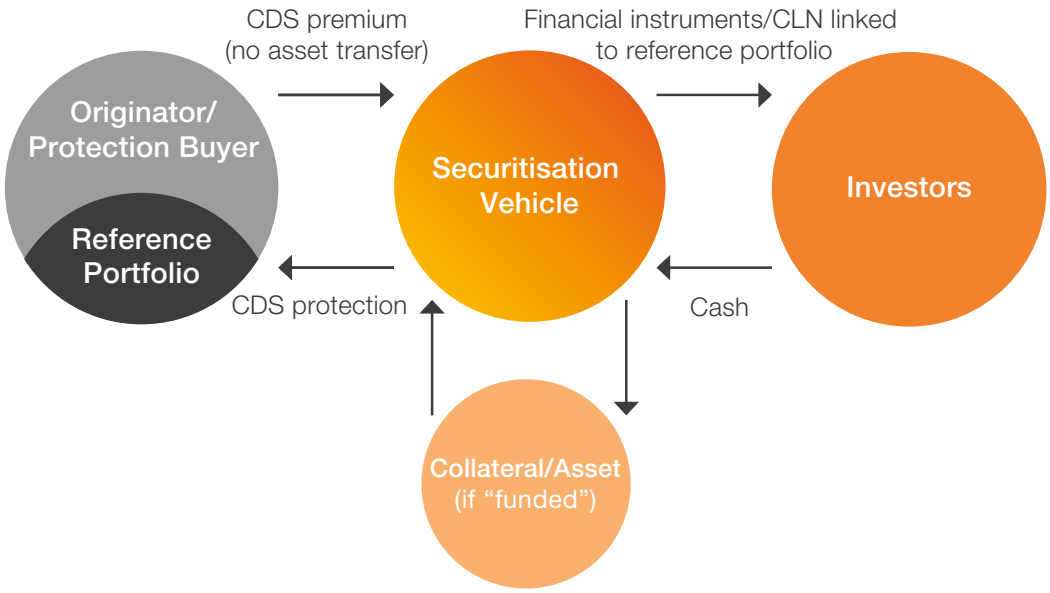
- The Protection Buyer might issue Credit-Linked Notes ("CLN") to the Protection Seller. The terms of these notes would provide for a reduction in the Protection Buyer's repayment obligation on the notes upon defaults or other credit events arising with respect to the Reference Portfolio.

- Alternatively, the Protection Buyer may enter into a Credit Default Swap ("CDS"), a Total Return Swap ("TRS") 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 total amount of the defaulted payments 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 to a cash deposit or to purchase a risk-free asset) that serves as collateral to cover the counterparty risk. In an unfunded transaction, no such initial cash flow is required.

Figure 9 illustrates a typical synthetic securitisation structure.

Figure 9: Typical synthetic securitisation structure



2.3 Benefits of securitisation

Even if setting up a SV – a separate legal entity requiring several service providers – incurs a certain amount of costs for the parties involved, the benefits outweigh these costs. 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.

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:

- **Providing efficient access to capital markets:** Structuring with high ratings is possible on most tranches of financial instruments issued. The non-existing link between the 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. To achieve a significant impact on borrowing costs is the main reason for the securitisation of such assets;

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

- **Creating liquidity:** Assets that are not readily saleable may be combined to create a diversified collateral pool funded by financial instruments issued by a securitisation vehicle;

- **Diversifying and targeting 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 that back particular debt offerings, enables issuers to market debt to investors based on their appetite for particular types of credit risk. At the same time, it allows these investors to minimise their exposure to unrelated issuer risks. Similarly, complex principal and interest payments and 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 of the seller

- **Raising capital to generate additional assets or apply to other more valuable uses:** For example, this allows credit lines to be recycled quickly to generate additional assets or frees up long-term capital for related or broader uses. The capital raised can be used for any allowable purpose, such as reducing existing debt, repurchasing stock, purchasing additional assets, or completing capital projects;

- **Raising 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;

- **Generating earnings:** When a true-sale securitisation transaction takes place between the originator and the SV, 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;

- **Completing mergers and acquisitions, as well as divestitures more efficiently:** Securitisation 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. It may assist in creating the most efficient combined structure and may serve as a source of capital for transactions.

- **Transferring risk to third parties:** Assets in the case of true-sale transactions or risks in the case of synthetic transactions can be partially or fully transferred to investors and credit enhancers; and

- **Lowering capital requirements for banks and insurance companies:** The supervisory authorities set out minimum capital requirements for banks and insurance companies, in accordance with their size and their nature of the risks. By removing assets from their balance sheet, related capital requirements are released, which can then be used for other purposes. The impact on these regulatory capital requirements are described in more detail in chapter 6.

Benefits for investors

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

- **Tailored investment targets:** 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 banks, tend to invest in bonds issued by securitisation vehicles, which are uncorrelated to their other investments; and

- **Higher returns:** Because of securitised assets and underlying risk-return-maturity profiles, 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.

2.4 Types of credit enhancements

Credit enhancements are measures taken in the structuring process to enhance the credit quality of the financial instruments issued to investors. For the investors, this increases the probability of receiving the cash flow to which they are entitled and gives the securities a higher credit rating. Accordingly, both internal (techniques structured within the transaction) and external (insurance-type policies purchased to protect investors in the event of default) credit enhancements are typically built into the structure.

Setting up credit enhancements is an essential step of the structuring process that drives the ultimate rating of the financial instruments issued. 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 desired credit rating and pricing. Most financial instruments also contain performance related features designed to protect investors (and credit enhancers) from portfolio deterioration. The originator will often negotiate the type and size of the internal and external credit enhancements with the rating agencies in order to accommodate the needs of the different investors. Some investors may request a AAA rating, which implies that such investment has a very low expected default risk. It is rather rare that a whole pool of, for example, residential mortgage loans, will have such a AAA rating. However, the default risk of this loan pool can be distributed differently to the different investors in a way that losses in the portfolio are first allocated to the lowest ranking position and only the additional losses to the most senior position. As such, this senior position (or tranche) would only suffer losses after a certain threshold of accumulated losses in the portfolio has been reached, while the junior tranche takes the hit immediately. With this "subordination" of the junior tranche compared to the senior tranche, a pool of medium quality loans is structured into a low risk and a high risk piece and attract different types of investors.

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. In this case, the nominal value of the underlying asset portfolio is higher than the nominal value of the financial instruments it collateralises. In other words, the financial instruments 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 financial instruments issued can still be arranged.

Subordination

Subordination means that classes of financial instruments with different rights are issued within the same transaction and that some are subordinated to the rights of other classes of financial instruments. Subordination usually relates to the rights of investors to receive expected payments, particularly in situations where there is not sufficient cash flow to pay the expected amounts to all investors. Subordinated financial instruments are repayable only after other classes of financial instruments with a higher ranking have been satisfied. The payments of senior tranches are (partly) protected or their quality enhanced by subordinated tranches in an event of losses.

Excess spread

The excess spread is the net amount kept in the structure from the received income/payments after having paid interest expenses to investors. The excess spread can be used to cover (current) losses and/or to top up reserve funds to cover for (future) losses.

Reserve fund

A reserve fund is an account available for use by the SV, for one or more specified dedicated purposes. Some reserve accounts are also known as “spread accounts”. Often, 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. This buffer can then be used in order to protect more senior investor positions from suffering losses immediately.

External credit enhancements

Third-party/Parental guarantees

In this case, a promise is provided by a third party or, in some cases, by the arranger of the securitisation transaction, to reimburse the SV 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 insurance companies typically provide third-party guarantees.

Letters of credit

With a letter of credit (“L/C”), a financial institution – usually a bank – receives a fee for providing a specified amount of cash, to reimburse the SV for any cash shortfalls from the collateral – up to the required credit support amount. L/Cs are becoming less common forms of credit enhancement.

2.5 Parties involved in securitisation transactions

In addition to the parties directly participating in a securitisation transaction, there are many others, generally defined as service providers, that are usually involved in the securitisation process. Figure 10 and the following paragraphs give an overview of the most relevant parties:

Arranger/Sponsor

The party (often a bank or an asset manager) that establishes the securitisation transaction and brings together the investors and the pool of assets. The arranger evaluates the assets, determines the characteristics of the financial instruments to be issued, assesses the need for specific structuring and arranges for distribution of the financial instruments to the investors.

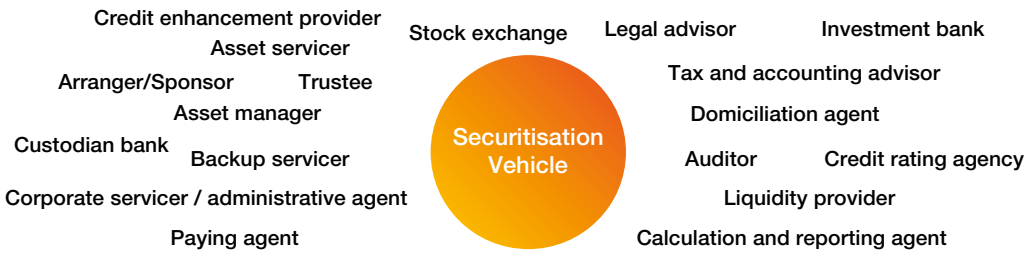
Obligor/Borrower

Obligors owe the payments on the underlying loans/ assets to the originator (and then the SV) and are, therefore, the ultimate cause of the performance of the issued financial instruments. As obligors are often not informed about the sale of their payment obligation (so-called "undisclosed assignment"), in many cases the originator maintains the customer relationship as a servicer.

Originator

The originator is the entity to assign assets or risks to the SV in a securitisation transaction. It is usually the party (the "original lender") who originates and securitises the assigned claims (loans). The obligations arising from such loans are originally owed by the obligor/borrower to the originator before the transfer to the SV takes place. Occasionally, the originator may be a third party to the original lender who buys the pool of assets from the latter with the intention to securitise it later. Regular originators to securitisation transactions captive financial companies of the major car manufacturers, other financial companies, commercial banks, building societies, manufacturers, insurance companies, and security companies.

Figure 10: The main securitisation service providers



Investor

Investors buy the financial instruments issued by the SV and are thus entitled to receive the repayments and interest based on the cash flow generated by the underlying assets. Collaterals may ensure the monetary claims from these assets. Typical investors are banks, pension funds, insurance companies, investment funds and family offices.

Asset servicer

The asset servicer is the entity that collects principal and interest payments from obligors and administers the portfolio after the transaction has closed. Regularly, the originator acts as asset servicer, but not always. For example, in most Non-Performing Loans ("NPL") transactions, specialised servicers tend to carry out

this role. Servicing includes customer service, payment processing, and collection actions in accordance with the servicing agreement. Servicing can further include default management, realisation of collaterals, and preparation of monthly reports. The asset servicer is typically compensated with a fixed or variable servicing fee.

Backup servicer

If the original servicer defaults, the backup servicer replaces it. The backup servicer takes over all the responsibilities allocated to the servicer.

Corporate servicer/administrative agent

The corporate servicer is the entity in charge of the administration, accounting, investor reporting and preparation of the annual accounts of the SV. Furthermore, the corporate servicer files the annual accounts and the tax returns and may provide local directors.

Domiciliation agent

The domiciliation agent provides the legal registered office for the SV. The domiciliary agent is responsible for the performance of functions and duties associated with the physical domicile, such as the provision of office space, handling all correspondence addressed to the SV and arranging the settlement of bills on its behalf. It is often identical to the corporate 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 another 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 of 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 to 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.

Investment bank

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

Tax and accounting advisor

These advisors 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 financial instruments issued to be minimised.

Credit rating agency

The financial instruments issued may be assessed by a credit 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 dominated by "Big Three" credit 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. But there is also a high number of other credit rating agencies that have been registered or certified in accordance with the EU

Credit Rating Agencies Regulation.
(see **https://www.esma.europa.eu/credit-rating-agencies/cra-authorisation.**)

In general, credit 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; and
- Quality of credit support, e.g. nature and levels of credit enhancements.

Paying agents

Paying agents are usually banks that have agreed to settle the payments on the financial instruments issued to investors. Payments are usually made via a clearing system.

Legal advisor

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

Credit enhancement provider

Credit enhancement is used to improve the credit rating of the issued financial instruments. 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 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.

Stock exchange

A stock exchange facilitates the access of investors to the financial instruments issued and vice versa. It provides a marketplace with information, listing and trading facilities. A stock exchange may have several market segments with a different level of regulation and characteristics.

Liquidity providers

Liquidity providers are usually banks that provide the SV 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 facility and it is not used to cover defaults within the underlying asset portfolio.

Asset manager

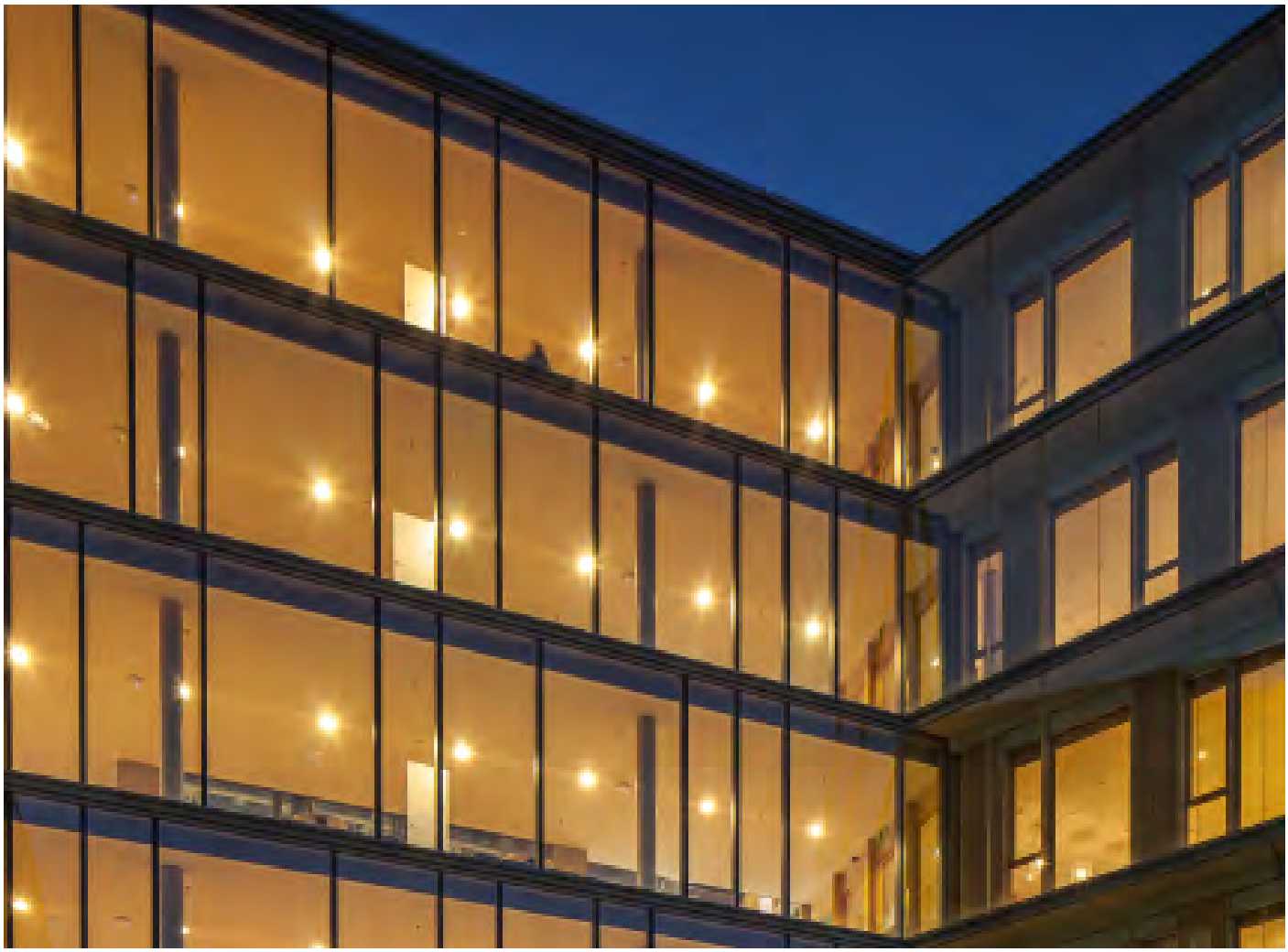
Asset managers are responsible for selecting underlying assets, monitoring the portfolio and, if foreseen, replacing underlying assets. They are common in CLO/CDO/Structured Credit transactions.

Custodian bank

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

Auditor

In Luxembourg, the annual accounts of securitisation vehicles have to be audited by one or more independent auditors (Réviseur d'Entreprises Agréé). The auditor plays an important role as they give comfort to the users of the financial statements (e.g. the investors) that the financial statements give a true and fair view of the financial situation of the SV.



03

Luxembourg Securitisation Law

Luxembourg Securitisation Law

3.1 Scope of Luxembourg securitisation vehicles

3.1.1 Broad definition of securitisation

In March 2024, the Luxembourg Securitisation Law celebrated its 20th anniversary. Developed based on the principles of legal certainty and flexibility in 2004, the Luxembourg Securitisation Law was modernised in 2022. The modernisation clarified some items, brought even more structuring options, and introduced the possibility of active management. Compared to the definition of securitisation in the European legislation, the Luxembourg Securitisation Law provides a rather broad and flexible approach. While the EU Securitisation Regulation, Capital Requirements Regulation (CRR) and Solvency II Directive require that the financial instruments issued by a securitisation vehicle transfer credit risk and are split into multiple tranches, the Luxembourg Securitisation Law does not contain such restrictions. 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 financial instruments (e.g. debt or equity securities, loans) whose value or yield depends on such risks.

Since 2022, securitisation vehicles are no longer required to issue highly formalised "securities" but may more flexibly use any type of "financial instrument" which allows to further adapt a securitisation structure to specific needs and reduce cost.

Transactions securitising other than credit risk, such as market risks or commodity risks, can also use a Luxembourg securitisation vehicle while not being subject to the EU Securitisation Regulation. In addition, non-tranched financial instruments, for which all investors have the same risks and rewards, can also be issued, again, without being subject to the EU Securitisation Regulation.

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").

3.1.2 Few limits for securitisation activities

The Luxembourg Securitisation Law allows for a wide range of assets to be securitised, 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 revenues. Furthermore, the Luxembourg Securitisation Law does not prescribe any specific diversification requirements. A securitisation vehicle transforms these assets or risks into financial instruments whose repayable amount is linked to the risks or assets that are being securitised.

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

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

The role of the securitisation undertaking is normally limited to administering financial flows linked to the securitisation transaction itself and to the "prudent man" management of the securitised risks, while any activity likely to qualify the securitisation undertaking as an entrepreneur is prohibited. Since 2022, active management (performed by the vehicle or a third party) is permitted for Luxembourg securitisation vehicles with investments linked to bonds, loans or other debt instruments, except if the financing instruments are issued to the public. Any activity which aims to promote the commercial development of the securitisation undertaking's activities remains prohibited.

The Luxembourg Securitisation Law itself gives only limited guidance to what exactly has to be understood by those terms. Therefore, the CSSF has interpreted them in a "Frequently Asked Questions" section published on its website ("CSSF FAQ") (see **https://www.cssf.lu/en/Document/faq-securitisation/**). Even if the CSSF FAQ are primary addressed to CSSF supervised securitisation vehicle, they serve as a reference interpretation of the Luxembourg Securitisation Law. An update of the CSSF FAQ following the described modernisation has not been yet published.

In this context, for example, the following types of transactions would still qualify as securitisation structures 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; and
- Holding shares and fund units, provided that the securitisation vehicle does not control the investee, does not actively intervene in the management of such entities, acts solely as a financial investor interested in receiving cash flow (e.g. dividends) and is not misused as a group holding company.

3.2 Flexible and robust legal environment

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

3.2.1 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 Figure 11 (see next page) provides an overview of the legal types of Luxembourg securitisation vehicles.

Securitisation companies can take one of many legal forms, with the last four added by the modernisation of the law in 2022:

- "Société anonyme" ("SA", equivalent to a public limited company); or
- "Société à responsabilité limitée" ("SARL", equivalent to a private limited liability company); or
- "Société en commandite par actions" ("SCA", partnership limited by shares); or
- "Société coopérative organisée comme une SA" ("Scoop SA", a cooperative company organised as a public limited company); or
- "Société en nom collectif" ("SNC", equivalent to a general partnership); or
- "Société en commandite simple" ("SCS", common limited partnership); or
- "Société en commandite spéciale" ("SCSp", special limited partnership); or
- "Société par actions simplifiée" ("SAS", public simplified company).

Securitisation companies are not subject to a specific regulatory minimum capital requirement, but only to the minimum capital prescribed for the respective legal form (e.g. EUR 30,000 for an SA and EUR 12,000 for an SARL). This minimum share capital refers to the whole legal entity and not to each single compartment.

Besides setting up a company, a securitisation vehicle can also be organised in a purely contractual form as a **securitisation fund**. The securitisation fund does not have a legal personality. It will, however, be entitled to issue units representing the rights of investors, in accordance with the management regulations. A securitisation fund may also issue debt instruments. Similar to a securitisation company, a securitisation fund can be created with a small number of fund units and financed almost entirely by the issue of debt instruments.

In the absence of legal personality, the securitisation fund may be organised as one or several co-ownership(s) or one or several fiduciary estate(s). In both cases, the securitisation fund will be managed by a management company, which is a normal commercial company with a legal personality in Luxembourg and is not subject to additional regulation or supervision.

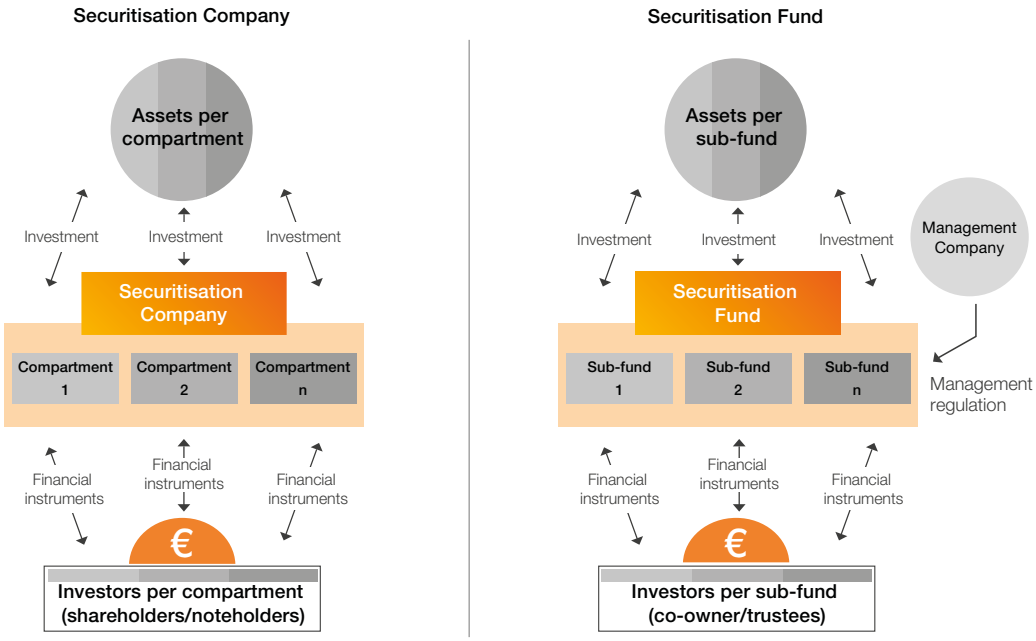
A securitisation fund also has to be registered directly with the Luxembourg Trade and Companies Register.

3.2.2 Ability to create compartments

One of the main advantages of Luxembourg securitisation vehicles is the possibility to create several compartments within one legal entity or fund. This concept permits a time and cost-efficient solution for frequent issuer vehicles. Precondition for the creation of multiple compartments is simply that the securitisation company's articles of incorporation or the management regulations of a securitisation fund, authorise the Board to create separate compartments or sub-funds. Each compartment corresponds to a distinct portion of assets and is financed by distinct financial instruments. The compartments allow a pool of assets and corresponding liabilities to be managed separately, so that the result of each compartment is not influenced by the risks and liabilities of the other compartments.

The compartment segregation of the securitisation vehicle is one example how the Luxembourg Securitisation Law combines great flexibility with legal certainty. Notably, this compartment segregation technique is either not applied or is not regulated by law in many other jurisdictions, making it a competitive advantage for Luxembourg.

Figure 11: Legal form of securitisation vehicles and creation of compartments



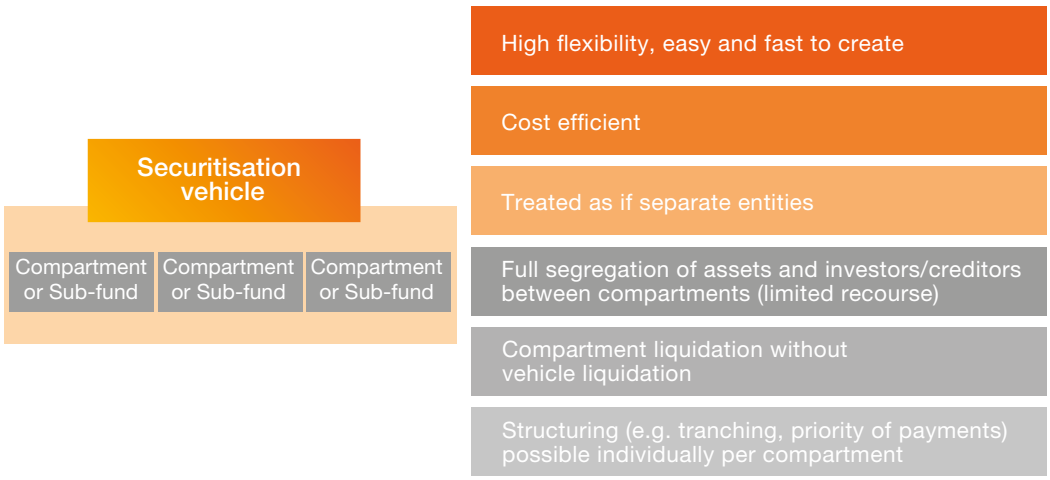
Compartment segregation means that the assets and liabilities of the vehicle can be split into different compartments, each of which is treated as if it were a separate entity executing distinct transactions. The rights of investors and creditors are limited to the risks of a given compartment's assets. The characteristics and rules applicable to each compartment or subfund may be governed by separate terms and conditions respectively management regulations. There is no recourse against the assets allocated to other compartments in the event that the claims under the financial instruments 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 (while the liquidation of the last sub-fund of a securitisation fund would entail the securitisation fund's liquidation).

In addition, the securitisation vehicle or one of its compartments may issue several tranches of financial instruments 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 the 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 two-tier structure, where the acquisition vehicles are separated from the issuing vehicle, the value, yield, and repayment terms of the financial instruments issued by the issuing vehicle may also be linked to the assets and liabilities of the acquisition vehicles.

With the modernisation of the Luxembourg Securitisation Law, it has now also been clarified that the compartment segregation remains when several compartments are equity financed, i.e. decisions like profit distribution are to be made on compartment level.

The main characteristics of compartment segregation are summarised in Figure 12.

Figure 12: Compartment segregation



3.2.3 Ability to issue fiduciary notes

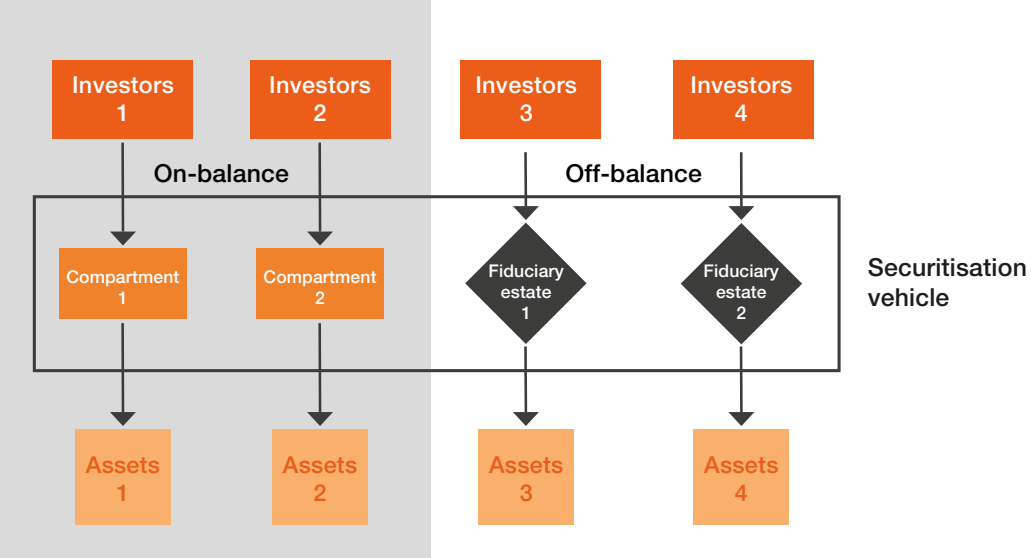
The Law of 27 July 2003 related to trust and fiduciary contracts ("Fiduciary Law") allows securitisation vehicles to act as a fiduciary and to issue notes on a fiduciary basis in their own name, but at the sole risk and for the exclusive benefit of the noteholder. In this case, the securitisation vehicle issues fiduciary notes that incorporate a fiduciary contract between the securitisation vehicle ("fiduciary") and the noteholder ("fiduciant"). Under the fiduciary contract, the noteholder transfers the ownership of certain assets ("fiduciary assets") to the fiduciary and instructs the fiduciary how to invest the issuance proceeds. The assets purchased by the securitisation vehicle in a fiduciary capacity and the returns generated by the assets are transferred to the noteholder. The notes issued by a securitisation vehicle on a fiduciary basis do not constitute debt obligations by the securitisation vehicle but are solely fiduciary obligations of the fiduciary and may be satisfied only out of the fiduciary assets.

Pursuant to the Fiduciary Law, the fiduciary assets (initial issuance proceeds and assets acquired) are segregated from all other assets of the fiduciary as well as from other fiduciary estates and noteholders recourse against the fiduciary is limited to the fiduciary assets (illustrated in Figure 13).

Similar to the creation of compartments, a securitisation vehicle may create several fiduciary estates in connection with the issue of series of notes issued by it. There is no recourse of investors and creditors against the assets allocated to other fiduciary estates.

The fiduciary transactions are recorded off-balance sheet by the securitisation vehicle, while still requiring sufficient disclosure in the financial statements.

Figure 13: Fiduciary structure



3.2.4 Numerous asset classes allowed

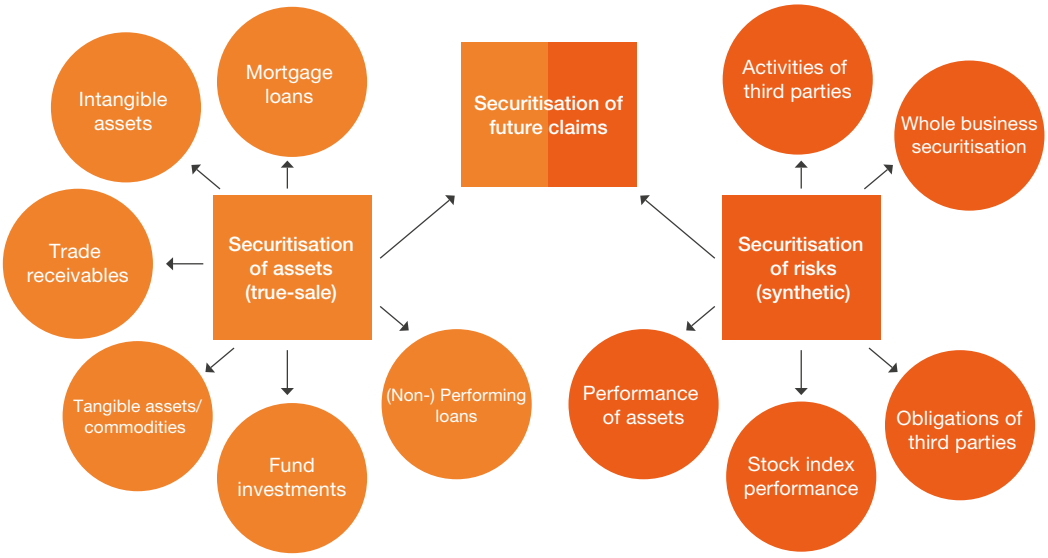
Another aspect of the Luxembourg Securitisation Law's great flexibility, is the wide range of asset classes that qualify for securitisation. Indeed, the Luxembourg Securitisation Law does not limit the type of assets (or risks) that may be acquired by a securitisation vehicle. In its early phases and in other jurisdictions, the securitisation market essentially covered credit-linked assets like loans and receivables acquired from financial institutions, such as mortgage-backed loans, credit card receivables, and student loans. Today, however, and especially in Luxembourg, thanks to the flexibility of the dedicated Luxembourg Securitisation Law, securitisation or rather more generally structured finance transactions also include tangible asset classes, such as aircrafts, railcars, and commodities, as well as intangible assets, such as intellectual property or any type of rights.

Under the Luxembourg Securitisation Law, it is also possible to securitise risks only, without acquiring the referring asset (so-called "synthetic" transactions). The securitised risks may relate to assets (whether movable or immovable, tangible or intangible) or result from obligations assumed by third parties. They may also be related to all or part of the activities of third parties. Thus, a securitisation vehicle can assume risks by acquiring the underlying assets themselves ("true-sale"), or by guaranteeing the third party's obligations or committing itself in any other way, e.g. via derivatives ("synthetic") (see Figure 14).

A securitisation vehicle may not only securitise existing claims, but also future claims. The latter 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. This does of course increase the risk for the investor.

As outlined in chapter 1, the main asset classes securitised through Luxembourg securitisation vehicles are securities, loans, mortgages, non-performing loans, auto loans, lease receivables, trade receivables, receivables in connection with real estate or loans in relation with SME financing. For many years, "trackers" or certificates, directly or indirectly linked to the value of an index or another underlying asset and structured for retail investors, have also been commonly used in Luxembourg.

Figure 14: No restrictions for asset classes and risk transfer



3.2.5 Different forms of risk transfer and transaction types possible

True sale vs. synthetic

Securitisation transactions can be executed in the two forms true-sale or synthetic. Within the scope of a "true sale" transaction, the originator sells the ownership in a pool of assets to a securitisation vehicle. Within the scope of a "synthetic" transaction, the originator buys credit or market risk protection (through a series of credit derivatives or swaps, guarantees or similar), without transferring the ownership of the underlying assets.

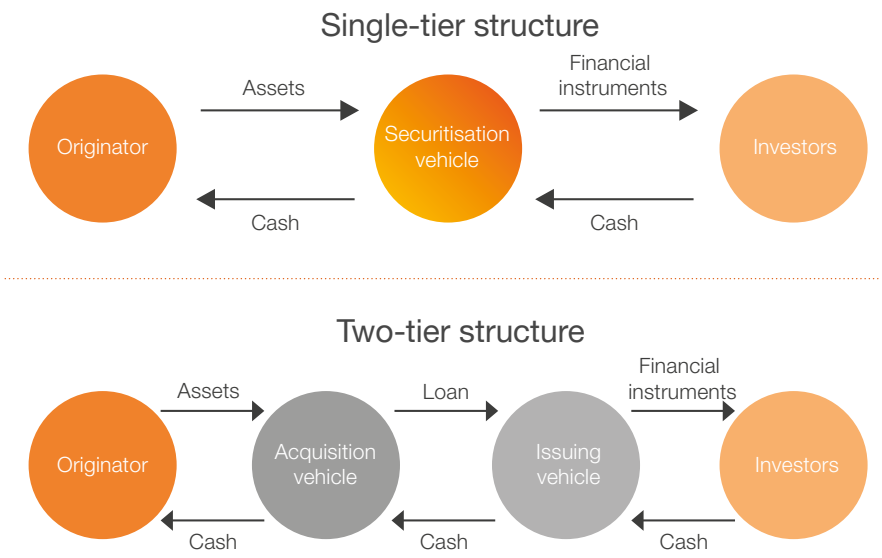
Single vs. two-tier structure

As shown in Figure 15, it is possible to structure securitisation transactions as single or as two-tier structures. In a single tier structure, the purchase of the assets or risks, as well as the issuance of the financial instruments is made by one single securitisation vehicle. In contrast, in a two-tier structure, the functions of acquisition of assets/risks and issuing of financial instruments would be split amongst two or more vehicles.

They would be referred to as "acquisition vehicle(s)" and "issuing vehicle", respectively, while the latter is back-to-back financing the former. The repayment of the securities issued by the issuing vehicle would be linked to the assets/risks and liabilities of the acquisition vehicle(s).

In a two-tier structure under the Luxembourg Securitisation Law, the acquisition vehicles can also be established in the countries of the originators or in the countries where the transferred assets are located, which may be advantageous for legal, tax or operational purposes. It might also be that the acquisition vehicle is set up in another legal form (e.g. an investment fund) not subject to the Luxembourg Securitisation Law. In some cases, the securitisation vehicle only acts as an acquisition vehicle which is financed by a loan from a fund issuing units to its investors.

Figure 15: Single vs. two-tier structure



3.3 Supervision of securitisation vehicles

3.3.1 Preconditions for authorisation requirement

The Luxembourg Securitisation Law differentiates between authorised and non-authorised entities. Authorised securitisation vehicles are authorised and supervised by the CSSF, who 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 financial instruments (i) to the public and (ii) on a continuous basis. In order to be subject to mandatory supervision, each of the two conditions must be met cumulatively (see Figure 16).

Since its modernisation, the Luxembourg Securitisation Law defines the notion of "public" as follows:

- Issues to professional clients within the meaning of Art. 1 (5) of the Financial Sector Law are not issues to the public;
- Issues whose denominations equal or exceed EUR 100,000 are assumed not to be placed with the public;
- The listing of an issue on a regulated or alternative market does not necessarily 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. Based on the existing CSSF guidance, 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 of financial instruments by an institutional investor or financial intermediary for a subsequent placement of such financial instruments 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[1].

[1] Please note that the definition of the term "public" in the area of securitisation is not the same as the one of the Prospectus Law, 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 Luxembourg Securitisation Law now also defined the notion "on a continuous basis" as when the securitisation vehicle issues financial instruments more than three times per calendar year. In the case of a multi-compartment securitisation vehicle, the number of issues per year has to be determined on the level of the securitisation vehicle cumulatively and not on the compartment level. Furthermore, following the CSSF guidance, when issuing financial instruments under an issuance programme, each series is assumed to be a distinct issue to be counted separately for this purpose (unless further analysis of programme and series leads to the conclusion that they rather demonstrate the characteristics of one single issue).

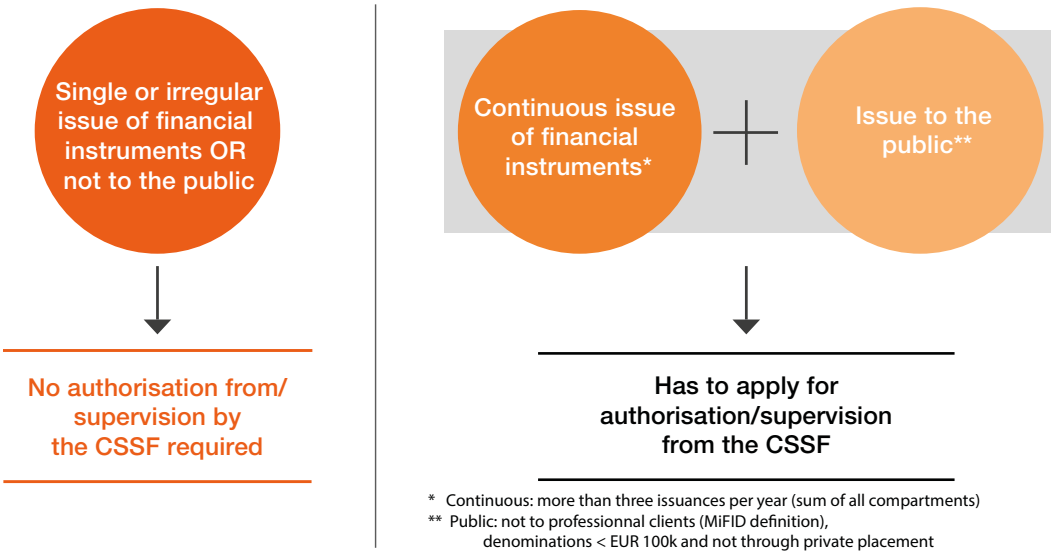
Because of the cumulative nature of the two conditions, for example an one-off issue of securities to the public as well as the continuous issue of securities with a denomination above EUR 100,000 may be carried out without prior approval from the CSSF.

3.3.2 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 before but now intend to issue securities to the public on a continuous basis.

To grant approval, the CSSF must be informed of the identity of the members of the securitisation vehicle's administrative, management and supervisory bodies. In the case of a regulated securitisation fund's management company, the shareholders in a position to exercise significant influence need to be named. The directors or managers of a securitisation company or a management company of a securitisation fund must be of good repute and have adequate experience and means required to perform their duties. The CSSF requires at least three board members for authorised securitisation vehicles, but allows legal persons to act as board members. In such cases, a natural person needs to be designated to represent this legal person and the CSSF will assess the criteria regarding the board members' competence and reputation at the level of the representatives of the legal persons acting as board members.

Figure 16: CSSF supervision



Securitisation companies and management companies of securitisation funds must have an 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 vehicle or management company is subject to the CSSF's prior approval.

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

For the authorisation process, at 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 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; and
- 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 personally present the intended securitisation transaction.

After authorisation, the CSSF enters the authorised securitisation vehicle on an official list. Being mentioned on that official list shall establish authorisation by the CSSF and the status as supervised securitisation vehicle; the securitisation vehicle is notified accordingly. This list and any amendments are published on the CSSF website.

3.3.3 Continuous supervision by the CSSF

The Luxembourg Securitisation Law has vested the CSSF with the authority to perform ongoing supervision of authorised securitisation vehicles. It has wide investigative powers regarding all elements likely to influence the security of investors. For this purpose, the CSSF has defined specific legal reporting requirements, which can be classified into three categories:

(i) The following documents need to be submitted to the CSSF ad-hoc as soon as they are finalised initially or updated thereafter:

- 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 the 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, within 30 days, statements on new issues of financial instruments, 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. There are no special requirements regarding the submission format or information medium used.

(iii) In addition, at the financial year-end, a draft balance sheet and a profit and loss account (by compartment, where applicable) must be added and provided within 30 days. The audited annual accounts and the management letter issued by the auditor must be provided to the CSSF within six months of the financial year-end.

The CSSF may also require any other information or perform on-site inspections and review any document of the securitisation company, the management company of a securitisation fund, the corporate servicer, or the credit institution in charge of safekeeping the assets of the securitisation undertaking. This allows the CSSF 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.

3.4 Luxembourg as an attractive marketplace

3.4.1 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 a payment of interest is in default, the investor may agree to wait for payment and not initiate legal action, as the situation is known or temporary; and

- 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 in case of several compartments, and to satisfy creditors' claims in connection with such assets. Therefore, compartment segregation prevents insolvency contamination between different compartments.

3.4.2 Qualified service providers

The involvement of the following parties leads to high investor protection as well as business opportunities for Luxembourg market players.

3.4.2.1 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 liquid assets and securities 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.

3.4.2.2 The auditor

Irrespective of their legal form and the accounting framework adopted, securitisation vehicles must be audited by an approved independent auditor ("Réviseur d'entreprises agréé") appointed by the management body of the securitisation vehicle or by the management company of the securitisation fund. For an authorised securitisation vehicle supervised by the CSSF, the approved independent auditor must be authorised by the CSSF.

The EU Audit Legislation introduced more detailed requirements regarding the statutory audit of Public Interest Entities ("PIEs"). The requirements have been enacted in Luxembourg with the Audit Law. The general rule is that all PIEs, e.g. all securitisation vehicles having securities listed on an EU-regulated market, must rotate their auditor after a maximum period of ten years, with the possibility of a further ten year extension based on a tender (or 14 years in case of joint audit).

3.4.2.3 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 Minister with responsibility for 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 125,000.

Even if the Luxembourg Securitisation Law has been in place for many years and although the Luxembourg Securitisation Law provides a special legal framework for such independent professionals, who are responsible for representing investors' interests, no fiduciary representative is registered in Luxembourg.

3.4.3 Defined liquidation process

As mentioned above, each of the compartments of a securitisation company can be liquidated separately (by a simple board resolution) without any negative impact on the vehicle's remaining compartments, i.e., without triggering the liquidation of other compartments or the company itself (while the liquidation of the last sub-fund of a securitisation fund would entail the securitisation fund's liquidation).

Usually, a securitisation vehicle is voluntarily liquidated once its transaction matures and all obligations have been repaid, except if it is again used for another transaction. In Luxembourg, there are two different procedures for the standard voluntary liquidation of a company (not specific to securitisation vehicles): a normal procedure and a simplified procedure (for vehicles with a single shareholder) as per Art. 1100-1 of the Luxembourg Commercial Law.

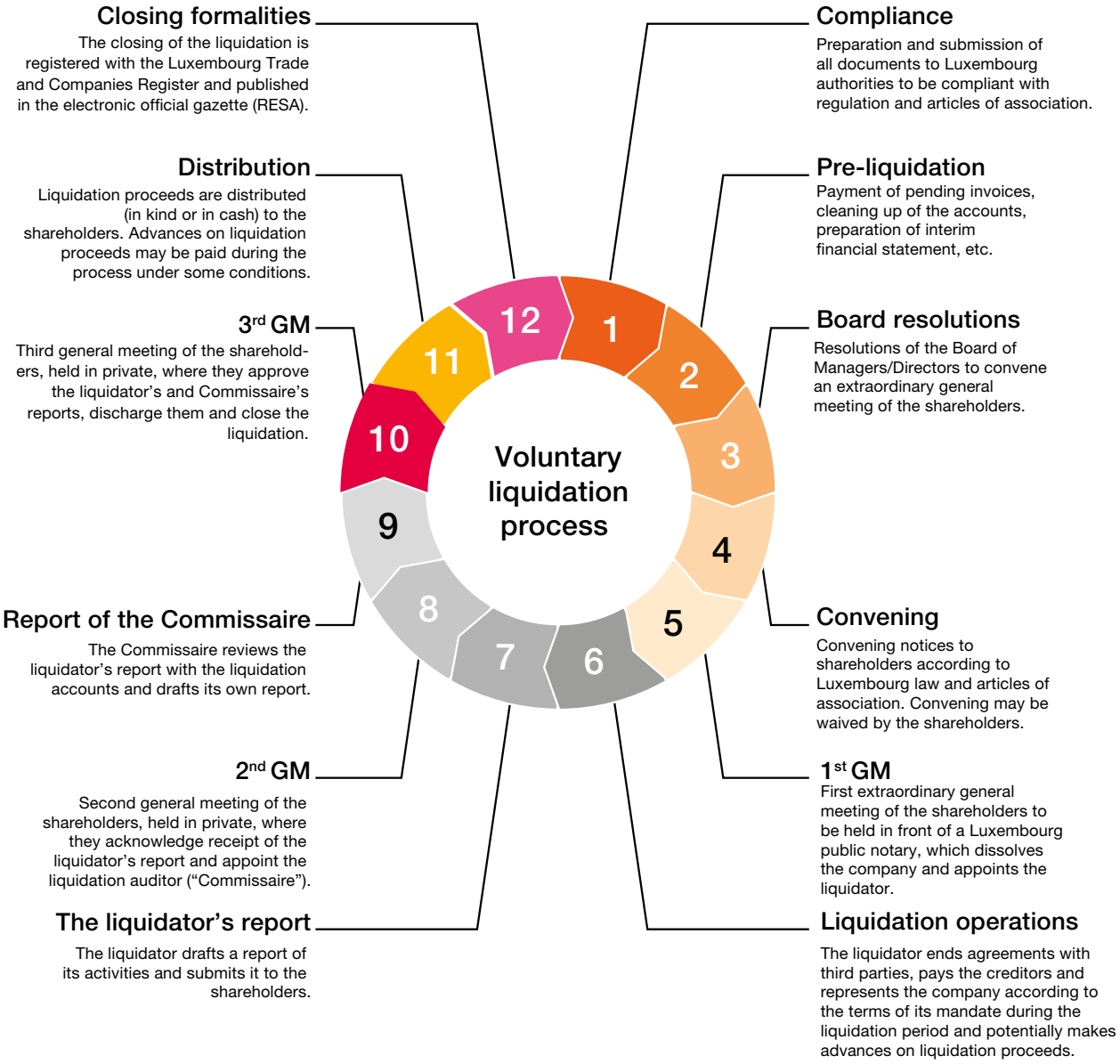
Within the **normal liquidation procedure** as illustrated in Figure 17, liquidation is performed in three steps: a first extraordinary general meeting of the shareholders ("EGM"), to be held in the presence of a notary, takes the decision to dissolve the company and appoints a liquidator. The company now must indicate in its documents that it is "in liquidation". The liquidator is 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 creditors or other appropriate parties.

After completion of the liquidation, the liquidator presents a report to the shareholders in a second ordinary general meeting ("OGM"), which also appoints an auditor as "Commissaire à la liquidation". The Commissaire à la liquidation reviews the work performed by the liquidator and prepares a report for the attention of the shareholders in a third OGM which then finally decides on the closure of the liquidation and the removal of the company from the Luxembourg Trade and Companies Register.

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.

For the simplified dissolution procedure to be applicable, all shares must be held by a sole shareholder. Furthermore, certain certificates from the Central Social Security Office, the direct tax administration and the registration tax and VAT administration must be obtained. Such certificates must confirm that the company follows its obligations to these bodies. The sole shareholder may then resolve to dissolve the company without liquidation and all assets and liabilities of the company will be transferred to him.

Figure 17: Liquidation process of a Luxembourg company



04

Accounting aspects

Accounting aspects

4.1 Accounting - LuxGAAP

The Luxembourg Securitisation Law itself does not contain any provisions with respect to specific topics, e.g., accounting principles. Instead, it refers to other laws depending on the legal form of the securitisation vehicle (an overview is shown in Figure 18). In addition to these, further industry practices have been developed.

4.1.1 Securitisation company accounting

Securitisation vehicles established as securitisation companies (including the partnership forms) must comply with the provisions of chapters II and IV of title II of the Accounting Law. The Accounting Law sets the legal framework for the accounting principles applied to Luxembourg companies, the Luxembourg Generally Accepted Accounting Principles ("LuxGAAP").

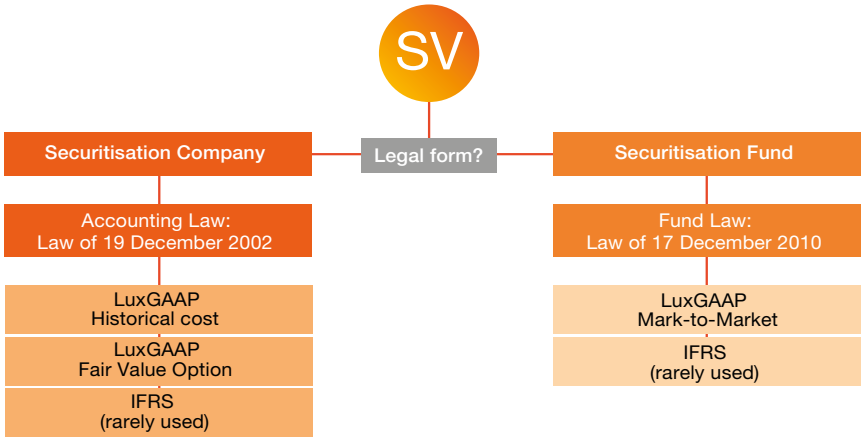
Contrary to general accounting requirements for partnerships (that are mainly based on the partnership agreement and accounts are not published), the Luxembourg Securitisation Law prescribes the application of the Accounting Law for securitisation companies in partnership forms (SNC, SCS, SCSp).

LuxGAAP provides a highly flexible accounting framework: for example when investing in financial instruments, the Accounting Law provides a choice between different accounting frameworks: (i) LuxGAAP under the historical cost model, (ii) LuxGAAP under the fair value option or (iii) International Financial Reporting Standards as adopted by the European Union ("IFRS"). Further guidance on LuxGAAP accounting and disclosure can be found in our publication **Securitisation in Luxembourg - Illustrative financial statements.**

Under LuxGAAP (historical cost model), a securitisation company's assets are valued either at their acquisition cost or at the lower value attributed to them. Under the historical cost convention, a valuation above the acquisition cost, e.g., based on higher market values, is generally not acceptable. However, when the value attributed to a fixed asset is lower than the acquisition cost, a value adjustment must be made for any durable value depreciation ("cost less impairment"). An accounting policy choice may also be made to recognise a value adjustment for any such decrease in value ("lower of cost or market value" or "LOCOM").

In addition, LuxGAAP offers the possibility to value most financial instruments at fair value without being subject to further provisions of the IFRS ("fair value option"). Nevertheless, some additional disclosure on the fair value instruments and valuation models, if any, must be presented 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 fair value option is often chosen when the repayable amount of the financial instruments issued directly depends on the fair value of assets like derivatives - as often seen in structured products transactions - or fund investments.

Figure 18: Flexibility in Luxembourg Accounting Law



Furthermore, it is expected that the Luxembourg's Accounting Law will be modernised soon. However, only some of the proposed changes will have a significant impact on the accounting for securitisation companies.

Securitisation companies having issued transferable securities that are listed on an EU-regulated market (so-called "EU Public Interest Entities" or "EU PIE") may also have to comply with further disclosure requirements pursuant to the Transparency Law and/or the Prospectus Regulation. 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 LuxGAAP. The stand-alone financial information may be prepared according to IFRS or national accounting standards, i.e., LuxGAAP. An obligation to use IFRS in this context exists only for consolidated financial statements, which a securitisation vehicle would usually not have to prepare.

Furthermore, an EU PIE must follow a specific filing format called European Single Electronic Format or ESEF if it cannot benefit from certain exemptions (please refer to chapter 4.1.7 for further details).

4.1.2 Securitisation fund accounting

A securitisation fund managed by a management company and governed by management regulations is subject to the "accounting and tax regulations" (except for the annual subscription tax) applicable to undertakings for collective investments ("UCIs") provided by the Fund Law on undertakings for collective investment, as amended (the "Fund Law"). The Luxembourg Securitisation Law does not refer to specific articles in the Fund Law, but our understanding is that provisions related to recognition, measurement and disclosure should be read as "accounting regulations".

This implies valuation of assets based on the last known representative stock exchange quotation or the most probable realisation value estimated with care and in good faith, i.e., a fair market valuation, unless otherwise stated in the management regulations. Thus, fair valuation is the default option but can be overridden by the management regulations, e.g., prescribing the use of historical cost or other valuation models.

In our separate publication "Illustrative financial statements" within our series "Securitisation in Luxembourg", we present an example of the financial statements of a securitisation fund.

The layout of the annual and the semi-annual report would be based on Article 151 (3) and (4) of the Fund Law, thus containing:

- a balance sheet or a statement of assets and liabilities;
- a detailed income and expenditure account for the financial year;
- a report on the activities of the past financial year;
- the other information provided for in Schedule B of Annex I of the Fund Law (e.g., net asset value per unit and units in circulation; analysis of the asset portfolio by economic, geographical, currency or other appropriate criteria); and
- any significant information necessary for investors' judgement on the development of the activities and the results of the fund.

4.1.3 Accounting for fiduciary estates

As mentioned above, a securitisation company or a securitisation management company may also act as fiduciary and issue notes on a fiduciary basis in its own name but at the sole risk and for the exclusive benefit of the fiduciary noteholder. Therefore, the fiduciary assets and liabilities do not constitute assets or obligations of the securitisation vehicle itself but need to be shown segregated from all other assets of the fiduciary (i.e. the securitisation (management) company) as well as from other fiduciary estates.

Consequently, the fiduciary transactions are recorded off-balance sheet by the securitisation (management) company. In our view, to meet the information function of the annual accounts, an investor in a fiduciary estate should receive the same

information as an investor in a compartment, both being exposed to the risks and rewards of the underlying assets. Therefore, we highly recommend providing a similar level of disclosure in the notes to the annual accounts regarding the fiduciary estates as if the transaction would have been recorded on-balance sheet. This enables the annual accounts to provide sufficient information to investors about their (fiduciary) investment. For example, a dedicated note describing the fiduciary investments and related liabilities as well as the directly linked income and charges of each fiduciary estate should be disclosed. More detailed information of other assets/liabilities or income/charges positions may not be necessary depending on their significance.

4.1.4 Accounting for multi-compartment vehicles

The Luxembourg Securitisation Law provides legal certainty that a compartment's assets are available exclusively to satisfy the rights of investors in relation to this compartment as well as the rights of creditors whose claims have arisen in connection with the creation, operation, or liquidation of that compartment.

As far as the accounting practice is concerned, the CSSF confirmed that multi-compartment securitisation companies should present their annual accounts and related notes to the annual accounts 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, for accounting purposes, a securitisation vehicle with several compartments is regarded as a combination of several "companies" under the umbrella of one legal entity. To achieve a true and fair view of a multi-compartment securitisation vehicle's activities and financial position, it is required to provide (and consequently audit) information on compartment level, and not only a combined balance sheet and a combined profit and loss account.

In practice, separate balance sheets and profit and loss accounts for each compartment are disclosed as part of the notes to the annual accounts. Alternatively, the notes to each asset, liability, income, and charges position should give sufficient detail per compartment. The accounting must be prepared in a way that such asset, liability, income and charges position of each compartment can be extracted separately, i.e., using a separate general ledger per compartment in the bookkeeping system. In our publication "Illustrative financial statements", we present an example of the annual accounts of a securitisation company, including an example of how to meet the disclosure requirements for a multi-compartment structure. The same applies for a securitisation fund with several sub-funds.

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 complying with the legal obligation to prepare and publish audited annual accounts for the entity as a whole (including information on all its compartments, on a combined basis).

4.1.5 Treatment of (unrealised) gains and losses of the financial instruments issued ("equalisation provision")

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

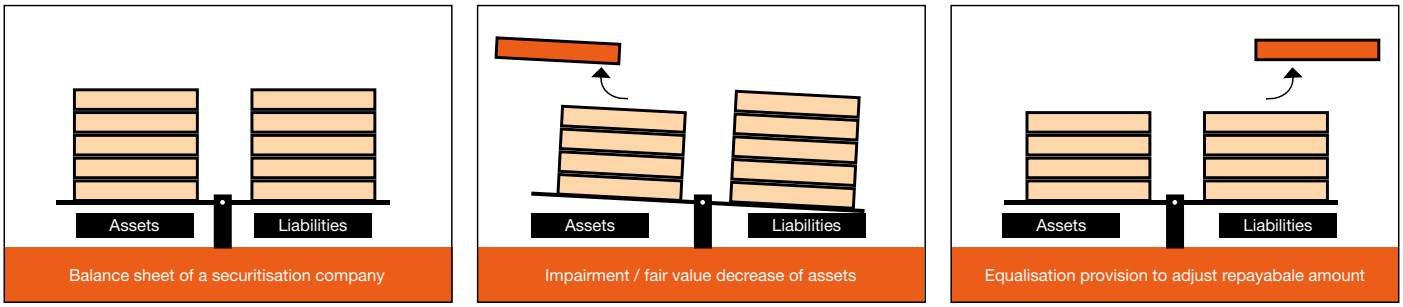
On the other hand, the recovery of the financial instruments issued is entirely dependent on the securitisation vehicle's asset pool generating sufficient cash flow, as the investors have no recourse to the transferor beyond its structural support, if the asset's cash flow is less than originally expected. The repayable amount of the financial instruments issued is thus not an ultimately fixed amount but directly depending on the value or cash flow of the securitised risks or assets.

The investor's risk is often managed by the structuring of the cash flow of the securitisation vehicle and financial instruments issued. This is most typically achieved by issuing at least one senior and one subordinated (or junior) financial instrument, each having a different seniority with regards to the payments from the cash flow of the pool of assets (so-called "tranching"). When the cash flow is collected, it is firstly used to meet the obligations of the most senior ranked investors (after tax and external expenses). Any residual cash flow after payment of the most senior class is then used to pay the less senior investors. This mechanism is known as "waterfall" or "priority of payments" and has the effect of allocating potential cash flow shortfalls to the most junior investors first and, on the other hand, enhancing the credit quality for the senior investors as they benefit from a first loss buffer in form of the junior instrument or subordinated loan (see chapter 2.1).

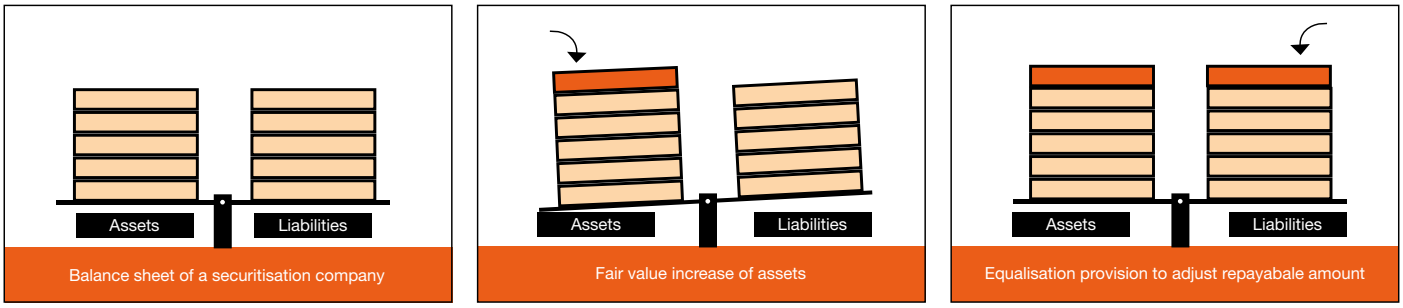
Therefore, any recognised value decrease of the assets (impairment or fair value loss) will be borne by the holders of the financial instruments issued through a reduced repayable amount in reverse order of the priority of payments. This variation in the repayable amount of the financial instruments issued based on the direct link with the asset is, for Luxembourg securitisation vehicles and as a best practice, immediately reflected in accounting and referred to as "equalisation provision" (see Figure 19). This value adjustment of the repayable amount must be clearly disclosed in the notes to the annual accounts. In the profit and loss account, such a reduced repayment obligation results in a gain for the securitisation vehicle. Consequently (and not per se for securitisation vehicles), the total net result in the profit and loss account will often be close to nil. The equalisation provision should not be confused with a write-off of the repayment obligation resulting from the financial instrument issued; the obligation remains based on the notional and the repayment formula or waterfall; only the estimated repayable amount as of the balance sheet date changes.

Figure 19: Illustration of equalisation provision concept

a. Decrease of asset value and corresponding repayable amount of the financing instrument



b. Increase of asset value and corresponding repayable amount of the financing instrument



To enhance the reader's understanding of the annual accounts, a description of the valuation method used to calculate the equalisation provision should be given in the notes to the annual accounts as well as a summary of the waterfall structure.

The reverse effect applies when the repayable amount of the financial instruments issued increases due to the direct link with the asset value.

A securitisation vehicle is usually bound by agreements to distribute all the cash flow received to the investors (e.g., as variable interest or as an increased repayable amount) or to other involved parties (e.g., arranger), but not necessarily in the same period in which the profit is recognised. Nevertheless, the liability for the increased payment obligation already incurred and thus a higher reimbursement value must be shown in the annual accounts.

However, neither Accounting Law nor electronic annual accounts filing formats ("eCDF") foresee a caption called "equalisation provision". Therefore, it has become market practice to directly deduct or add the total equalisation provision from the financial instruments' repayment value under the liabilities on the balance sheet and to disclose the effects in the profit and loss account under "other operating income" and "other operating charges" respectively (as it is the consequence of the securitisation vehicle's activity and a realised loss/gain rather than an interest charge/income).

4.1.6 Legal reserve/subscribed capital for compartments

Another regular question, especially for equity financed securitisation companies (even though a minority in the market), concerns the treatment of the legal reserve within a multi-compartment securitisation company (not applicable for securitisation funds). Neither Accounting Law nor Commercial Law provide detailed guidance on this as a multi-compartment structure is a specificity of the Luxembourg Securitisation Law and not covered by Accounting Law and Commercial Law.

In general, the Commercial Law states in Articles 461-1 and 710- 23 that a company is required to allocate a minimum of 5% of its annual net profit to a legal reserve, until this reserve equals 10% of the subscribed share capital. As most of the securitisation companies in Luxembourg are financed by debt and do not make any profit, a legal reserve will not be built up. However, equity-financed structures or securitisation transactions leaving a profit margin in the company would have to allocate a legal reserve until it reaches 10% of the subscribed capital of the company.

In the past, this created some confusion for equity financed multi-compartment vehicles as the compartments are fully segregated from each other but the overall result of the company equals the total of all profits and losses of the compartments. Not only was the allocation of the legal reserve concerned but also the possibility to distribute profits from the profit-making compartments. With the modernisation of the Luxembourg Securitisation Law in 2022, this has been clarified. Now, the treatment and distribution of profits and losses of equity financed compartments is clearly defined stating that this has to be done on a compartment basis. Consequently, profit-making compartments that are financed by equity must allocate at least 5% of the net profit to the legal reserve until reaching 10% of the compartments' subscribed capital.

An example of an equity financed three-compartment vehicle is outlined in Figure 20 below. This example illustrates that, although the company is in total (i.e. in its combined figures) in a loss position, the profit-making compartments need to allocate part of their profits to a legal reserve. In addition, compartments 1 and 3 are able to distribute a dividend after allocation to legal reserves of EUR 9,500 and EUR 4,750 respectively to their shareholders, given that the distribution is adequately approved by the general meeting of the shareholders of the compartment. In this context, it is important to clearly define, for example in the articles of incorporation, that only the shareholders of a respective compartment can decide on a dividend distribution of that compartment and not on other compartments.

Figure 20: Legal reserve - example

Compartment	Subscribed capital	Result of the year	Allocation to legal reserve
1	EUR 100,000	EUR 10,000	EUR 500
2	EUR 200,000	EUR (20,000)	EUR 0
3	EUR 100,000	EUR 5,000	EUR 250
Combined	EUR 400,000	EUR (5,000)	EUR 750

4.1.7 Standard Chart of Accounts and European Single Electronic Format

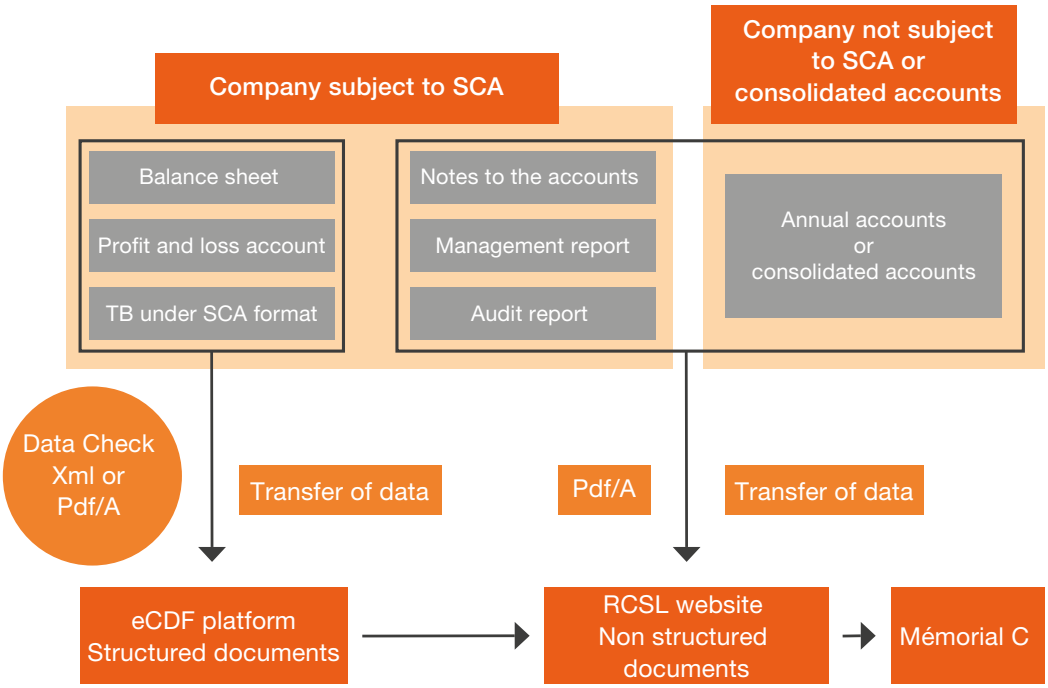
In Luxembourg, legislation prescribes the use of a Standard Chart of Accounts ("SCA") and "eCDF" for most companies. All securitisation companies that do not fall under CSSF supervision are, among other companies, obliged to use SCA and eCDF (not applicable for securitisation funds). The Luxembourg Securitisation Law as lex specialis makes it clear that this shall also apply to securitisation vehicles in partnership form (SNC, SCS, SCSp). Companies that prepare and publish their annual accounts under IFRS are exempt from filing their trial balance and annual accounts under the SCA and the eCDF.

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 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, which would not have to be in eCDF format. If "small" size criteria are met based on the Accounting Law, the company can opt for an abridged format presentation of its balance sheet and profit and loss account.

As per Article 75 of the Accounting Law, all Luxembourg-based companies are required to file their annual accounts with the Luxembourg Trade and Companies Register ("RCSL") electronically, as illustrated in Figure 21. Since the audit of a securitisation vehicle is a legal obligation, the audit report needs to be filed together with the annual accounts.

Since financial periods beginning on or after 1 January 2021, Luxembourg companies with securities issued (equity or debt) and admitted to trading on an EU-regulated market must prepare their annual financial reports using the European Single Electronic Format ("ESEF") unless an exemption applies. Companies must prepare a single file in XHTML (webpage) format that includes financial statements, the management report (incl. corporate governance statement) and the responsibility statement. The aim is to enhance comparability and usability of the financial information. Issuers that have exclusively issued debt securities admitted to trading on an EU-regulated market with a denomination per unit of at least EUR 100,000 are exempted from this requirement. In addition, issuers preparing IFRS consolidated financial statements must fulfil certain tagging or mark-up requirements using iXBRL.

Figure 21: e-filing procedure



4.2 Accounting - IFRS Accounting Standards

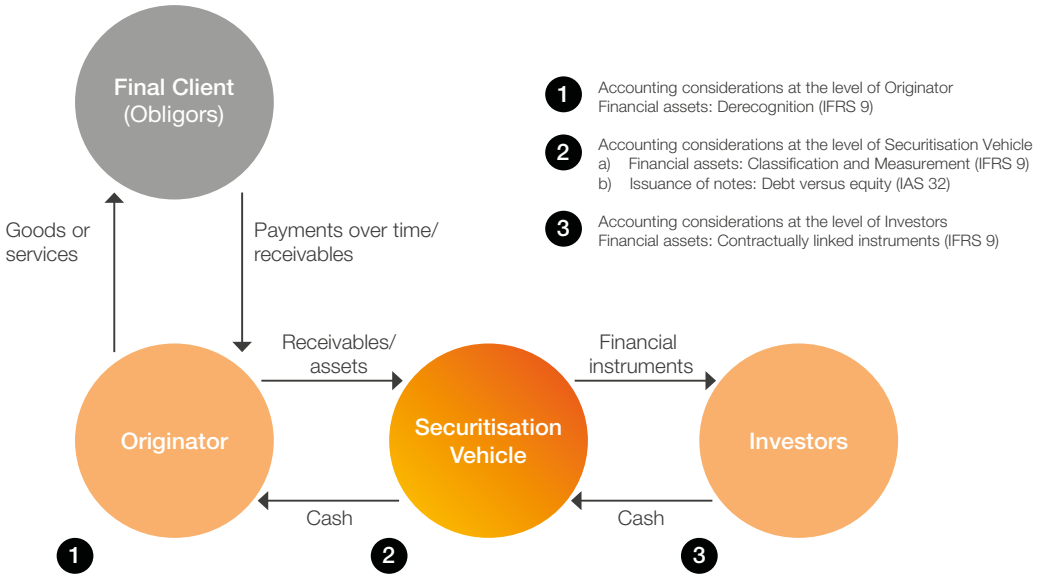
Accounting based on International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") is applied by some Luxembourg securitisation vehicles, while the vast majority uses LuxGAAP or LuxGAAP with fair value option for preparing their mandatory financial statements.

Some securitisation vehicles opt to prepare their financial statements under IFRS, which is an option in the Luxembourg Accounting Law. In addition, other securitisation vehicles become part of a consolidated group, which prepares its financial statements under IFRS or have investors requiring financial reporting under IFRS. In the latter cases, the securitisation vehicle does not usually prepare a full set of financial statements under IFRS, but instead prepares a dedicated reporting package applying only the relevant IFRS requirements.

Due to the nature of the securitisation business, the assets of the securitisation vehicle mainly comprise financial instruments while the liabilities are formed of financial instruments issued. Therefore, we have highlighted below the key challenges the securitisation vehicle (or other parties involved in the securitisation transaction) may face when preparing financial statements under IFRS. Due to the nature of the assets and liabilities, i.e. being financial instruments, the applicable accounting rules are mainly covered by "IFRS 9 - Financial Instruments" (IFRS 9). Consolidation requirements are prescribed in "IFRS 10 - Consolidated Financial Statements" (IFRS 10).

The purpose of this chapter is to give a first guidance on what may be the most relevant factors in the context of a securitisation transaction; it shall not be seen as a detailed commentary on IFRS 9, IFRS 10, or other IFRS Standards. The accounting considerations under IFRS largely depend on the role the preparer of financial statements has in a securitisation transaction (see Figure 22).

Figure 22: Different accounting considerations for the different actors



4.2.1 Originator's perspective - Derecognition of financial assets

One of the challenges faced by the originator or one objective it/they may wish to achieve is the ability to derecognise the securitised assets from his balance sheet. The rules on derecognition of financial instruments under IFRS are defined in IFRS 9 and summarised in Figure 23 below.

When transferring assets to a securitisation vehicle in order to derecognise them from their own balance sheet, originators need to pay attention to:

- credit enhancements provided to the securitisation vehicle (e.g., subordinated retained interests, credit guarantees, total return swap with transferees, excess spread, etc.); and
- continuing involvement in transferred assets (e.g., full or partial guarantees of the collectability of receivables, conditional or unconditional agreements to re-acquire the transferred assets, written or held options, retained servicing depending on fee, etc.).

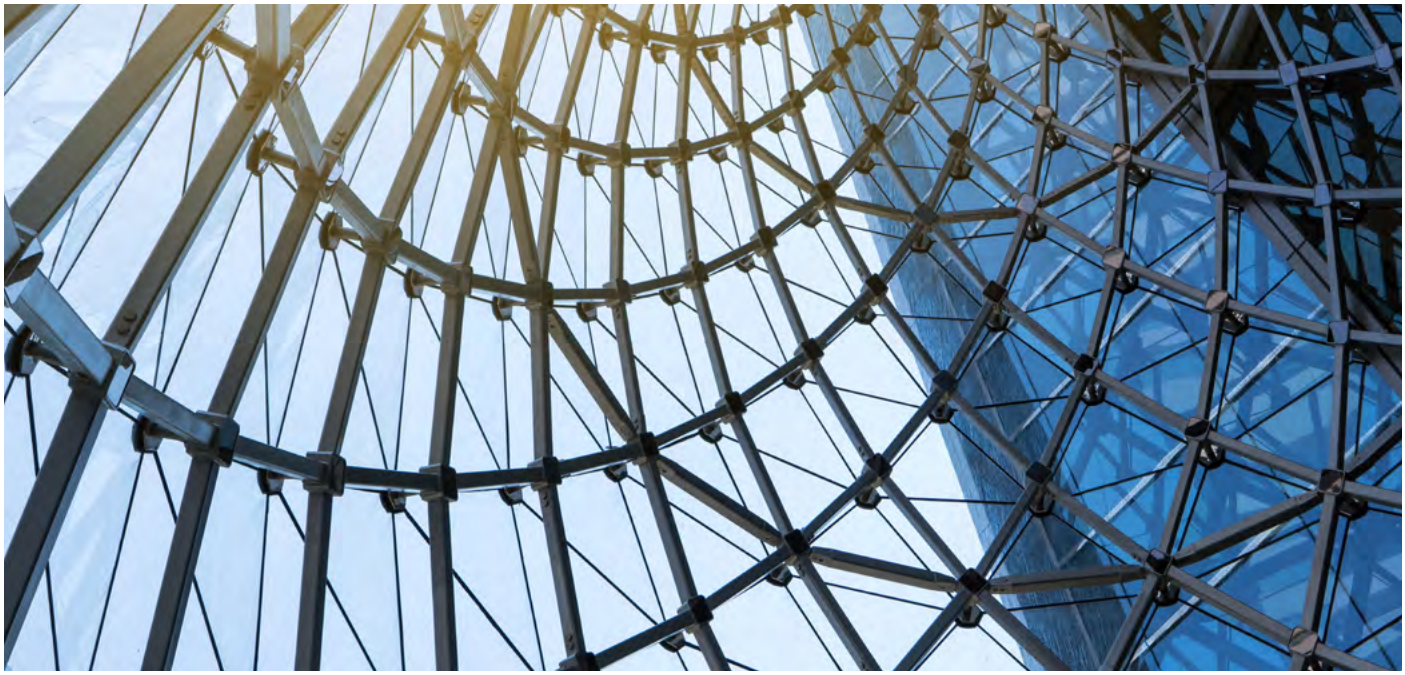
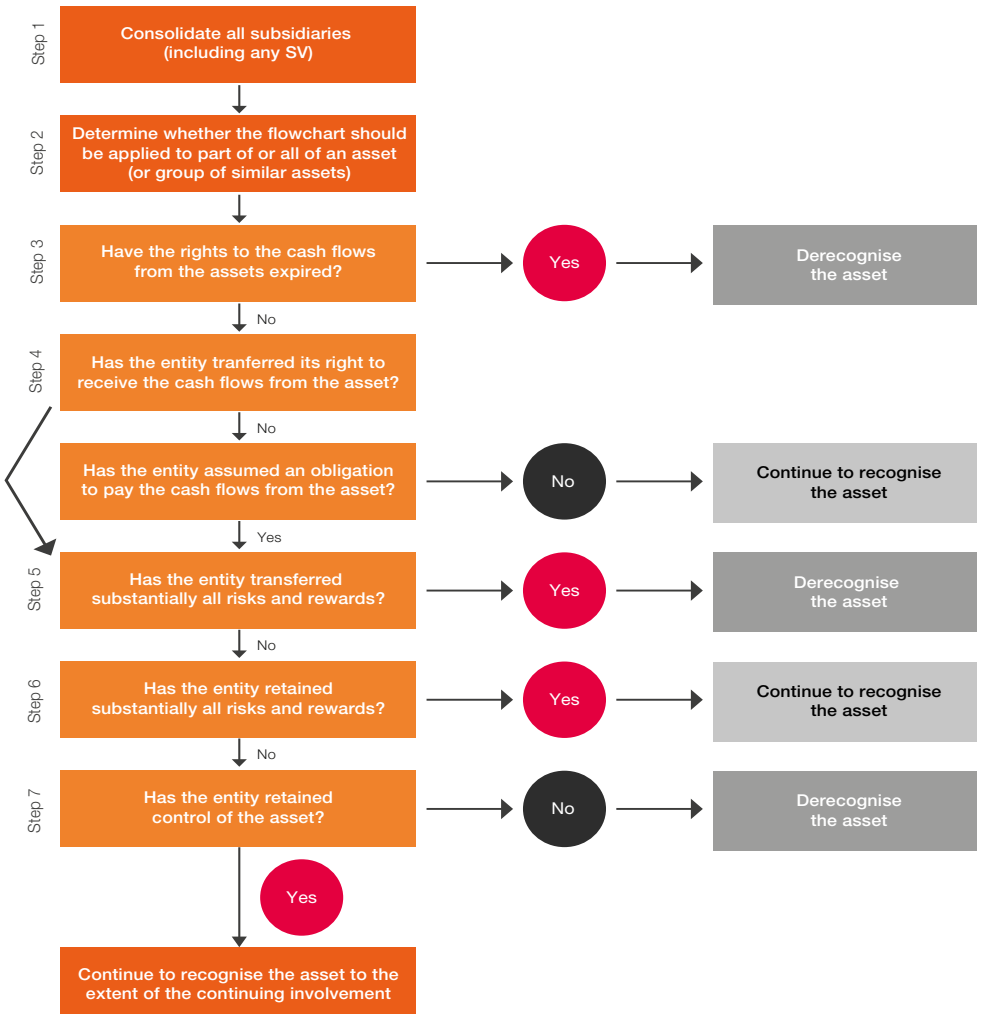


Figure 23: Rules of derecognition under IFRS 9



4.2.2 Securitisation vehicle's perspective - Financial assets and liabilities

a) Financial assets – classification and measurement

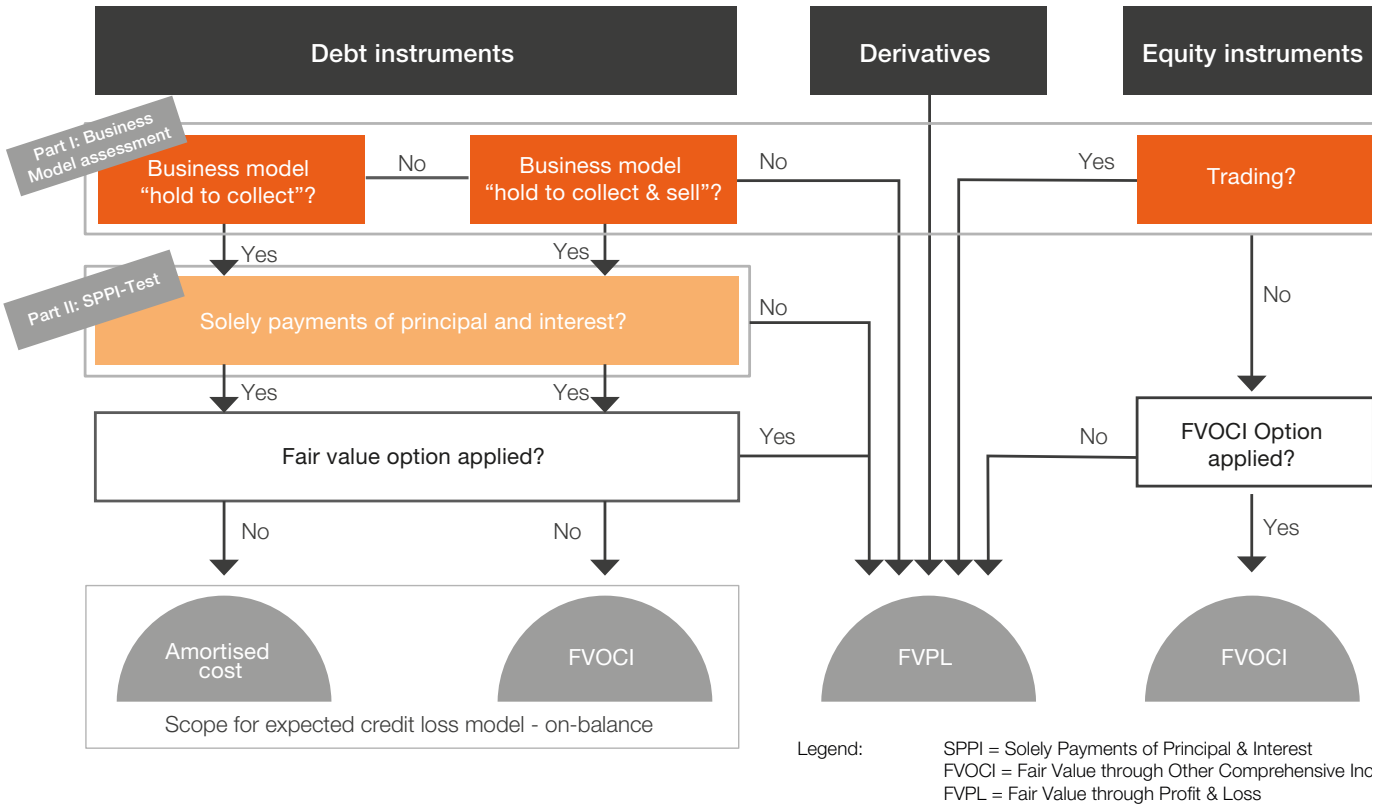
Initial recognition

Under IFRS 9, classification and measurement of financial assets are assessed based on the instrument's nature (debt or equity), features (characteristics of contractual cash flows), and underlying business model (how an entity manages its financial assets to generate cash flows and create value for the entity). This is summarised in Figure 24.

For debt instruments, there are three defined classification categories:

- Amortised cost ("AC"), when contractual cash flow represents solely payments of principal and interest ("SPPI") and the entity's business model is "hold to collect" (mainly collecting the contractual cash flow);
- Fair value through other comprehensive income ("FVOCI"), when contractual cash flows are SPPI and the entity's business model is "hold to collect and sell" (a mix model of collecting the contractual cash flow and realising capital gains through sales); and
- Fair value through profit or loss ("FVPL"), the residual category.

Figure 24: Overview of financial asset classification under IFRS 9



Investments in equity instruments are always measured at fair value. However, to reduce the volatility of the profit and loss account ("P&L"), the entity can make an irrevocable election on an instrument-by-instrument basis to present changes in fair value through other comprehensive income ("OCI"), provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value must be recognised in P&L.

For designated equity instruments at fair value in OCI, there is no recycling of amounts from OCI to P&L – for example, on sale of an equity investment – nor are there any impairment requirements.

Expected credit loss model

Debt instruments classified at "Amortised cost" and "Fair value through other comprehensive income" are subject to impairment loss assessment. The same holds true for lease receivables, contract assets, loan commitments, and financial guarantees not measured at fair value. If the vehicle intends to hold these assets to collect the contractual cash flows, and not to sell, the business model to apply for accounting purposes is "hold to collect".

In this context, IFRS 9 uses the expected credit loss ("ECL") model for the recognition of impairment losses. The ECL model is a forward-looking approach and requires entities to recognise credit losses it anticipates over a certain timespan. As such, it will record a day 1 loss based on the probability of assets to default in the next 12 months. The impairment assessment under IFRS 9 also considers the change in credit quality of financial assets since initial recognition which is divided in three stages: (i) materially unchanged credit risk, (ii) significantly increased credit risk, (iii) objective evidence of impairment. A significant increase in the credit risk of assets will further trigger a higher provisioning (for the lifetime expectation of default).

A simplified approach is used for trade receivables, lease receivables and contract assets resulting from transactions that are within the scope of "IFRS 15 - Revenue from Contracts with Customers" (IFRS 15) without significant financing component, and it can be used for trade receivables and contract assets with significant financing component as well as for lease receivables. For this asset class, IFRS 9 establishes a simplified impairment approach for qualifying trade receivables, contract assets within the scope of IFRS 15 and lease receivables (see Figure 25 below). For these assets a securitisation structure can, or in one case must, recognise a loss allowance based on lifetime ECLs rather than the two step process under the general approach.

Figure 25: Scope of the simplified approach

Trade receivables and contract assets within the scope of IFRS 15	Basis of application
Do not contain a significant financing component, or the entity applies the practical expedient to measure the asset at the transaction price under IFRS 15	Mandatory
Contains a significant financing component	Policy choice
Lease receivables	
Finance leases	Policy choice
Operating leases	Policy choice

An entity may select its accounting policy for trade receivables, lease receivables and contract assets independently of one another

The general impairment model does not apply to purchased or originated credit-impaired assets. Indeed, some securitisation structures are designed to hold portfolios of distressed loans which were bought at a substantial discount from their nominal value. A financial asset is considered credit-impaired on purchase or origination if there is evidence of impairment at the point of initial recognition. In that case, impairment is determined based on full lifetime ECL on initial recognition. Lifetime ECL are already included in the estimated cash flow when calculating the effective interest rate on initial recognition. Therefore, the effective interest rate for interest recognition throughout the life of the asset is a credit-adjusted effective interest rate. As a result, no loss allowance is recognised on initial recognition. Any subsequent changes in lifetime ECL, both positive and negative, will be recognised immediately in the income statement, even if the lifetime ECL are less than the amount of ECL that was included in the estimated cash flow on initial recognition. To enhance the comparability of financial assets that are credit-impaired on initial recognition with those that are not, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on those assets. Such disclosure allows the reader to see the theoretically possible contractual cash flow that an entity could collect if there was a favourable change in expectations of credit losses for such assets.

b) Financial liabilities – classification and measurement

Initial recognition

IFRS 9 foresees two categories for financial liabilities:

- Fair value through profit or loss, if held for trading or designated upon initial recognition. Such designation is permitted if it eliminates an accounting mismatch, or a group of financial liabilities (and assets) is managed, and its performance is evaluated on a fair value basis. For designated liabilities, the movement in fair value due to the deterioration of its own credit risk is to be recognised in OCI, so that P&L is impacted only by appropriate components of movements in fair value;

- Amortised cost, residual category.

Debt versus equity

Securitisation vehicles are issuing financial instruments that have particular features to satisfy the investors' needs in terms of desired level of risk and returns. Under IFRS, such features might affect classification between debt and equity. "IAS 32 – Financial Instruments: Presentation" (IAS 32) contains the principles for distinguishing between financial liabilities and equity.

A contractual agreement's substance takes precedence, resulting in some situations where instruments that qualify as equity for regulatory, tax, legal or LuxGAAP purposes, on closer examination, are financial liabilities under IFRS or vice versa. Contractual features that lack substance are not to be considered regardless of whether such features would significantly affect the classification.

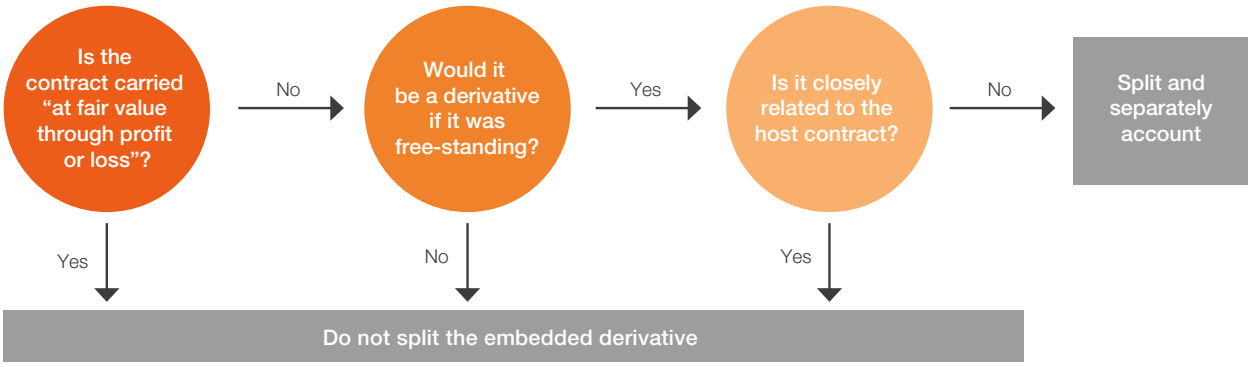
Other features such as interest/dividend payments triggered or conditioned by other classes of instruments have to be closely analysed as they might have an impact on assessing if an instrument is debt or equity or components of such instruments have different classifications.

If the securitisation vehicle issues convertible bonds, the equity conversion option is an equity instrument for the issuer provided that it meets the conditions for equity classification under IAS 32. Such instruments are referred to as compound financial instruments. A compound financial instrument is a non-derivative financial instrument that, from the issuer's perspective, contains both a liability and an equity component. An issuer should account for the components of a compound financial instrument separately as financial liabilities, financial assets or equity instruments. This is commonly referred to as split accounting. If a conversion option does not meet equity instrument definitions under IAS 32 it is treated as an embedded derivative under IFRS 9.

Embedded derivatives

The financial instruments issued by securitisation vehicles might also contain embedded call, put, or prepayment options. In general, such options are not closely related to the debt host instrument as they relate to factors other than interest rate risk and credit risk of the issuer. In these cases, IFRS would impose a split accounting or bifurcation of the financial instrument issued. For example, interest and principal payments that are linked to an equity index are not closely related to the debt host contract, unless the index is a non-financial variable specific to the entity. Whether an embedded optional component needs to be bifurcated would depend on its underlying and whether it is in or out of the money. Close attention needs to be paid to these aspects, especially if the securitisation vehicle is issuing structured products.

Figure 26: Treatment of derivatives embedded in financial liabilities under IFRS 9



In accordance with IFRS 9, an issuer separates an embedded derivative in a hybrid contract containing a financial liability host contract if:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid contract is not measured at FVPL.

Alternatively, the securitisation vehicle could avoid separating an embedded derivative from a host contract by electing the fair value option and designating the entire hybrid contract at FVPL.

c) Disclosure requirements

IFRS requirements in terms of disclosures were designed to provide useful information to investors and other financial statement users, such as:

- significance of financial instruments in relation to an entity's financial position and performance;
- nature and extent of risks arising from financial instruments to which the entity is exposed (i.e. market risk, liquidity risk, credit risk) and how these risks are managed;
- fair value measurement hierarchy. These disclosure requirements are also partly applicable under LuxGAAP if the fair value option described in chapter 4.1.1 is used.

4.2.3 Investors' perspective – Look-through approach

Contractually linked instruments

In a securitisation transaction, the risk of a pool of assets in which the securitisation vehicle is investing is transferred to investors using particular structuring methods for the instruments issued. The payments under the instruments issued are contractually linked to the payments received on the pool of assets. Under IFRS, such instruments are called "contractually linked instruments". Often, the refinancing of the securitisation vehicle is structured in a way that some of the instruments issued are prioritised (senior) for the payment of principal and interest compared to the others (junior). This concept is referred to as "tranching". Investors holding these types of instruments have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flow to satisfy any higher-ranking tranches before.

Accounting-wise, the classification and implicitly the measurement criteria for the holder of these tranches (the investor) should be assessed by using a "look through" approach. This approach takes not only the terms of the instrument itself into account, but also the characteristics of the pool of underlying assets as well as the tranche's relative exposure to credit risk given its ranking compared to other instruments issued.

Non-recourse assets

Financial instruments issued by a securitisation vehicle usually include a non-recourse provision, i.e. an agreement that, if the securitisation vehicle (or one of its compartments) defaults on the secured obligation, the investor can request the securing assets (whether financial or non-financial) to recover its claim. In Luxembourg, the non-recourse is even manifested in the Securitisation Law. Therefore, the investor has recourse only to the assets subject to the securitisation transaction but not to any other assets of the securitisation vehicle.

The fact that a financial asset is non-recourse does not necessarily preclude the financial asset from meeting the SPPI criterion (see chapter 4.2.2). However, the investor is required to assess (that is, to "look through to") the particular underlying assets or cash flow to determine whether the financial assets' contractual cash flow is SPPI. If the instrument's terms give rise to any other cash flow, or if they limit the cash flow in a manner that is inconsistent with the SPPI criterion, the instrument will be measured in its entirety at FVPL.

Following the post implementation review of IFRS 9, further guidance on contractually linked instruments and non-recourse financial assets has been provided. Amendment effective for annual reporting periods beginning on or after 1 January 2026.

4.2.4 Consolidation of securitisation vehicles

At the level of the originators and the investors

In the context of a securitisation transaction, IFRS may oblige one of the involved parties to consolidate the assets and liabilities of the securitisation vehicle. The consolidation considerations may affect both the originators and the investors. From an accounting perspective, one question needs to be addressed: who, if any, of the originator(s) or investor(s) controls the securitisation vehicle, and therefore must consolidate it in its consolidated financial statements. The result of such analysis could conclude that nobody controls the securitisation vehicle; in that case, it remains as a non-consolidated company.

The answer to this question has major impact, as the entity consolidating the securitisation vehicle must recognise and disclose in its consolidated financial statements the assets and liabilities held by the securitisation vehicle.

Consolidation – general considerations

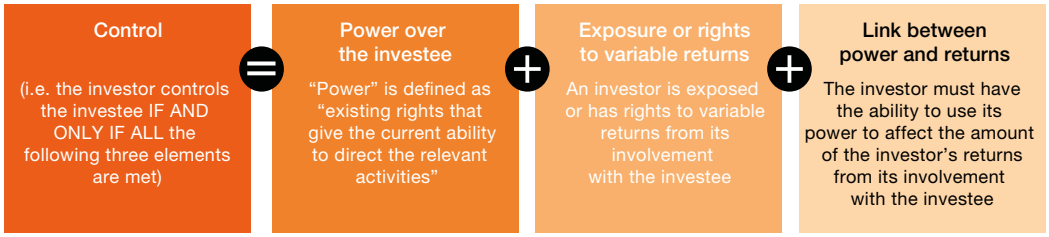
Consolidation requirements and the interpretation of the control notion are provided by IFRS 10. However, a securitisation transaction and the relations between the involved parties do not have the same characteristics as a "normal" group of entities consisting of parent and its subsidiaries. A securitisation vehicle is considered as a "structured entity", as it fulfils (some or all) the following features or attributes as described in "IFRS 12 – Disclosure of Interests in Other Entities" (IFRS 12):

- Restricted activities.
- A narrow and well-defined objective, such as:
    - to effect a specific structure like a tax efficient lease;
    - to carry out 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).

Although having different and specific characteristics compared to a normal parent-subsidiary relationship, the assessment of who controls a structured entity is determined using the control definition and criteria of IFRS 10. This means, one entity has control over another when, cumulatively, (i) having power over the investee, (ii) having exposure or rights to variable returns, and (iii) having a link between power and returns (see Figure 27). This means that the following indicators need to be considered when assessing control:

- The purpose and design of the structured entity;
- What the relevant activities are;
- How decisions about these activities are made;
- Whether the rights of the investor give it the current ability to direct the relevant activities;
- Whether the investor is exposed, or has rights, to variable returns from its involvement with the investee;
- Whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns.

Figure 27: Consolidation requirements under IFRS 10



What makes it complex when assessing the relationship to a structured entity is that often the voting or similar rights are not the means by which a securitisation vehicle could be controlled (as the equity is usually held by a Stichting). The relevant activities of the structured entity are rather directed by means of contractual arrangements. If these contracts are tightly drawn, it may appear that none of the parties seems to have power. However, 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 and considered in aggregate. Nevertheless, such detailed analysis may well lead to the conclusion that there is no party that controls and has to consolidate the securitisation vehicle.

Consolidation - Silos (Compartments)

Another important consideration in relation to securitisation vehicles is the potential for the existence of silos. Silos consist of specific assets and liabilities of an entity that might, in certain circumstances, be ring-fenced from the entity's other assets and liabilities. A silo typically has no separate legal entity but consists of a portfolio of assets and liabilities that are contractually separated from (and do not share risk with) other assets and liabilities in the same legal entity. The assets of each individual silo are not available to the creditors of any other part of the same entity. A compartment of a Luxembourg securitisation vehicle perfectly matches this definition and would usually be treated as "silo" under IFRS 10.

Where the conditions set out below are met, the silo would be viewed as "deemed separate entity" for the purpose of IFRS 10. As a consequence, an investor or originator of the silo would have to assess whether it has control over the silo rather than assessing control over the whole legal entity. This can result in the originator or the investor consolidating only a part of the securitisation vehicle, i.e. his compartment only.

IFRS 10 states that an investor or originator should treat a portion of an investee (i.e. a silo) as a deemed separate entity only if the following conditions are satisfied:

- The investee's specified assets (and any related credit enhancements) are the only source of payment for specified liabilities of, or specified other interests in, the investee;

- Parties other than the investee with the specified liability do not have rights or obligations related to the investee's specified assets or to residual cash flow from those assets;

- In substance, none of the returns from the investee's specified assets can be used by any remaining investee, and none of the liabilities of the deemed separate entity are payable from the assets of any remaining investee;

- In substance, all of the assets, liabilities, and equity of the deemed separate entity are ringfenced from other investors.

If it is concluded that the investor/originator has control following this analysis, it should consolidate the silo. The other investors in the entity will then need to exclude that portion of the investee in their own assessment of control.

The exception to consolidation: Investment entity

Assuming that the analysis leads to the conclusion that a securitisation vehicle (or compartment) is controlled for accounting purposes by one of the involved parties, that entity shall normally consolidate the vehicle/silo. However, IFRS 10 includes an exception to this rule for parent entities considered as "investment entities". If the criteria of an investment entity are fulfilled, as described in Figure 28, then IFRS 10 prohibits the parent from consolidating its subsidiaries/investments line-by-line and requires these to be accounted for at FVPL. This requirement does not apply to subsidiaries that are not themselves investment entities and whose main purpose is to provide services relating to the investor's investment activities.

An investment entity is defined as an entity that holds investments for the sole purpose of capital appreciation, investment income (such as dividends, interest or rental income), or both. The most useful information for such an entity is provided by measuring all investments, including investments in subsidiaries, at fair value.

In addition, the following typical characteristics of an investment entity must be considered:

- holding more than one investment (this might refer to both equity (share investments) and debt (receivables) investments;

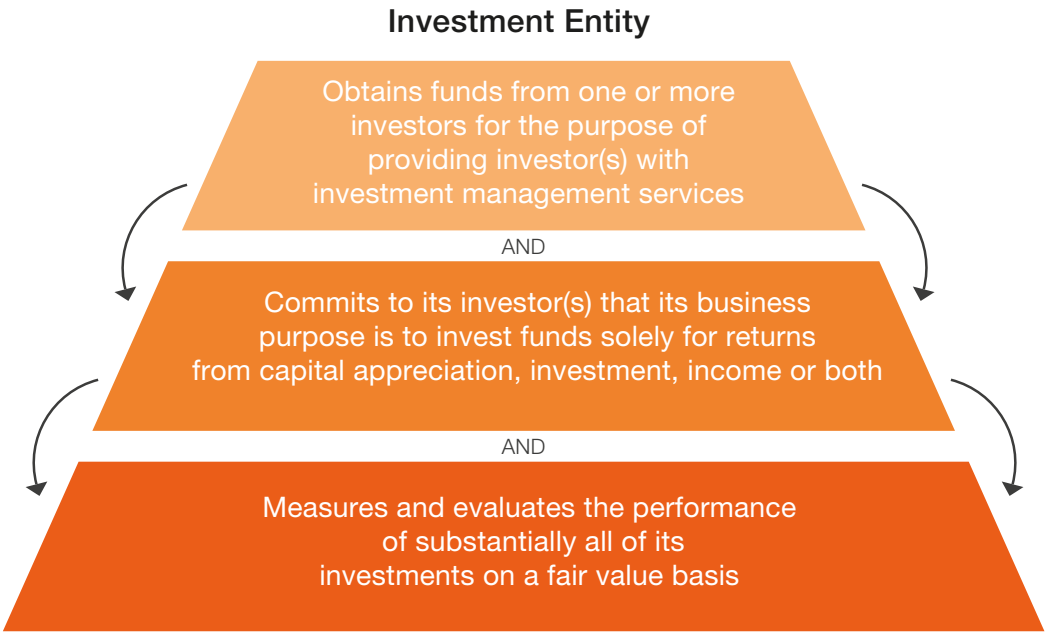
- having more than one investor;

- having investors that are not the entity's related parties; and

- having ownership interests in the form of equity or similar interests.

These typical characteristics are indicative and supplement the general definition of the term "investment entity" in order to allow the use of judgement in assessing whether an entity qualifies as an investment entity. To ease the process, we recommend that an investor controlling a securitisation vehicle shall firstly assess whether it qualifies as investment entity before consolidating the securitisation vehicles line-by-line.

Figure 28: Definition of an investment entity



Consolidation – Disclosures

IFRS 12 contains disclosure requirements for consolidated financial statements and intends to give relevant information to users to help them understand judgements and assumptions made, such as about controlling another entity. Even if an investor/originator has concluded that the securitisation vehicle shall not be consolidated, IFRS 12 requests transparency about the risks that the investor/originator is exposed to due to its involvement with structured entities.

These requirements include:

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

4.3 Other reporting requirements

BCL/ECB statistical reporting

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

These regulations and the BCL Circular are applicable to Luxembourg securitisation vehicles subject to the Luxembourg Securitisation Law (companies and funds), as well as to commercial companies outside the scope of the Luxembourg Securitisation Law but conducting securitisation transactions.

The BCL 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 based on private placements.

In its 2013 FAQ, the BCL distinguishes three types of securitisations for statistical purposes:

a) Traditional securitisation, referring to a securitisation involving the economic transfer of the exposures being securitised to a FVC which issues securities. This is 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 FVC that do not fall in the first two categories.

Each vehicle falling under this securitisation definition must comply with the below BCL reporting requirements.

First, each concerned Luxembourg securitisation vehicle shall proactively inform the BCL of its existence within one week after its incorporation date irrespective whether it expects to be subject to any of the statistical reporting requirements. A registration form is available on the BCL website. Afterwards, the securitisation vehicles must provide the BCL regularly with information about their assets and liabilities and the transactions made.

This information contains details on the securitised assets, including a breakdown of the country and economic sector of the counterparts, the currency and maturity as well as nominal values. Also, information about the issued securities needs to be provided.

The data must be filed with the BCL within 20 working days 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”.

The BCL annually establishes and publishes on its website a calendar of remittance dates on which the monthly and quarterly statistical reports must be submitted to the BCL.

Therefore, the reporting entity must ensure that all the data is made available in time to comply with the BCL requirements.

However, small-sized securitisation vehicles are exempted from the reporting requirements, apart from the obligation to report, end-of-quarter outstanding amount data on total assets. The exemption threshold is defined based on the principle that the securitisation vehicles subject to reporting provide a coverage rate of at least 95% of the aggregated assets of all Luxembourg securitisation vehicles. The threshold is compiled on yearly basis and currently amounts to EUR 70 million (on a combined level).

For more detailed information see: https://www.bcl.lu/en/Regulatory-reporting/Vehicules_de_titrisation/index.html

Nevertheless, all securitisation vehicles concerned, even those exempted from regular reporting, must provide their annual accounts to the BCL if they are not public, i.e., published in the Luxembourg Trade and Companies Register 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.

As per BCL circular letter ST-24-0013 (“2024 BCL Circular Letter”) from 16 January 2024, as from May 2024, the ECB and the BCL will be monitoring reporting agents’ compliance with the statistical reporting requirement laid down in ECB regulations and decisions. A database will record the various infringements detected during the production month. Sanctions up to EUR 200,000 may be imposed by the ECB following an infringement procedure in the event of non-compliance with minimum standards for compliance with transmission, for compliance with accuracy and for compliance with concepts. Furthermore, serious misconduct (as defined in the 2024 BCL Circular Letter) will also be recorded and sanctions may be imposed by the ECB. In some cases, the concerned reporting agent may submit a remedial plan, based on which the BCL may decide not to initiate the infringement procedure for the same alleged infringement before the expiration of the final deadline or extension of the remedial plan.

EU Securitisation reporting

Entities falling in the scope of the EU Securitisation Regulation need to do additional extensive and standardised reporting under the transparency requirements of EU Securitisation Regulation. This is described in more detail in chapter 6.

4.4 An overview of reporting requirements

Securitisation vehicles are subject to various reporting requirements, at different levels and jurisdictions. The following list is non-exhaustive and is based on financial year closing end-December:

- **January**
  - 15/01 - Quarterly VAT return
  - 31/01 - Quarterly statistical reporting to BCL (report of December)
  - 31/01 - Submission to CSSF of draft annual accounts for supervised vehicles
- **March**
  - 01/03 Annual VAT return concerning N-1 financial year
- **April**
  - 15/04 - Quarterly VAT return
  - 30/04 - Transparency annual reporting
  - 30/04 - Audited annual accounts to be filed for vehicles under Transparency and Annual VAT return (Y-1) deadlines are commonly observed on 31 October (simplified VAT regime) and 31 December (full VAT regime)
  - 30/04 - Quarterly statistical reporting to BCL (report of March)
- **June**
  - 30/06 - AGM approving audited annual accounts (+ 6 months after closing)
  - 30/06 - FATCA/CRS annual reporting
- **July**
  - 15/07 - Quarterly VA return
  - 28/07 - Quarterly statistical reporting to BCL (report of June)
  - 31/07 - submission to CSSF of semi-annual for supervised vehicles
  - 31/07 - Filling for audited annual accounts (+ 7 months after closing)
- **September**
  - 30/09 - Transparency semi-annual reporting
- **October**
  - 15/10 - Quarterly VA return
  - 31/10 - Quarterly statistical reporting to BCL (report of September)
- **December**
  - 31/12 - Annual Net Wealth Tax return for N financial year
  - 31/12 - Annual CIT/MBT for N-1 financial year

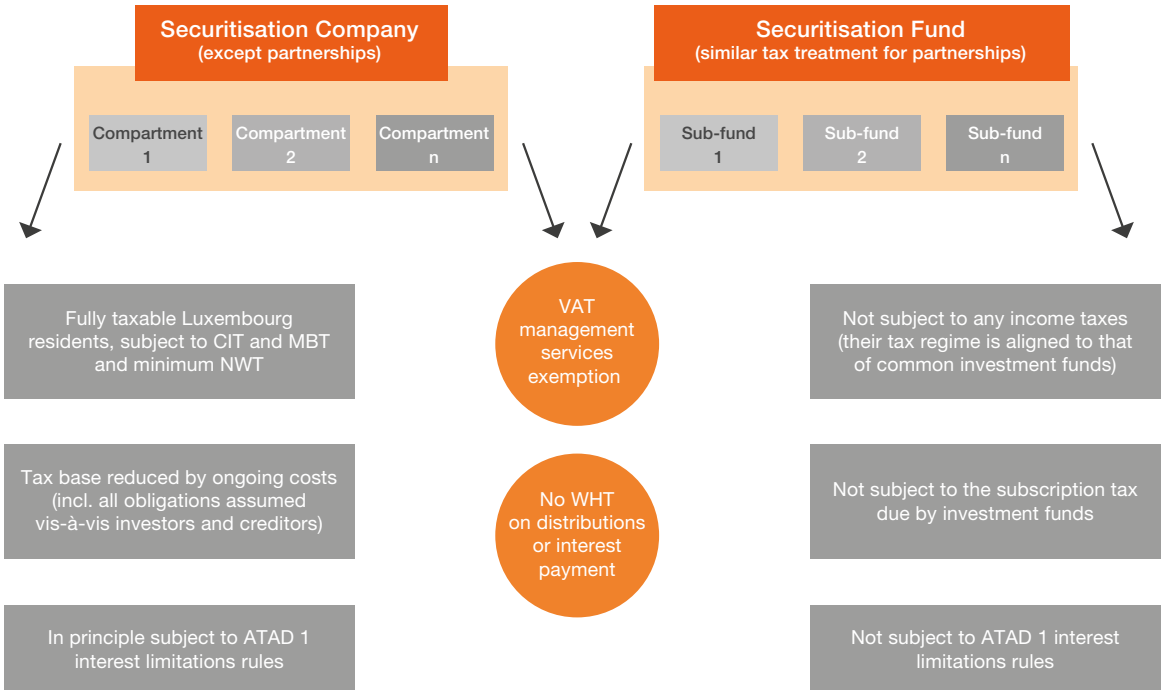
05

Taxation aspects

Taxation aspects

The Luxembourg Securitisation Law has been successful in achieving almost complete tax neutrality. The following scheme shows the different types of taxes applicable to the two types of securitisation vehicles, securitisation companies and securitisation funds (see Figure 29).

Figure 29: Tax treatment of securitisation vehicles depending on their legal form



5.1 Tax specificities of securitisation companies

Securitisation corporate entities

Securitisation vehicles organised as corporate entities (i.e. SA, SARL, SCA, SAS and Scoop SA) are, as a rule, fully liable to corporate income tax ("CIT") and municipal business tax ("MBT") at an aggregate tax rate of 23.87% (tax rate applicable for 2025 for entities based in Luxembourg City, taking into account the solidarity surcharge of 7% on the corporate income tax rate of 16% and including the 6.75% municipal business tax rate).

Income tax

Securitisation corporate entities are in principle taxed on their net accounting profits (i.e., gross accounting profits minus expenses). Exception to this principle can happen when the securitisation corporate entity invests in entities that should be regarded as transparent for Luxembourg tax purposes.

The tax status as a corporate entity may be important for the securitisation vehicle to secure tax treaty benefits depending on the nature of the assets. In that respect, conditions to be met to get tax treaty access should be analysed from the source country perspective on a case-by-case basis.

An interesting feature is that, according to the Luxembourg Income Tax Law ("LIR"), as amended by the Luxembourg Securitisation Law, a securitisation company's commitments to remunerate investors for issued bonds or shares and other creditors qualify as tax deductible expenses even if paid as return on equity (for which the commitment to distribute would normally have to be materialised by a decision of the Board taken before year-end). Accordingly, they shall be considered as tax deductible expenses for CIT and MBT purposes, so the tax liability should be rather limited unless such commitments can be regarded as borrowing costs not fully tax deductible because of the interest limitation rules (see chapter 5.7.1.1).

Thus, the shareholders of a securitisation corporate entity are treated like bondholders in this respect. Dividend distributions made by a securitisation company are thus as much exempt from withholding tax as interest payments are.

Net wealth tax ("NWT")

All securitisation vehicles organised as corporate entities, though excluded from the general net wealth tax obligations, fall within the scope of the minimum NWT. Securitisation vehicles organised as partnerships are not liable to NWT.

From tax year 2025 on, the minimum NWT amounts to:

- EUR 535 for a balance sheet total up to and including EUR 350,000;
- EUR 1,605 for a balance sheet total exceeding EUR 350,000 up to and including EUR 2 million;
- EUR 4,815 for a balance sheet total exceeding EUR 2 million.

Securitisation partnerships

Securitisation vehicles organised as partnerships (i.e., SCS, SCSp or SNC) are, as a rule, not liable to CIT unless they qualify as a reverse hybrid entity. They should not be subject to MBT as long as they are not conducting a commercial activity or are not deemed to conduct a commercial activity in Luxembourg.

As the Luxembourg Securitisation Law allows an active management of a portfolio of debt instruments, a securitisation vehicle set up as a SNC, SCS or SCSp could be regarded in certain circumstances as carrying out a commercial activity. Moreover, a SNC should be deemed to conduct a commercial activity in Luxembourg if it is held by Luxembourg capital companies representing at least 50% of the interest while a SCS and SCSp should be deemed to conduct a commercial activity in Luxembourg if the general partner is domiciled in Luxembourg and holds an interest of at least 5% in the SCS or SCSp. This is usually not the case in practice.

Fiduciary structures

In case of a fiduciary structure, assets held by the securitisation vehicle acting as the fiduciary for the account of the fiduciant are regarded as held by the fiduciant for Luxembourg CIT, MBT and NWT purposes by application of § 11 of the Steueranpassungsgesetz of 16 October 1934. Consequently, only the fiduciant will be taxed on the income, gains and wealth derived from the assets when resident in Luxembourg. In the presence of a non-Luxembourg resident fiduciant, such fiduciant will be taxable in Luxembourg only on Luxembourg sourced income unless it holds these assets through its own Luxembourg permanent establishment but may of course be taxable in its country of residence.

5.2 Transfer pricing aspects

A general transfer pricing regime is included in the Luxembourg tax code applying to all transactions between associated companies. This is per se also applicable to securitisation companies yet normally not to securitisation funds or partnerships. The legislation restates the arm's length principle, which becomes more aligned with the Model Tax Convention of the Organisation for Economic Co-operation and Development ("OECD"). The provisions provide for both upward and downward profit adjustments where transfer prices do not reflect the arm's length principle. In addition, the legislation clarifies that the current disclosure and documentation requirements for taxpayers to support their tax-return positions also apply to transactions between associated enterprises.

Yet, a securitisation company is normally not involved in intra-group financing activities (e.g., it does not hold loan receivables from related parties) and, therefore, transfer pricing rules should not have a significant impact on the securitisation companies and related tax treatment. However, it is recommended to undertake a detailed analysis to verify that approach, including the analysis from the source country perspective, on a case-by-case basis as some securitisation transactions may still contain related party transactions from a transfer pricing perspective.

For a securitisation fund managed by a Luxembourg management company or for the Luxembourg partnership (SCS, SCSp) that are managed by a Luxembourg general partner taking the form of a Luxembourg SARL, such Luxembourg SARL should be properly remunerated for its functions performed and risks incurred.

5.3 Access to Double Tax Treaties

Since securitisation vehicles organised as corporate entities (i.e., excluding partnerships and funds) are fully taxable resident entities, they are expected to benefit from Luxembourg's tax treaty network and from the EU Parent-Subsidiary Directive. As at 31 December 2024, Luxembourg has concluded 88 treaties and 11 others are under negotiation or still subject to ratification (see Figure 30).

Figure 30: Luxembourg Double Tax Treaty (DTT) network

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

The DTTs with countries marked with * are under negotiation or subject to ratification.

5.4 Tax specificities of securitisation funds

Since securitisation funds are treated in the same way as investment funds for Luxembourg taxation, they are exempt from CIT, MBT and NWT. Securitisation funds furthermore benefit from a subscription tax (“taxe d’abonnement”) exemption.

The unitholders of the securitisation fund are treated like bondholders. Dividend distributions and payments on fund units are thus exempt from withholding tax.

From the investors’ tax perspective, the securitisation funds are likely to be treated as tax transparent vehicles (this would need to be verified with the relevant analysis on a case-by-case basis), which means that income taxes would not apply on the level of the securitisation fund.

5.5 FATCA/CRS

FATCA

The Foreign Account Tax Compliance Act ("FATCA") rules have been incorporated in the US tax legislation and regulation to fight tax evasion by US persons holding accounts or investments abroad.

The regulations impose documentation of due diligence, an identification of "US accounts" and a reporting and withholding obligation on Foreign Financial Institutions ("FFIs") that enter into an agreement with the Internal Revenue Service ("IRS"). FFIs that do not enter into such agreements would be subject to a 30% withholding tax on certain US source income (notably interests and dividends) and possibly on some non-US source income in the future (notion of pass-thru payment still being reserved for future guidance). To help Luxembourg Financial Institutions to comply with FATCA, Luxembourg signed an Intergovernmental Agreement ("IGA") with the US. 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.

Based on the Circular ECHA n°2 issued by the Luxembourg tax authorities, an authorised securitisation vehicle should qualify as FFI (i.e., Investment Entity) for FATCA purposes. In this case, we recommend conducting a FATCA analysis to assess whether a Non-Reporting FI status might be applicable.

With respect to a securitisation vehicle that is not authorised by the CSSF, it would need to be analysed on a case-by-case basis whether the securitisation vehicle might be considered as an Investment Entity or whether it might qualify as Non-Financial Foreign Entity (NFFE). Whether the securitisation vehicle would issue debt securities to investors and market itself as an investment vehicle are key elements of that analysis. Depending on the result of the analysis, different obligations will arise (please refer to the CRS chapter for more details).

CRS

Like FATCA, the Common Reporting Standard ("CRS") requires 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 intergovernmental exchange of financial account information, as reported to tax authorities by Financial Institutions and covering accounts held by individuals and entities, including trusts and foundations.

Depending on its activities, nature of assets, the number and volatility of its equity and debt holders as well as its regulation, a securitisation vehicle might be considered as a Financial Institution for CRS purposes as well. To assess the potential effects and obligations derived from the CRS status of the vehicle, a thorough analysis will definitely be required.

Please note that if the securitisation vehicle qualifies as a Luxembourg Reporting Financial Institution, it would need to:

- Identify holders of equity and debt instruments it issued (and in some cases, their Controlling Persons) by collecting a CRS self-certification;
- Ensuring that such documentation is (and remain) complete and reasonable base on the CRS rules, AML documentation and publicly available information;

- Report on an annual basis the value of those instruments as well as any gross amounts paid to those holders;

- Notify any reported persons that would be an individual on the content of the upcoming report at least one month prior to the filing of the CRS report so that they could exercise their rights of access and rectification of data.

In addition, a governance around those regulations should be put in place and must include written policies and procedures, control over delegated functions and IT systems proportional to the size of the organisation.

5.6 Value-added Tax (VAT)

5.6.1 VAT status of Luxembourg securitisation vehicles

Securitisation vehicles qualify as VAT taxable persons in Luxembourg.

Due to their VAT taxable person status, securitisation vehicles are required to register for VAT in Luxembourg and to file VAT returns if:

- they perform activities allowing input VAT recovery (e.g., portfolio of interest-bearing loans directly held with non-EU counterparts); or

- in absence of activities allowing input VAT recovery, they receive taxable services from non-Luxembourg suppliers on which they are liable to self-account for Luxembourg VAT under the reverse-charge rule (or in the unlikely event they acquire goods transported to Luxembourg from another EU Member State and those acquisitions exceed EUR 10,000 in a calendar year).

VAT on costs incurred by a securitisation vehicle that are directly linked to activities allowing input VAT recovery is deductible, whereas VAT on costs directly linked to activities not allowing input VAT recovery is not deductible. The input VAT recoverable on overhead expenses incurred by a securitisation vehicle should be determined on a case-by-case basis, based on the activities or the investments performed by the securitisation vehicle.

Securitisation vehicles without input VAT recovery right and liable to self-assess Luxembourg VAT under the reverse charge mechanism are only required to file a single short-form VAT return per calendar year to declare their expenses from abroad. However, the VAT authorities can request the filing of periodic and annual recapitulative VAT returns if certain thresholds of reverse chargeable services received by the securitisation vehicle (or goods acquired and transported from another EU Member State to Luxembourg) are exceeded.

It is also important to note that a securitisation vehicle that, at its own risk, purchases defaulted debts at a price below their face value does not perform activities in the scope of VAT when the difference between the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment. A careful analysis of the activities performed by each securitisation vehicle should therefore be made to determine the VAT status of such entities and their reporting requirements correctly.

5.6.2 VAT exemption of management services rendered to securitisation vehicles

Article 135 (1) (g) of the VAT Directive 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 eligible funds/ vehicles. As this list includes securitisation vehicles, management services rendered to Luxembourg securitisation

vehicles are consequently VAT exempt. This is a competitive advantage of Luxembourg compared to some other jurisdictions.

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. The Luxembourg VAT authorities have clarified in their Circular letter 723bis the VAT exemption of outsourced fund management services. 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. If only 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.

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 can significantly reduce the amount of irrecoverable VAT and operational costs.

5.7 Anti-Tax Avoidance Directives (ATAD)

The international tax system is constantly changing due to coordinated actions taken by governments and unilateral measures designed by individual countries, both intended to tackle concerns over base erosion and profit shifting ("BEPS") and perceived international tax avoidance techniques of high-profile multinationals. The recommendations of the BEPS project led by the OECD are at the root of much of the coordinated activity, although the timing and methods of implementation vary.

The EU followed the above trend with the Anti-Tax Avoidance package, i.e. ATAD 1, ATAD 2 and Draft ATAD 3 – together known as "ATAD" – as well as with the Directive of 25 November 2022 introducing a global minimum level of taxation for multinationalenterprise groups and large-scale domestic groups in the European Union (so called "Pillar 2 Directive").

5.7.1 Anti-Tax Avoidance Directives (ATAD 1/2/3)

ATAD basically sets out minimum standards that the EU Member States need to adhere to in several areas covered by the OECD works on the BEPS initiative including, inter alia, (i) rules on the deductibility of interest limitations addressed in ATAD 1 and (ii) rules on how to tackle hybrid mismatches (between EU Member States as well as between EU Members States and non-EU countries) addressed in ATAD 1 and ATAD 2. Whereas ATAD stipulates minimum standards to be applied to all taxpayers subject to corporate tax in one or more EU Member States, it does not prohibit other anti-avoidance rules designed to give greater protection to the corporate tax base.

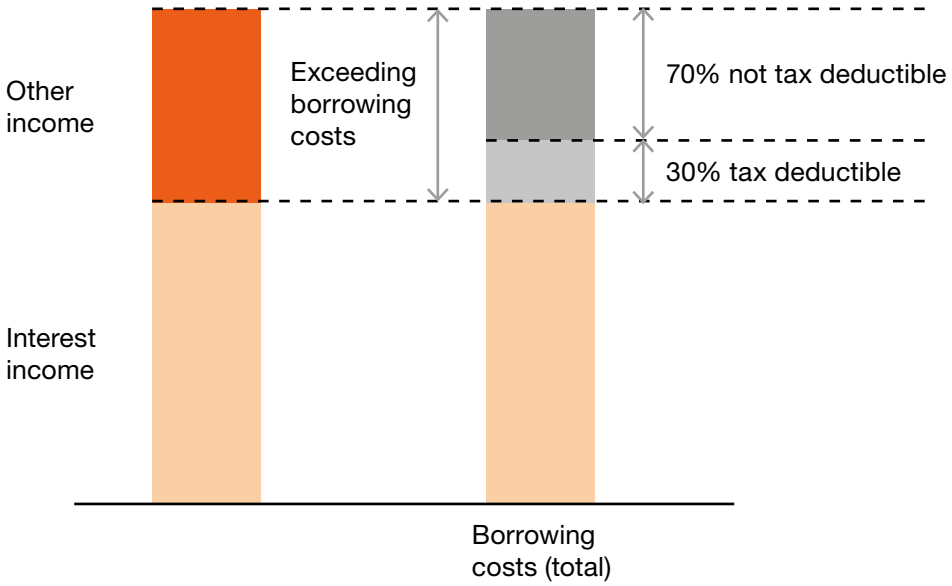
The "ATAD 1 Law" entered in to force on 1 January 2019 and introduced (i) interest limitation rules and (ii) antihybrid mismatch rules between EU Member States. From 1 January 2020, the "ATAD 2 Law" introduced anti-hybrid mismatch rules with third countries.

Moreover, on 22 December 2021, the European Commission released Draft ATAD 3 that aims to prevent the misuse of shell entities for tax purposes that could limit the tax benefit claimed and would have been applicable as from 2024. Draft ATAD 3 would be applicable to securitisation companies with an exemption for those falling under the EU Securitisation Regulation. However, Draft ATAD 3 still needs to be approved by the Council of the European Union and may likely be significantly altered before approval. As such, the final text and effective date is uncertain.

5.7.1.1 Interest limitation rules (ATAD 1)

The aim of the interest limitation rules is to limit the tax deduction of interest expense that exceeds the amount of interest income or income economically equivalent to interest income (i.e., exceeding borrowing costs) to 30% of the EBITDA of the taxpayer (see figure 31). Tax exempt revenues like dividend income and capital gains derived from qualifying participation ("parent-subsidiary regime") shall be excluded when computing the EBITDA of the taxpayer.

Figure 31: Illustration of the concept of exceeding borrowing costs



As the interest limitation rules apply only to Luxembourg entities subject to corporate tax and to foreign entities having a Luxembourg permanent establishment, securitisation funds or (normally) partnerships, that are not subject to CIT, are also not subject to these interest limitation rules .

However, securitisation vehicles organised as corporate entities (e.g., SA, SARL, SCA, Scoop SA and SAS) which are fully subject to CIT are in scope of the interest limitation rules, unless an exemption applies. Conversely, securitisation vehicles organised as partnerships (i.e., SCS, SCSp or SNC) which are not liable to CIT should not be subject to the interest limitation rules unless they constitute a permanent establishment in Luxembourg for their non-resident partners. In theory, this could happen only if the partnership conducts a commercial activity through a fixed place of business in Luxembourg. Therefore, it is important that securitisation partnerships do not carry any commercial activity through a fixed place of business. Moreover, limited partners of the securitisation partnership should not be Luxembourg corporate entities as by transparency these latter would be regarded as holding the assets of the partnership.

Available exemptions

The ATAD 1 Law provides for multiple exemptions as follows:

De minimis rules of EUR 3 million per year

The exceeding borrowing costs incurred during the financial year are deductible without any limitation up to EUR 3 million. This amount needs to be calculated at the company level and not on a compartment level

Grandfathering for debt instruments concluded before 17 June 2016

When determining the amount of exceeding borrowings costs, a taxpayer may exclude borrowings costs arising from borrowings concluded before 17 June 2016. The exclusion shall not extend to any subsequent modification of the debt

instrument or agreement, which means that the amount of deductible borrowing costs should be computed as if no amendments took place. Therefore, interest expenses on debt instruments issued before 17 June 2016 (subject to review of their potential amendments and their effects on the initial debt) should not be subject to these interest limitations rules.

In their administrative circular of 8 January 2021, the Luxembourg tax authorities took the position that any drawdown made under a credit facility concluded before 17 June 2016 should also be grandfathered even when they have been made after that date so that one could conclude that any payment made under notes issued under terms and conditions agreed prior to 17 June 2016 should be grandfathered and therefore should not be subject to the interest limitations rules.

Stand-alone entity

The ATAD 1 Law provides that a stand-alone entity is exempted from the interest limitation rules. The ATAD 1 Law defines a stand-alone entity as a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise (to be understood as an entity which includes trusts, foundations, and Stichtings holding directly or indirectly more than 25% of the share capital, voting rights or profits entitlements of the taxpayer. According to the administrative circular of 8 January 2021, the 25% threshold must be analysed from an economic perspective) or no Luxembourg permanent establishment.

Based on common understanding, securitisation companies whose shares are held by a trust, foundation, or Stichting are usually considered as “orphan”.

As a result of the provisions of the ATAD 1 Law, a securitisation company fully held by a single trust, foundation, or Stichting that can be regarded as the beneficial / economic owner should not be regarded as a stand-alone entity and should thus be in scope of the interest limitation rules.

EU securitisation vehicles

Securitisation companies in the meaning of Article 2 point 2 of the EU Securitisation Regulation are currently out of scope of the interest deduction limitation rules. In substance, this will suppose the existence of securitisation of credit risk and the subordination of its financing through tranching.

However, in the May 2020 infringements package, the European Commission requested Luxembourg to amend the ATAD 1 Law considering that this exemption goes beyond the allowed exemptions even though it is an exemption foreseen in Draft ATAD 3. Because of this, on 9 March 2022, the Luxembourg government released a draft bill n°7974 to remove this exemption for tax years starting on or after 1 January 2023. As this draft bill has not been voted yet, there is a question mark if such law will still apply for tax years starting on or after 1 January 2025 if voted in the course of 2025.

On 20 February 2024, the European Commission brought action against Luxembourg to the European Court of Justice declaring that, in its view, Luxembourg has failed to fulfil its obligations under ATAD 1 by adding securitisation special purpose entities (as defined in the EU Securitisation Regulation) to the list of financial undertakings excluded from the interest limitation rules.

Alternative Investment Funds

Alternative Investment Funds (“AIF”) in the meaning of the AIFMD are out of scope. Therefore, a securitisation company qualifying as an AIF in the meaning of the AIFMD, should not be subject to the interest limitation rules.

Equity ratio exemption

When the Luxembourg securitisation company meets the conditions to be consolidated for accounting purposes before application of any exemption, the indebtedness of the consolidated group may be considered for the purpose of assessing whether the interest limitations rules apply. In other words, if the debt-to-equity ratio of the securitisation company is not lower than 2% compared to the debt-to-equity ratio of the consolidated group, the interest limitation rules do not apply to the securitisation company. Such exemption must be claimed every year in the tax return of the securitisation company.

Single entity group exemption

The 2025 Finance Act introduced in the Luxembourg tax law the concept of single entity group. The modification aims to allow a taxpayer who is not part of a consolidated group for financial accounting purposes and not being considered as a stand-alone entity, to deduct, on request, the entirety of its exceeding borrowing costs provided that it can demonstrate that the ratio between its equity and all of its assets is equal to or greater than the equivalent ratio of the single entity group (while a 2% points margin would be acceptable).

The ratio of the single entity group should be calculated according to specific rules which provide that the amount of equity of the single entity group is to be increased by the amounts due to associated companies. This mechanism for calculating the group ratio aims to ensure that only taxpayers who are indebted to companies that are not associated companies are eligible to request the benefit of this safeguard clause. It should be noted that for the purposes of this calculation, the borrowing costs to be considered are those due to associated companies within the meaning of article 168ter LITL.

This provision is already applicable as from the fiscal years beginning on or after 1 January 2024.

This exemption for single entity group can notably apply to orphan securitisation companies that are not part of a consolidated group and which do not have debt with associated enterprises.

Importance of the definition of exceeding borrowing costs

When the securitisation company cannot rely on any of the above exemptions, it is important to compute the amount of exceeding borrowing costs. Borrowing costs are defined in the ATAD 1 Law as interest expenses on all forms of debt and other costs economically equivalent. The rule applies to any financing, irrespective of whether provided by related parties or third parties. The ATAD 1 Law provides the following non-exhaustive list of borrowing costs:

- Remuneration due under profit participating loans;
- Imputed interest on instruments such as convertible bonds and zero coupon bonds;
- Amounts disbursed under alternative financing arrangements, such as Islamic finance;
- Finance cost element of finance lease payments;
- Capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest;
- Amounts measured by reference to a financial return under transfer pricing rules where applicable;

- Notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings;
- Certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance;
- Guarantee fees for financing arrangements;
- Arrangement fees and similar costs related to the borrowing of funds.

In practice, securitisation companies not having significantly more interest expenses than interest income should thus not be substantially impacted by the interest limitation rules.

One of the issues for some securitisation companies comes from the fact that the ATAD 1 Law does not provide a clear definition or guidance for interpretation of what constitutes interest revenue and other economically equivalent taxable revenue.

However, in their administrative circular of 8 January 2021, the Luxembourg tax authorities consider that regarding the definition of interest revenue and other revenue economically equivalent to interest revenue, a symmetrical approach should be followed, i.e. what is regarded from a Luxembourg tax perspective as interest expenses on all forms of debt payable or other expenses economically equivalent to interest expenses according to the law shall be regarded as interest revenue and revenue economically equivalent to interest revenue when accrued on all forms of debt receivables (and vice versa).

In this context, the Luxembourg tax authorities consider that foreign exchange gains on debt principal should not be regarded as interest revenue (while foreign exchange gains on accrued interest should be regarded as interest income) and impairments booked on debt instruments should not be regarded as borrowing costs. Conversely, one could conclude that a reversal of an impairment should not be regarded as interest income.

The administrative circular does not expressly address the tax treatment applicable to gains made from performing and especially non-performing loans bought at a discount. This creates some uncertainties for the taxpayers that cannot benefit from one of the above-mentioned exemptions. Therefore, each transaction should be analysed on a case-by-case basis to determine if the gains could be regarded as economically equivalent to interest income or not.

Similarly, uncertainty remains for the tax treatment applicable to distributions / commitments made by securitisation vehicles that have the particularity to be in principle tax deductible. Depending on the terms of the instruments held by the investors, any payment made by the securitisation company may be regarded or not as borrowing costs subject to interest limitation rules.

Practical implications

We have analysed the most common securitisation transactions with regards to the potential implications the ATAD 1 Law might have on them in case an exemption is not available. The following simplified examples reflect our general view based on our interpretation of the text of the ATAD 1 Law and OECD BEPS Action 4 (on which ATAD 1 is based) as well as tax circulars. They shall not be understood as general guidance on specific structures; a case-by-case ATAD 1 analysis by a tax expert would still be required in most cases.

- Transactions paying (or accruing) regular interest income to the securitisation vehicle should normally not be adversely impacted by the ATAD 1 Law. Those payments to noteholders that qualify as borrowing costs would thus remain deductible up to that amount of interest income. Typical interest receiving

transactions are mainly securitisations of bonds, performing loans, trade or leasing receivables. Also discounts received on those assets are usually accounted for as interest to which they are economically linked. For non-performing loans, the situation is more complex and the tax treatment of gains from repayments above acquisition costs of the non-performing loans as interest revenue or economically equivalent revenue depends on the specific situation. In some circumstances, notably based on the expected internal rate of return ("IRR"), a fraction of the return derived from non-performing loans could be considered as economically equivalent to interest income for accounting and tax purposes.

- Repackages of investment funds refinanced by notes issued are another common form of securitisation in Luxembourg. If the underlying funds are paying dividends which are distributed as variable interest to the noteholders, we expect a negative impact of the interest limitation rule due to the asymmetry of the type of cash flow. If the repayable amount of the notes tracks the net asset value of the underlying funds (regardless of the dividend case described before), the realisation of the asset would result in a capital gain (loss). Such gain would then normally be paid out to the noteholders in form of an increased (decreased) repayment amount, i.e. a capital loss (gain) for the securitisation company. Based on the principle of symmetry, one could argue that neither the capital gain or loss from assets nor from notes issued should be treated as interest revenue or borrowing costs respectively, and therefore the interest limitation rule should not have an impact. In their administrative circular, the Luxembourg tax authorities do not address this specific case. They only describe that a premium paid upon repayment of a debt instrument can be regarded as borrowing costs when such premium can be regarded as imputed interest on debt instruments such as convertible bonds and zero coupon bonds. The application of the interest limitation rules to the specific example described above remains uncertain.

- Another important part of the Luxembourg securitisation market consists of structured products, i.e. the issuance of performance linked certificates. Typically, the proceeds of the certificates issued are invested into debt instruments, like a bond or a deposit. The interest from the debt instrument is then swapped into the performance promised to the certificate holders. For structures with a debt instrument as underlying, the amount received is booked as interest revenue and as the swap or derivative instrument payments are hedging this income, any payment made and received under the swap of the derivative instrument could be regarded as respectively borrowing costs and interest revenue. Therefore, as in this scenario only interest revenue would be considered as received by the securitisation vehicle, all borrowing costs accruing under the notes issued should remain fully tax deductible. For other forms of underlyings, this may be less obvious and we recommend performing an in-depth analysis as tax implications may vary on a case-by-case basis.

5.7.1.2 Anti-hybrid mismatch rules (ATAD 2)

The ATAD 1 Law and ATAD 2 Law also introduced rules to tackle hybrid mismatches that are defined as situations resulting in either a deduction without inclusion or a double deduction for tax purposes. Such situations can happen amongst others in the presence of payment made under a hybrid instrument or payment made to or by a hybrid entity. Moreover, such hybrid mismatch must notably result from either a structured arrangement or an arrangement between associated enterprises.

There can be a hybrid mismatch when an investor subscribes to an instrument (e.g. note, certificate, warrant) through a hybrid entity which is regarded as tax transparent in its jurisdiction of residence and as a taxable entity under the laws of the jurisdiction of the investor which leads to a deduction at the level of the securitisation company and an absence of inclusion at the level of the investor.

However, unless the case of a structured arrangement as defined in the ATAD 2 Law, such anti-hybrid mismatch rules only apply between associated enterprises which supposes that the investor holds directly or indirectly a participation of more than 25%

in the securitisation company in terms of voting rights, capital ownership, or entitlement to profits or consolidate the securitisation company or has a significant influence over the securitisation company. Such percentage is set at 50% when the investor holds the participation in a securitisation company through a hybrid entity. Investors acting together shall be aggregated to determine these 25% or 50% thresholds.

As investors are often not meeting the conditions to be regarded as associated enterprises particularly when they are not shareholders but only creditors, such anti-hybrid mismatch rules provided by the ATAD 1 Law and ATAD 2 Law should in practice have limited implications for the majority of the securitisation companies. Nevertheless, it is recommended to undertake detailed analysis to verify the absence of implications of the ATAD 1 Law and ATAD 2 Law notably when investors are also shareholders of the securitisation company/partnership or unitholders of the securitisation fund.

5.7.1.3 Anti-shell entities rules (ATAD 3)

On 22 December 2021, the European Commission released a draft ATAD 3 directive that aims to prevent the misuse of EU shell entities for tax purposes that could limit the tax benefit claimed and should have been applicable since 2024. It would also apply to Luxembourg securitisation companies if no exemption applies.

A shell entity is defined as an entity domiciled in the EU that does not meet the minimum cumulative substance indicators that are (i) premises available for the exclusive use of the undertaking, (ii) a bank account open and active in the EU and (iii) at least one qualified director who is tax resident in the same Member State. Such shell entities will no longer be able to get a tax certificate unless it can demonstrate that it has been set up for genuine economic reasons (i.e. non-tax reasons) or there is no tax benefit for its beneficial owner(s).

Interestingly, the draft ATAD 3 provides for an exemption for companies which have transferable security (equity or debt instruments) admitted to trading or listed on a regulated market or multilateral trading facility as defined under Directive 2014/65/ EU as well as for regulated financial undertakings that include securitisation special purpose entities as defined in the EU Securitisation Regulation.

Final provisions of ATAD 3 have not been agreed yet by the ECOFIN which requires unanimity between Member States and therefore it is unlikely that ATAD 3 will be applicable before 2026 and the draft text may well be significantly altered in the meantime

5.7.2 Pillar 2 Directive

On 15 December 2022, the EU Member States adopted the Directive 9778/22 introducing a global minimum level of taxation of 15% for multinational enterprise groups and large-scale domestic groups in the European Union (the “Pillar 2 Directive”) as from fiscal years starting on or after 31 December 2023. Luxembourg Parliament transposed the Pillar 2 Directive through a law voted on 20 December 2023.

The Pillar 2 Directive applies only to groups which have annual gross revenue in the consolidated financial statements exceeding EUR 750 million. Consolidation should generally be on a line-byline basis (with exceptions for certain joint venture entities). On 2 February 2023, the OECD published their administrative guidance and confirmed that the Pillar 2 rules do not apply to entities meeting the EUR 750 million threshold when the Authorised Financial Accounting Standard explicitly permits the non-consolidation (e.g. IFRS 10 on investments entities, fund product laws like SIF, RAIF and SICAR Laws, EU Accounting Directive 2013/34/ EU). Therefore, (securitisation) vehicles which are not part of a consolidated group because they are not in scope or an exemption is available should in principle not be subject to the Pillar 2 Directive.

A securitisation vehicle could be part of a consolidated group if the "parent" entity owns the majority of the securitisation vehicle's equity, both in the case of debt- and of equity-funded vehicles. In addition, a securitisation vehicle could have to be consolidated if the "parent" has control in the meaning of IFRS 10 over the securitisation vehicle, even if it does not have shareholding in the securitisation vehicle. This needs to be assessed on a case-by-case basis.

In theory, even when part of a consolidated group, a securitisation vehicle could still benefit from an exemption if it qualifies as an "investment fund" meeting some criteria - however, this would be rare in practice.

When part of a consolidated group and when the effective tax rate applicable to all the Luxembourg constituent entities (including the securitisation vehicle) of the consolidated group is below 15%, a top-up tax may apply, unless the jurisdiction can qualify for one of the safe-harbour exclusions foreseen in the Pillar 2 Directive. Such top-up tax could possibly apply either in the jurisdiction of the ultimate parent company, in Luxembourg or in another jurisdiction implementing the minimum taxation rules, including EU and non-EU jurisdictions. When a top tax is due in Luxembourg as a consequence of undertaxed profits of a Luxembourg securitisation vehicle, the Luxembourg tax law provides that such top-tax can be allocated to any other constituent entities that are located in Luxembourg so that no top-tax payment will be due by the securitisation vehicle but only by any other constituent entity existing in Luxembourg.

5.7.3 Interest payment made to corporate entities located in non-cooperative jurisdictions

Since 1 March 2021, interest payment made by a securitisation company to corporate entities that are related parties and established in countries that are listed by the Council of the EU as being "non-cooperative" should no longer be tax deductible unless the Luxembourg securitisation company can prove that the arrangements giving rise to the expense satisfy the "valid commercial reasons that reflect economic reality" test

In practice, this new tax provision should have a limited impact on Luxembourg securitisation vehicles as often the cumulative conditions are not all met.

5.7.4 Multilateral Instrument

In 2017, Luxembourg was one of the original 68 jurisdictions to sign the OECD-sponsored Multilateral Convention to implement Tax Treaty Related Measures to prevent base erosion and profits shifting – commonly referred to as the "Multilateral Instrument" or "MLI".

The aim of the MLI is to supplement existing double tax treaties concluded by participating jurisdictions in order to include anti-tax treaty shopping provisions like the Principal Purpose Test. Under the Principle Purpose Test, a benefit under a double tax treaty shall not be granted in respect of an item of income or capital if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provision of this double tax treaty.

On 14 February 2019, Luxembourg Parliament ratified the MLI which took effect on 1 January 2020. As a consequence, once the relevant treaty cosignatory has also ratified the MLI, any Luxembourg securitisation company claiming benefit from a double tax treaty will now have to pass the Principal Purpose Test to secure the benefit from reduced or nil withholding taxes at source.

As the vast majority of securitisation companies have been set up for genuine economic reasons, just a few should be impacted by the entry into force of the MLI.

5.7.5 Mandatory Disclosure Requirements / DAC 6

Council Directive 2018/822 introduced a mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements implemented after 25 June 2018. The directive implements the recommendation made by the OECD in the BEPS Action 12 and requires in substance that EU tax intermediaries report cross border arrangements that are potentially aggressive tax planning arrangements.

The directive has been transposed into Luxembourg law through the MDR Law, also referred to as DAC 6 Law, and may result in extra reporting obligations notably for sponsors, arrangers or tax advisors advising securitisation arrangements.

The MDR Law provides that only cross-border arrangements between associated enterprises that include some specific hallmarks are reportable. As a consequence, a case-by-case analysis shall be conducted to determine whether arrangements involving a securitisation vehicle are reportable under the MDR Law.

06

Regulatory aspects

Regulatory aspects

6.1 EU Securitisation Regulation

In 2017, the European Parliament adopted the EU Securitisation Regulation.. It is applicable to European securitisation transactions whose securities (or other securitisation positions) are issued on or after 1 January 2019 and constitutes a key element of the European Commission's Capital Markets Union ("CMU") and, more recently, the Savings and Investments Union ("SIU") which support the development of the European securitisation market. The purpose of the EU Securitisation Regulation is to promote securitisation as an important tool for the well-functioning of the financial markets, diversifying funding sources and allocating risk more widely. It allows for a broader distribution of financial sector risk and can help free up originators' balance sheets to enable further lending to the real economy.

With the EU Securitisation Regulation, the European Union aims to streamline the legislative framework on securitisation into a single harmonised securitisation regulatory framework. Consequently, the EU Securitisation Regulation applies to many parties involved in a securitisation transaction, namely institutional investors (in principle no distribution to retail clients), originators, sponsors, original lenders, and securitisation special purpose entities ("SSPE" or the issuer).

The EU Securitisation Regulation is divided into two parts: The first general part which provides a definition of securitisation and its related concepts establishes, among others, due-diligence, risk retention, and transparency requirements for parties involved in any securitisation that falls within the definition of the EU Securitisation Regulation. The second part creates an additional specific framework for simple, transparent, and standardised ("STS") securitisation.

In addition to the EU Securitisation Regulation, the European Banking Authority ("EBA") and the European Securities and Markets Authority ("ESMA") as well as the European Insurance and Occupational Pensions Markets Authority ("EIOPA") have published together the Level 2 Regulations, known as the regulatory technical standards, and the Level 3 Guidelines, to give further guidance and detail on several aspects of the EU Securitisation Regulation. While the Level 2 Regulations cover the implementation of some aspects of the EU Securitisation Regulation such as the requirements for third party verification, STS notification, the implementation of the transparency requirements, risk retention and homogeneity requirements for the securitised portfolio, the Level 3 Guidelines predominantly cover the uniform interpretation and application of the STS requirements throughout Europe.

In 2021, the EU Securitisation Regulation was further amended. The EU Securitisation Regulation now includes the key definition of NPE securitisations, while the existing framework was built around the characteristics of performing loans. This includes adjustments to the risk retention requirements, the credit-granting rules, and a proposal for amending the CRR concerning the risk weighting for NPEs. Furthermore, on balance sheet synthetic securitisations can now qualify as STS transactions, while arbitrage securitisations remain ineligible for STS. This implies a preferential capital requirements treatment for such transactions therefore taking advantage of the flexibility offered by the amendments.

Recently, the implementation and functioning of the EU Securitisation Regulation has been reviewed by the Joint Committee of the European Supervisory Authorities ("ESAs[2]"). Its report mainly suggested improvements with regards to (i) investor due diligence requirements, (ii) proportionality of transparency framework, (iii) jurisdictional scope, and (iv) supervisory consistency.

Furthermore, by mid-2025, the European Commission is expected to make a legislative proposal amending the EU Securitisation Regulation for which it consulted the stakeholders during the end of 2024.

[2] Joint Committee Report on the implementation and functioning of the Securitisation Regulation (Article 44), 31 March 2025

6.1.1 General framework for all EU securitisations

Definition of securitisation within the meaning of the EU Securitisation Regulation ("EU Securitisation")

Pursuant to Article 2.1 of the EU Securitisation Regulation, the term "securitisation" is defined as "a transaction or scheme, whereby the credit risk associated with an exposure, or a pool of exposures is tranched", having all of the following characteristics:

1. Payments are dependent upon the performance of the underlying exposure (or the pool of exposures);

2. The subordination of tranches determines the distribution of losses during the ongoing life of the transaction;

3. The transaction shall not constitute a specialised lending to finance or operate physical assets as defined in Article 147 (8) of Regulation (EU) No 575/2013 (CRR)

In addition, Article 8 of the EU Securitisation Regulation prescribes that the securitised risk shall, as a rule, not be another securitisation, i.e., the EU Securitisation Regulation prohibits in general re-securitisation. This can be seen because of the lessons learnt from the 2008 financial crisis. By way of derogation, this ban shall not apply to (i) any securitisation the securities of which were issued before 1 January 2019 and (ii) any securitisation to be used for legitimate purposes.

The "legitimate purposes" are left at the discretion of the relevant authority (i.e., in Luxembourg the CSSF). The relevant authority has to assess, among others, whether the re-securitisation takes place (i) to facilitate the winding-up of a credit institution, an investment firm or a financial institution, (ii) to ensure the viability of the latter and (iii) to protect the investors' interest.

The securitisation's definition seems to be rather simple with only credit risk and tranching as key criteria. However, in practice, the notion of tranching gives room to some interpretation around the following three main discussion points:

- **Does tranching only refer to different transferable securities issued, or does it include other ways of subordination?** Even though the recitals and some Articles of the EU Securitisation Regulation refer to "securities", the securitisation and tranching definitions themselves do not make such restriction. This implies that subordinated loans or other forms of distribution of credit losses would also be seen as tranching.

- **Is the share capital of a securitisation vehicle (in addition to one single note issued) be seen as tranching?** Reference is made to "contractually" separate tranches, while it is legally defined that the share capital ranks lower than debt. Therefore, this alone would not trigger tranching. Since its modernisation, the Luxembourg Securitisation Law further prescribes a more detailed legal ranking of debt and equity positions which may then not meet the tranching definition of the EU Securitisation Regulation. Nevertheless, each transaction should be analysed individually since, for example, a contractual structuring within an entity's share capital (e.g. differently ranked share types or classes) would most likely be seen as tranching.

- **Is it tranching if all tranches are held by the same investor?** In our view, for the EU Securitisation Regulation it is not relevant who the investor is. One needs to analyse from a transaction/vehicle point of view, not from an investor's angle. Therefore, having issued several tranches with different rankings with regards to credit risk would imply tranching in the meaning of the EU Securitisation Regulation, regardless of the investor. is likely to be seen as tranching.

Furthermore, multi-compartment structures are not explicitly dealt with in the EU Securitisation Regulation, i.e. it does not clarify if it shall be applied on an entity or compartment basis. In our opinion and what we understand to be best practice, each compartment should be treated separately being legally ring-fenced silos with clear segregation of assets and liabilities. This implies that any below mentioned obligation would have to be fulfilled for compartments falling in the scope of the EU Securitisation Regulation, not for all compartments of the securitisation vehicle.

The Luxembourg Capital Markets Association has issued an updated position paper in November 2024 to its members, addressing specific elements of the EU Securitisation Regulation. This paper provides a more in-depth analysis of various aspects of the EU Securitisation Regulation, many of which are also covered in this Securitisation guide. Certain topics, such as Credit Enhancement options and the EU Securitisation Regulation's non-application to the Specialised Lending exemption, are explored in greater detail. Additionally, the paper examines specific cases and approaches, including deferred purchase price, reserves in trade receivables structures, synthetic structures - total return swap, subscription facilities extended to debt funds in the form of a partnership, debt fund repackaging, and dual structures involving loans/notes.

Parties subject to the EU Securitisation Regulation

An institutional investor within the meaning of the EU Securitisation Regulation may be a European Union-based:

- insurance or a reinsurance undertaking;
- institution for occupational retirement provision;
- alternative investment fund manager ("AIFM") that manages or markets alternative investments funds in the EU;
- undertaking for the collective investment in transferable securities ("UCITS") if internally managed, or otherwise its management company;
- credit institution or investment firm.

Pursuant to Article 25 of the EU Securitisation Regulation, the role of a sponsor within the meaning of the EU Securitisation Regulation is limited to credit institutions (whether located in the European Union or not) and EU investment firms (the latter must be supervised under Directive 2013/36/ EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment forms ("CRD")). On the other hand, any entity pursuing the respective activity can act as originator or original lender. The SSPE is not restricted in legal form or jurisdiction (except that SSPEs shall not be established in a third country fulfilling the conditions mentioned in Article 4 of the EU Securitisation Regulation i.e., listed as a high-risk and non-cooperative jurisdiction by the Financial Action Task Force ("FATF")). The latter could be, for example, established as a limited partnership, a limited liability company, a trust, or a corporation. If STS compliance is intended, the SSPE, the sponsor or the initiator must be established within the European Union pursuant to Article 18 of the EU Securitisation Regulation.

This also means that a non-EU or non-regulated originator could be caught by the EU Securitisation Regulation. Similarly, a non-EU SSPE that meets the abovementioned credit risk and tranching criteria would trigger further obligations for an EU institutional investor and the SSPE itself. For example, US agency MBS are not per se out of scope of the EU Securitisation Regulation but only if they do not meet the definition of a securitisation as per the EU Securitisation Regulation (which, for example, is usually the case for the so-called passthrough securities).

All these actors must meet one or more of the requirements prescribed by the EU Securitisation Regulation. Those are, among others, relating to (i) due-diligence (for institutional investors), (ii) risk retention (for originators, sponsors, or original lender) and (iii) transparency (for originators, sponsors, and SSPEs).

Furthermore, the EU Securitisation Regulation prescribes that loan origination must follow the same credit-granting process as the usual process of the originators, sponsors, and original lenders.

The EU Securitisation Regulation further foresees that any relevant data under the transparency requirements need to be collected by a so-called "securitisation repository" for public securitisations.

The UK implemented most of the EU Securitisation Regulation's provisions into UK Law (through "Securitisation (Amendment) (EU Exit) Regulations 2019") but is itself no longer part of the European Union since 31 December 2020. For the EU Securitisation Regulation, this means that requirements linked to a geographic location in the EU (e.g., key parties involved in an STS transaction) would no longer be fulfilled by UK entities.

Not long after the end of the Brexit transition period and to face the Covid-19 crisis, the European Union approved several modifications to the EU Securitisation Regulation. Inevitably, divergences came to light between the UK and EU regulatory frameworks rendering cross-border securitisation deals more complicated; securitisation fitting into one jurisdiction's standards may not automatically fit into the other jurisdiction's standards.

The details on the jurisdictional scope of the EU Securitisation Regulation have been a point of discussion since its application. On 25 March 2021, the European Supervisory Authorities (EBA, EIOPA and ESMA, together the "ESAs") suggested some amendments to the EU Securitisation Regulation. The opinion addresses situations where one of the parties is non-EU and the implications for investment managers' due diligence. The ESAs report published on 31 March 2025 again outlined the need to clarify the jurisdictional scope of the application of the EU Securitisation Regulation.

Key requirements under the EU Securitisation Regulation

(i) Due-diligence

Investor protection benefits from an important focus under the EU Securitisation Regulation since securitisation operations may turn out to be risky and complex and should consequently be addressed by a strict due diligence requirement.

Pursuant to Article 5 of the EU Securitisation Regulation, prior to holding a securitisation position, institutional investors must verify certain elements of the transaction, e.g.:

- the existence of a well-defined credit-granting process of the originator (except if EU credit institutions or investment firms);
- the compliance of originator/sponsor/original lender with risk retention requirements;
- the regular provision of required information by originator/sponsor/SSPE.

Institutional investors also must carry out a due-diligence assessment, which enables them to assess the risks characteristics and structural features. They must establish written procedures (initially and on an ongoing basis) and regularly perform stress tests to monitor the above-mentioned compliance and the performance of the securitisation position.

For due diligence, no Level 2 Regulation was produced that could give further guidance. However, non-compliance could lead to significant sanctions. A strong focus of the due-diligence will be placed on the Loan Level Data templates (see (iii) below).

(ii) Risk retention

To align their interests with those of the investors, each of the originator, sponsor or original lender must retain a material net economic interest in the securitisation on an ongoing basis. Risk retention must meet the following additional requirements:

- the material net economic interest shall be not less than 5% of the ongoing nominal value of the tranches sold or exposures securitised and shall not be subject to any credit-risk mitigation or hedging;

- only one of the parties/roles must retain the material net economic interest (i.e., no split between the involved parties/roles, yet several originators could share the risk retention) and, if no agreement is reached between the parties, the originator shall fulfil the risk retention obligation.

The EU Securitisation Regulation introduces a conclusive catalogue of possibilities to meet the risk retention requirement and solely exempts exposures that are fully, unconditionally, and irrevocably guaranteed by public authorities. This catalogue, completed by a Regulatory Technical Standard ("RTS") on the risk retention requirements for securitisations published by EBA, specifies several aspects on the risk retention requirements and closely resembles the one applicable under the previously existing regulations.

The requirement for risk retention is similar to the ones under the Dodd-Franck Act in the USA but different in the details. Thus, a securitisation valid for US risk retention is not necessarily EU Securitisation Regulation compliant. Consequently, some sponsors have developed dual compliant securitisations.

Furthermore, as mentioned above, changes for NPE securitisations have been made, including the risk retention to be calculated based on 5% of the net (discounted) value of the securitised NPE exposures, as opposed to the nominal value. In addition, the servicer in an NPE transaction may also act as risk retainer.

(iii) Transparency

The transparency and due-diligence provisions of the EU Securitisation Regulation are inherently linked since transparency should facilitate due-diligence. The EU Securitisation Regulation establishes transparency as one of its main pillars and imposes transparency requirements concerning all types of securitisation, in order to allow investors to understand, evaluate and compare the operations.

Article 7 of the EU Securitisation Regulation sets out transparency requirements for all securitisations, including private and non-STS transactions. Thus, they should not be mixed up with additional transparency requirements for transactions seeking the STS label. Under Article 7, each of the originator, the sponsor and the SSPE must provide detailed quantitative and qualitative, static, and dynamic information on the securitisation to its investors, to the competent authorities and, upon request, to potential investors. This includes, amongst others, to:

- provide the (potential) investors on a regular basis with sufficient information, e.g., on the underlying exposure and documentation;

- designate who among themselves will provide the required information;

- make this information available via the securitisation repository to provide the investors with a single and supervised source of the data necessary for performing their due diligence (except for private securitisations).

The ESMA published Level 2 Regulation on transparency requirements. The Level 2 Regulation introduced many very detailed reporting templates that must be used. Public securitisations (i.e., having issued securities listed on an EU regulated market) need to complete more templates than a private securitisation and must report to a securitisation repository. Nevertheless, private securitisations also need to report under the predefined templates even if the investor would not require it. Recently, ESMA has performed a consultation in relation to the securitisation disclosure templates and potential modifications and simplifications. ESMA has also published Questions and Answers (Q&As) on the EU Securitisation Regulation with regards to the transparency requirements and which are updated from time to time.

The EU Securitisation Regulation imposes certain transparency requirements relating to all types of securitisations to entitle investors to understand, evaluate and compare the transactions. The transparency obligations are reinforced by the securitisation repository system consisting of a legal person that centrally collects and maintains the records of public securitisations. The securitisation repository provides investors with a single and controlled source of data necessary for the appropriate exercise of due diligence.

(iv) Ban on re-securitisations

As mentioned above, the EU Securitisation Regulation states that the underlying exposures used in a securitisation shall not include any securitisation positions. Under Article 8 of the EU Securitisation Regulation, re-securitisation is generally prohibited but certain exceptions may be granted by the competent authority, e.g. when wind-up issues or NPEs are part of the transaction.

(v) Criteria for credit granting

To avoid “credit origination to securitise” (equalling pre-crisis “originate-to-distribute”-models), originators, sponsors and original lenders shall apply the same sound and well-defined criteria for credit-granting which they apply to non-securitised exposures. Certain exceptions apply to NPE originators having purchased the exposures themselves from third parties’ originators having purchased the exposures themselves from third parties.

6.1.2 Specific framework for STS securitisations

In addition to the general framework described above, the EU Securitisation Regulation also introduces a specific framework for “high quality” securitisations to establish a more risk sensitive prudential framework for STS securitisations. Banks and insurers investing in STS securitisations benefit from lower capital requirements.

To be considered as STS, an EU securitisation must fulfil numerous criteria relating to simplicity, transparency and standardisation as mentioned under Chapter 4 of the EU Securitisation Regulation. Those criteria are further interpreted by guidelines published by the EBA.

This does not mean that an STS securitisation position is free of risks, but it indicates that a prudent and diligent investor will be able to properly analyse the risks involved in the securitisation.

Requirements for STS in addition to those applicable to all EU Securitisations

As mentioned above, an STS securitisation must fulfil numerous criteria relating to simplicity, transparency and standardisation summarised in the table below.

Figure 32: STS criteria

Simplicity	Transparency	Standardisation
Portfolio and cashflows • True-sale only* • No active management (eligibility criteria) • Homogeneous asset type • No re-securitisation • No defaulted exposures • Cashflows not substantially dependent on sale of asset • At least one payment made • …	Investor data availability • Historical (≥5yrs) default and loss performance data • Sample of exposure independently verified • Liability cash flow model linked to exposure • Originator and sponsor responsible for transparency (incl. STS notification and quarterly investor reporting) • …	Structural elements • Risk retention satisfied by originator, sponsor original lender • Interest and currency risk mitigated • Roles and responsibilities of transaction parties, esp. servicer, clearly described • Remedies and actions in case of delinquency/default of debtors or conflicts of investors predefined • …

* since 2021, on-balance synthetic securitisations allowed

Originally, synthetic securitisations were fully excluded from the STS regime. Pursuant to Section 2bis of the EU Securitisation Regulation and in order to maintain one of the CMU's (or now SIU's) objectives consisting in the recovery of the European economy through the capital markets, the EU Securitisation Regulation now enables on-balance sheet synthetic securitisations to qualify as STS transactions implying a preferential capital requirements treatment for such on-balance sheet synthetic transactions if STS and certain other requirements (sometimes referred to as "STS+") are fulfilled. The so-called arbitrage securitisations remain, on the other hand, ineligible for the STS label.

In addition to fulfilling the STS criteria presented above, further conditions must be met, for example:

- Originator, sponsor, and SSPE (i.e. the securitisation vehicle) must be established in the European Union, e.g. in Luxembourg;
- All STS securitisations must be published in a list on the official website of the ESMA;
- Originators and sponsors shall jointly notify ESMA of a new STS securitisation. This notification shall include an explanation by the originator, the sponsor, and the SSPE on 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, like the STS Verification International GmbH, Frankfurt or PCS in London and Paris.

Upon communication by the SSPE to the ESMA, the instruments are entered into a publicly available centralised web data repository listing all STS securitisations, both private and public ones. As at 31 December 2024, a total of 998 "active" STS securitisations were registered as STS with ESMA. Around 35% are public transactions (2022: 37%), with 65% the majority are private deals. Almost all the transactions (86%) are set-up as true-sale or traditional securitisation, with the remainder (14%) being synthetic STS securitisations (which is only authorised under the EU Securitisation Regulation since 2021). With regards to the asset classes of the STS transactions, about 31% are linked to auto loans/leases, 30% relate to trade receivables, 11% residential mortgages, 6% SME loans and 13% to consumer loans. The remaining 8% have not specified the asset class. This is a similar picture compared to prior year.

Third party verification

Each originator, sponsor and SSPE may use the service of an authorised third party to verify whether a securitisation complies with the STS criteria. However, the use of such service shall under no circumstances affect the liability of the originator, sponsor and SSPE in respect of their legal obligations under the EU Securitisation Regulation nor the due-diligence obligations imposed on institutional investors. Third parties undertaking to offer this kind of verification undergo a thorough licensing process and are supervised by ESMA.

Competent authorities and sanctions

As securitisation transactions involve several parties, it is important to clarify which supervisory authority will be responsible for the supervision of each party and action in the securitisation process. The EU Securitisation Regulation attributes some powers directly to competent authorities, while it confers the power to assign other supervision duties to the Member States (for Luxembourg, the CSSF and the CAA are the designated competent authorities).

ESMA is granted with the role of assuring consistent implementation of the EU Securitisation Regulation throughout the European Union. As each securitisation can involve parties from different sectors (banking, insurance, asset management) and different countries, competent supervisory authorities will have to communicate and collaborate to find common grounds on securitisation matters in order to avoid any inconsistency.

The EU Securitisation Regulation further includes certain specific provisions relating to the sanction of misconduct under the EU Securitisation Regulation. Sanctions are imposed in case of misconduct 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 supervisory authority ascertains that a securitisation previously considered STS does no longer fulfil these requirements, the product will be removed from the website listing STS products and a financial sanction will be imposed on the originator (the financial penalty amounts to a maximum administrative fee of at least EUR 5 million, or up to 10% of the annual turnover of the offender at individual or group consolidated level). The originator may also be banned temporarily from issuing STS products, not to mention the significant reputation loss.

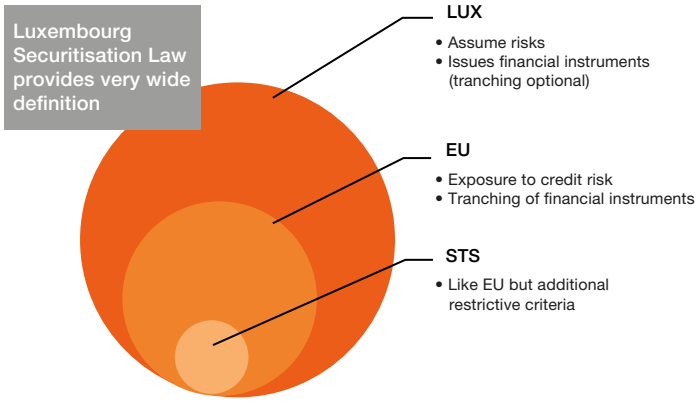
Member States also have the possibility to introduce criminal charges, but they are not obliged to do so.

6.1.3 Impact on Luxembourg

The EU Securitisation Regulation does not per se apply to all Luxembourg securitisations since its scope is different from the one of the Luxembourg Securitisation Law. According to the securitisation definition under the Luxembourg Securitisation Law, not all Luxembourg securitisation transactions meet the definition of a securitisation as per the EU Securitisation Regulation, and, therefore, the EU Securitisation Regulation may not apply to all Luxembourg securitisations. On the other hand, vehicles performing securitisation under the EU definition may not have opted for the Luxembourg Securitisation Law.

A Luxembourg securitisation vehicle may acquire or assume any risk (and not only credit risk as per the EU Securitisation Regulation) and issue financial instruments linked to this risk, while tranching is not mandatory (unlike the EU Securitisation Regulation). Contrary to the general rule of the EU Securitisation Regulation, financial instruments issued by Luxembourg securitisation vehicles may also be sold to retail clients, under the condition of supervision by the CSSF if certain conditions are met (see chapter 3 above).

Figure 33: Impact of EU Securitisation Regulation on Luxembourg



LUX-only Securitisation	EU Securitisation	STS Securitisation
Subject to Luxembourg Securitisation Law but out of scope of the EU Securitisation Regulation; because of either securitising a risk other than credit risk or by not tranching the securities issued. For regulatory purposes potentially rather treated similar to a corporate bond than securitisation. This may incur different (regulatory) treatment for investors and less obligations for originator and sponsor as would be prescribed by the Regulation.	Securitises credit risk and issues tranched, subordinated securitisation positions. May also be subject to Luxembourg Securitisation Law. This would imply that the above-mentioned requirements (e.g. risk retention, transparency, due-diligence) need to be complied with.	Fulfils definition of EU Securitisation, i.e. securitises credit risk and issues tranched, subordinated securitisation positions. It may also be subject to Luxembourg Securitisation Law but does not have to. In addition, the STS criteria mentioned above need to be complied with.

Thus, a Luxembourg securitisation vehicle may be structured in three possible ways: "LUX-only", "EU" or "STS" (see Figure 33). As such, Luxembourg remains a very flexible and attractive environment, providing legal certainty and an interesting product toolbox. In addition, Luxembourg Securitisation Law allows for the creation of compartments or sub-funds under one legal entity.

6.2 Regulatory treatment of securitisation for bank and insurance investors

6.2.1 Capital requirements for banks

The banking prudential regulatory framework in the European Union is primarily governed by the Capital Requirements Regulation CRR and the Capital Requirements Directive 2013/36/EU ("CRD"). Both were recently updated to reflect the final elements of the Basel reforms (also known as Basel IV).

CRR III became effective as of 1 January 2025 (except the amendments to Fundamental Review of the Trading Book – ("FRTB") /market risk, which will apply from 1 January 2026), and CRD VI will need to be transposed into national law by Member States by 10 January 2026 (except for the amendments to the third-country branches regime, which will apply from 2027).

The CRR and CRD texts cover the prudential requirements for credit institutions and investment firms. CRR sets capital and liquidity requirements, concentration limits, reporting and disclosure expectations. CRD, on the other hand, focuses on internal governance and risk management practices, remuneration and supervisory powers. Together, they aim to ensure that banks hold sufficient capital and liquidity buffers, coupled with robust internal governance frameworks to remain resilient during periods of financial stress.

The EU securitisation framework for credit institutions and investment firms, Regulation (EU) No 2017/2401 ("SecReg") supplements CRR and provides:

- a set of common requirements on risk retention, due diligence and disclosure;
- criteria to identify STS (simple, transparent and standardised) securitisation positions; and
- a system of supervision to monitor the correct application of those criteria by originators, sponsors, issuers and institutional investors.

While the new Regulation (EU) 2024/1623 amending Regulation (EU) No 575/2013 (aka CRR III) did not introduce any significant changes to the treatment of securitisation positions, the EBA has been tasked to monitor the application of the Output Floor to securitisation exposures to ensure that the capital reduction obtained by originator institutions recognising a significant risk transfer (SRT) will not excessively reduce risk sensitivity. A report (in collaboration with ESMA) on findings is expected for publication by 31 December 2026, with the Commission submitting a potential legislative proposal by 31 December 2027 – where deemed appropriate.

Identification of securitisation positions

There are two key notions related to the regulatory approach for calculating the capital requirements of securitisation transactions. Firstly, the overall approach of the amended CRR is based on economic substance rather than legal form. Therefore, the analysis of securitisation transactions follows the same principle.

Secondly, a credit institution needs to broadly assess its securitisation exposures, i.e. not only the related credit risk exposure but also structural elements (such as early amortisation and clean-up call options, for instance) as well as commercial aspects (such as implicit support).

Operational requirements for the recognition of significant risk transfer

There are detailed operational provisions that an originating credit institution has to comply with to recognise significant risk transfer. The provisions can be divided in the following categories:

a. those for traditional and synthetic securitisations (e.g., originator institution does not hold >20% of the exposure value of the first-loss tranche, or the Risk-Weighted Exposure Amounts (RWEA) of the mezzanine securitisation positions do not exceed 50% of all mezzanine securitisation positions in the securitisation);

b. those related to clean-up calls (e.g., originators can exercise them at their discretion); and

c. those for early amortisation provisions (e.g., the provisions do not subordinate the institution's senior / pari passu claim on the underlying exposures).

Calculation of capital requirements and risk-weighted exposure amounts (RWEA)

The securitisation framework must be applied on the relevant securitisation exposures, as determined. Credit institutions are required to hold capital against all their securitisation exposures, including those arising from:

- positions in different tranches in a securitisation (which must be considered separately);
- provision of credit protection to securitisation positions;
- interest rate or currency derivative contracts entered into with the transaction.

Originator, sponsor, or other institutions using the SEC-IRBA, SEC-SA, or SEC-ERBA (see section 'The hierarchy of approaches' below) can apply a maximum capital requirement for securitisation positions equal to the capital requirements of the underlying exposures as if they had not been securitised.

For traditional securitisations, if significant credit risk is transferred, the underlying exposures can be excluded from the RWEA and Expected Loss ("EL") amounts. Unless deducted from Common Equity Tier 1 (CET 1) items, the RWEA is included in the total risk-weighted exposure amounts.

Specific credit risk adjustments and non-refundable purchase price discounts must be deducted from the exposure value if assigned a 1,250% risk-weight or deducted from CET 1.

For senior securitisation positions, institutions that have continuous knowledge of the composition of the underlying exposures can use the look-through approach. This means that the max risk-weight applicable is equal to the exposure-weighted-average risk weight of the underlying exposures as if they had not been securitised.

In the case of overlapping positions (i.e., where an institution holds multiple positions in the same securitisation transaction, after investing in different tranches of the same securitised asset pool), only one position should be included in the calculation of the RWEA; however, for partially overlapping positions, the institution can either split the position or treat them as fully overlapping. For Asset-Backed Commercial Paper (ABCP) positions, institutions can use the risk-weight of a liquidity facility if it covers 100% of the ABCP and ranks pari passu (i.e., overlapping position).

Recognition of Credit Risk Mitigation ("CRM") for securitisation positions

Institutions can recognise both funded and unfunded credit protection for securitisation positions, if they meet the requirements. SSPEs can be protection providers if they own eligible financial collateral, the assets are not subject to higher-ranking claims, and all requirements for financial collateral recognition are met.

The protection amount must be adjusted for currency and maturity mismatches, limited to the volatility-adjusted market value. Credit protection providers calculate the RWEA for the protected portion as if held directly, while credit protection buyers calculate the RWEA for the protected portion in line with chapter 4 of CRR ('Credit Risk Mitigation').

The hierarchy of approaches

The CRR framework implements a hierarchy of three approaches. Institutions must use the same approach applicable to the underlying assets in the securitisation, unless not allowed. For example, an institution normally using the Internal Ratings Based ("IRB") approach to treat the underlying exposures will need to use the SEC-IRBA. Following the introduction of CRR III, institutions using the IRB approach will also need to compute their securitisation exposures under SEC-SA due to the output floor.

The hierarchy follows this order:

a) Securitisation Internal Ratings Based Approach – "SEC-IRBA"

The default option to calculate the capital requirements for securitisation exposures is the SEC-IRBA, using the Simplified Supervisory Formula Approach ("SSFA"). Institutions should first compute the capital requirements of securitised exposures (the so-called "K-IRB"), which is the capital charge of the pool of underlying exposures as if they had not been securitised, expressed in decimals.

The K-IRB is found by multiplying the amount of expected and unexpected losses associated with the underlying exposures by 8% and dividing that by the exposure value of the underlying. Where dilution risk is material, a separate K-IRB should be computed – unless losses from dilution and credit risk are treated in aggregate in the securitisation.

The SSFA then assigns risk weights to specific tranches based on the subordination level and thickness of the tranche within the securitisation structure, to take into account the relative seniority of the securitisation exposure.

The RWEA is subject to a minimum risk weight floor of 15%. For STS securitisations, the risk weight floor for senior securitisation positions is 10%. The maximum risk weight is 1,250%.

b) Securitisation Standardised Approach - "SEC-SA"

Where the SEC-IRBA may not be used (because sufficient information on the underlying exposures is not available or Competent Authorities have precluded its use due to securitisations presenting highly risky/complex features), the SEC-SA shall be used.

Under this method, institutions should first compute the capital charge KSA, by multiplying the RWEA (in line with requirements under the Standardised Approach to Credit Risk, chapter 2 of CRR) gross of any specific credit adjustments and additional value adjustments (AVAs) by 8% and dividing it by the value of the underlying exposures.

The RWEA is subject to a minimum risk weight floor of 15%. For STS securitisations, the risk weight floor for senior securitisation positions is 10%. The maximum risk

weight is 1,250%, which is also applicable in cases where an institution does not know the delinquency status for >5% of underlying exposures in the pool but does not apply to re-securitisations. SEC-SA is also the only approach available for re-securitisation positions and imposes a risk weight floor of 100%.

c) Securitisation External Ratings Based Approach - "SEC-ERBA"

With the third method in the hierarchy, the capital requirements are calculated by multiplying the exposure value by the relevant risk-weight based on its external rating – which range between 15% and 1,250%, except for STS positions where the minimum is 10%. The EBA is responsible for mapping the External Credit Assessment Institutions ("ECAI")'s external ratings to credit-quality steps (CQS) provided in the CRR.

d) Internal Assessment Approach (IAA)

Upon obtaining Competent Authorities' approval, credit institutions may be allowed to use the IAA for the computation of RWEA for unrated ABCP programmes or transactions that meet certain criteria (e.g., the positions in the commercial paper issued from the ABCP are rated, the internal assessment must reflect publicly available assessment methodology of one or more ECAIs as well as include corresponding grades, and the ABCP programme must include guidelines on asset eligibility, exposure types, loss distribution, and asset isolation).

Under the IAA, institutions must assign the positions to rating grades based on their internal assessments. The position is given a derived rating (which must be at least investment grade or better when first assigned) equivalent to the credit assessments corresponding to that rating grade.

Institutions cannot revert to other methods for positions within the IAA scope without demonstrating good cause and receiving prior permission from the Competent Authority.

Market risk requirements for securitisation positions

Under CRR, securitisation positions in the trading book or in the Alternative Correlation Trading Portfolio (ACTP) should only be treated using the Alternative Standardised Approach (ASA). Securitisation positions qualifying for inclusion in the ACTP must meet certain criteria (e.g., those with single-name underlying instruments for which a two-way liquid market exists).

According to the ASA, institutions must apply specific credit spread risk factors (sensitivities-based method for own funds requirements) to securitisation positions included in the ACTP (buckets for credit spread risk are the same as those for non-securitisations) compared to the ones not included (specific risk buckets). For example:

Credit spread risk factors	ACTP	NON-ACTP
Delta risk factors	Relevant credit spread rates of the issuers of the underlying exposures, inferred from debt instruments and credit default swaps, for maturities of 0.5, 1, 3, 5, and 10 years.	Relevant tranche credit spread rates, mapped to maturities of 0.5, 1, 3, 5, and 10 years.
Vega risk factors	Implied volatilities of the credit spreads of the issuers, mapped to the same maturities as the delta risk factors.	Implied volatilities of the tranche credit spreads, mapped to the same maturities as the delta risk factors.
Curvature risk factors	Credit spread yield curves of the issuers, expressed as vectors of credit spread rates for different maturities.	Same as delta risk factors, with a common risk weight applied.

Where securitisation tranches included in the ACTP do not have an implied volatility, then vega risk should not be calculated (only delta and curvature).

Computation of own funds for default risk also proposes two different approaches based on whether the positions are included in the ACTP or not.

Default risk	ACTP	NON-ACTP
Gross Jump-to-default (JTD)	For securitisation exposures, the gross jump-to-default amounts are their market value or, if unavailable, their fair value as per the applicable accounting framework	
Net JTD	Calculated by offsetting long and short gross JTD amounts. Offsetting is only possible between exposures that are identical except for maturity and various other conditions apply.	Determined by offsetting long and short gross jump-to-default amounts (with offsetting only allowed between securitisation exposures with the same underlying asset pool).
Own funds calculation	Tranched products: Net JTD amounts must be multiplied by the default risk weights corresponding to their credit quality. Non-tranched products: Net JTD amounts multiplied by the default risk weights. Risk-weighted net JTD amounts are assigned to buckets that correspond to an index prior to computing own funds.	Net JTD multiplied 8% of the risk-weight applicable to the securitisation exposure (incl. STS). One-year maturity applies to all tranches where risk-weights are calculated according to SEC-IRBA/ERBA. Risk-weighted JTD amounts are capped at FV of the position (cash securitisation positions only).

Under the standardised approach (SA), securitisations should be treated as debt instruments – in relation to the calculation of own funds requirements for position risk.

For securitisation positions in the trading book, institutions must weigh the net positions with 8% of the risk weight that would apply to the position in the non-trading book. Weighted positions must be summed, regardless of whether they are long or short, to calculate the own funds requirement against specific risk.

If an originator institution of a traditional securitisation does not meet the significant risk transfer conditions, it must include the underlying exposures in its own funds requirement calculations as if they had not been securitised. For synthetic securitisations, if the conditions are not met, the originator must include the underlying exposures in its own funds requirement calculations and ignore the synthetic securitisation's credit protection effects.

Disclosure and reporting requirements for securitisation

Under CRR, institutions are required to disclose comprehensive information regarding their securitisation positions to ensure transparency and effective supervision. Banks must provide detailed descriptions of the securitisation structures, including the types of underlying exposures, risk management and investment objectives related to those activities, and the performance metrics of the securitised assets.

This includes disclosing the nature and level of risks associated with these positions, the strategies employed to mitigate such risks, and the impact on the bank's overall risk profile. Additionally, banks are expected to report the capital requirements for their securitisation positions. This level of detail is crucial for supervisors to assess the soundness and stability of the bank's securitisation activities.

Furthermore, the CRR mandates regular reporting to supervisors, which includes both quantitative and qualitative data. Banks must submit periodic reports that detail the credit quality and performance of the underlying assets, any significant changes in the risk profile, and the measures taken to manage these risks. These reports should also include information on new securitisation issuances and any material changes to existing positions.

Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)

In terms of liquidity, although securitisation exposures may generate inflows and outflows, they can (under certain conditions) be recognised as eligible liquid assets for calculation of the liquidity buffer (expressed as LCR for short-term funding and NSFR for longer-term funding profile). This is relevant for institutions covering an investor role in securitisation transactions, but not for originators.

For example, recognition of securitisation positions as eligible liquid assets is limited to specific instances as outlined in the Delegated Regulation (EU) 2015/61 (as amended) supplementing CRR. In particular, Level 2B securitisation positions refer specifically to ABS exposures that are STS with external credit assessment equivalent to CQS 1, position in the most senior tranch(-es) and backed by a pool of specific exposures. The market value of Level 2B securitisation is subject to haircuts between 25% - 35%.

6.2.2 Capital requirements for (re-)insurance companies

All insurers and reinsurers have to apply the Solvency II requirements which includes the solvency capital requirements. Under Solvency II, equity-type investments - especially in the alternative sector - could be less attractive compared to debt products with the same underlying, as these may require different amounts of solvency capital at the insurers' level depending on their design and features. Therefore, the use of securitisation vehicles instead of mere fund structures could be an attractive choice.

For debt instruments, e.g. bonds or notes 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 the solvency capital.

For any "collective investment undertaking" (i.e. UCITS or AIF), other investments packaged as a fund", or "securitisation", Solvency II foresees a "look-through" approach. This means that the Solvency Capital Requirement ("SCR") shall be calculated by analysing each of the underlying assets. In order to avoid this "look-through" obligation, the securitisation vehicle shall not meet either of the three definitions. This is relatively obvious for any fund-like definition (except for securitisation vehicles qualifying at the same time as AIF) but may be more difficult with regards to the "securitisation" definition of Solvency II.

In a first step, it has to be assessed whether the transaction should be considered as "securitisation" under Solvency II, since the definition differs from the one of the Luxembourg Securitisation Law. Based on the EU Securitisation Regulation, Solvency II requires a transaction to securitise credit risk associated with an exposure or pool of exposures and to issue tranched securities or financial instruments. A securitisation vehicle set up according to the Luxembourg Securitisation Law can be structured without tranches or securitise other than credit risk and may thus not qualify as securitisation in the meaning of Solvency II, depending on the individual structural elements. This would normally entail an easier capital requirements treatment under Solvency II.

Furthermore, the look-through approach shall also apply to indirect exposures to market risk other than collective investment undertakings and investments packaged as funds, to indirect exposures to underwriting risk and to indirect exposures to counterparty risk.

Therefore, when structuring the debt instrument issued by a securitisation vehicle, one also needs to consider whether the instrument has an "indirect exposure to market risk" as this would consequently lead to a "look-through" requirement. Only securitisation vehicles issuing debt securities set-up without direct link or 1:1 relationship to the market risk of the underlying portfolio or otherwise creating an indirect market risk exposure for the investor may be considered as debt instruments without any "look-through" obligation.

In conclusion, we believe that a Luxembourg securitisation vehicle is attractive to European insurers under Solvency II. Properly structured and with a good external rating, it ultimately leads to a lower amount of underlying required capital at the insurers' level.

6.3 Packaged Retail and Insurance-based Investment products (PRIIPs) regulation

General

The PRIIPs Regulation requires that all "packaged" financial products sold to retail investors have a Key Information Document ("KID").

Very limited flexibility is allowed to manufacturers for drawing up the KID as the template, the form, the narratives, and the other contents have been defined in the appendices of a Regulatory Technical Standard ("RTS").

Information disclosed in the KID are:

- product and manufacturer's names, code, supervisory authority;
- a comprehension alert in case of complex product;
- the investment objectives and the means to achieve it;
- the intended retail investors (or "target market");
- the recommended holding period or product's maturity;
- a risk indicator from 1 to 7 combining market and credit risk;
- future performance under different market conditions;
- the breakdown of the costs including transaction costs;
- the impact of the costs on the product's future performance;
- the process to lodge a complaint;
- some explanations in case of default of the manufacturer.

Finally, the KID shall be translated in one of the official languages of the country where the PRIIP is distributed.

In the context of securitisation

Firstly, by "packaged", the PRIIPs Regulation means financial products "where the amount repayable to the retail investor is subject to fluctuation because of exposure to reference values, or subject to the performance of one or more assets which are not directly purchased by the retail investor. […] financial instruments issued by special purpose vehicles that conform to the definition of PRIIPs should also fall within the scope of the PRIIPs Regulation".

Secondly, by "retail" investors, PRIIPs refer to the definition under Market in Financial Instruments Directive ("MiFID"). Briefly, all non-professional investors including well-informed, semi-professional, or high net worth individuals are considered as "retail" investors by the PRIIPs Regulation.

In this context, there are two situations where securitisation vehicles could be impacted by PRIIPs and we will distinguish the situation between direct (requirement to prepare a KID) and indirect impact (requirement to provide information).

1) Direct impact

If securities issued by securitisation vehicles are sold directly to non-professional investors in Europe, a full PRIIPs KID will be required. The KID will need to be finalised and provided to the investors before the transaction. It will also require publication on a website and monitoring. Indeed, any material changes in the KID should trigger immediate update and publication of the document.

2) Indirect impact

When a PRIIP (e.g. an investment fund) invests in securitisation vehicles, they will require cost information to draw the KID. Indeed, where the investments of a PRIIP (i.e. the fund) are not producing a KID, it will be necessary to obtain KID equivalent information for the direct investments (i.e. the securitisation vehicle). All the cost paid by the vehicle during the past year will have to be provided to the fund.

As stated above, a different situation can occur in the specific case of securitisation vehicles, therefore an assessment of potential impact of PRIIPs regime will have to be performed before selling the securities issued by the securitisation vehicles.

6.4 Securitisation in the context of the AIFMD

The AIFMD provides a harmonised regulatory and supervisory framework within the EU, as well as a single EU market for managers of 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 AIFM Law.

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 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 1075/2013 of the ECB of 18 October 2013 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions, replacing Regulation (EC) No 24/2009 (ECB/2008/30). Compared to the Luxembourg Securitisation Law, this EC regulation provides a much narrower definition of securitisation. This definition is also different to the one defined in the EU Securitisation Regulation.

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 its scope. 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.

3. Whether 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.

4. Whether 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, most securitisation vehicles established in Luxembourg are outside the scope of the AIFM Law. Most of the Luxembourg securitisation companies established as platforms issuing structured products through many compartments do not fall within the scope of the AIFM Law. For a securitisation fund issuing only an immaterial number of fund units and the residual funding via debt, in our view, it is legitimate not to consider the securitisation fund as an AIF. It is the responsibility of the securitisation fund's management company to decide whether the securitisation fund is an AIF or not.

Nevertheless, some securitisation vehicles may qualify as an AIF. This is particularly the case if the securitisation vehicle is closely related to a fund in a two-tier structure (see chapter 3.2.5), i.e., the securitisation vehicle acts as an acquisition vehicle purchasing the assets and the related fund acts as an issuing vehicle and finances the securitisation vehicle.

6.5 Distribution and listing

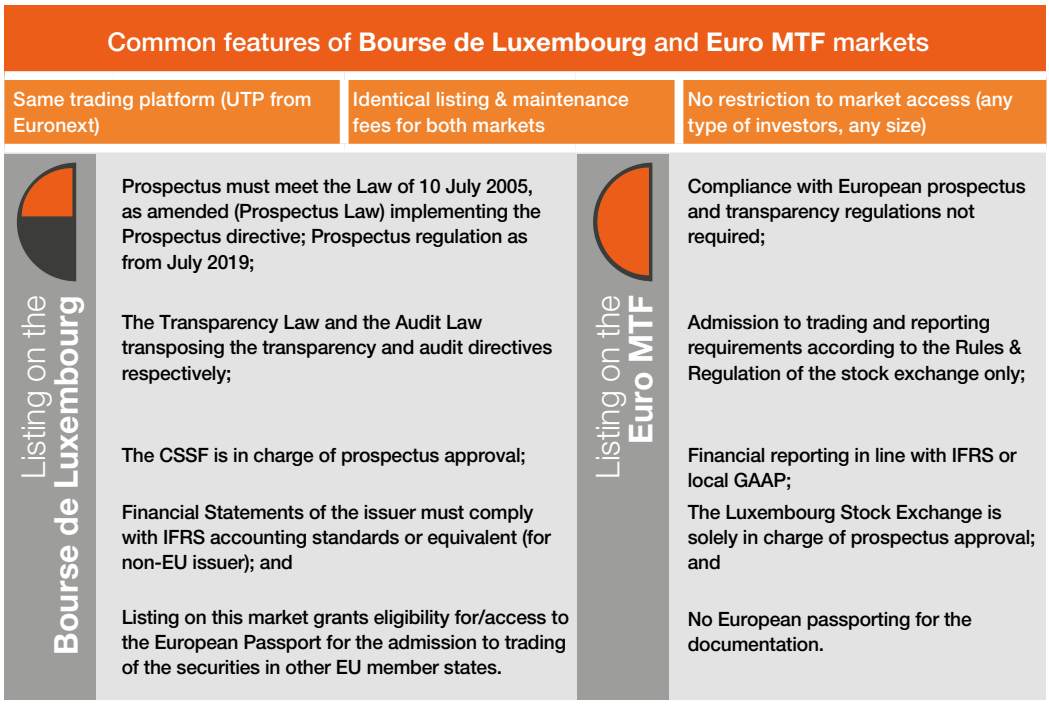
6.5.1 Listing in Luxembourg

There are two possible ways of listing as the Luxembourg Stock Exchange ("LuxSE") operates two markets: (1) the EU-regulated market, the "**Bourse de Luxembourg**", and (2) the exchange-regulated market, the "**Euro MTF**" (see Figure 34).

You can find more information on the listing process in PwC Luxembourg's recent publication "The Luxembourg Stock Exchange: A prime location for listing" (published together with PwC Legal and the Luxembourg Stock Exchange)[3].

[3] Please refer to: **https://www.pwc.lu/en/capital-markets/docs/pwc-luxembourg-stock-exchange.pdf**

Figure 34: Common features of Bourse de Luxembourg and Euro MTF markets



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

For issuers looking for visibility and for whom admission to trading is not prerequisite, the LuxSE offers the possibility to admit securities to its official list without admission to trading. These securities will be displayed on the LuxSE Securities Official List ("LuxSE SOL"), a dedicated section of the entire LuxSE's official list.

Furthermore, disclosures required in the annual accounts of the issuers will differ. Entities having securities listed on an EU-regulated market will always have to publish a management report, a corporate governance statement and a remuneration report and must also be ESEF compliant, except if an exemption applies. While consolidated accounts (securitisation vehicles normally do not have to prepare consolidated accounts) would have to be drawn up under IFRS, stand-alone accounts can still be published under local GAAP. Nevertheless, they should be accompanied by a cash flow statement as per the requirements of the Prospectus Regulation.

The Luxembourg Stock Exchange features two Professional Segments, available on the EU-regulated and the Euro MTF markets. Issuers targeting professional investors can apply to have their financial instruments admitted to trading in the new segments. Admitted securities will not be accessible for retail investors as trading on the Professional Segments is only allowed for professional investors. Advantages of being admitted to trading on the Professional Segments, among other things, consist of having:

- Less onerous information requirements than those applying to securities offered to retail investors;
- No requirement to include a summary in the prospectus;
- More flexible language requirements;
- No requirement to identify, and communicate to distributors, a compatible target market of investors and periodically review that target market;
- No requirement for KID.

6.5.2 Prospectus disclosure obligations

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 the Prospectus Regulation and transposed into Luxembourg legislation by the Luxembourg Prospectus Law.

The Prospectus Regulation responds 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.

On 8 October 2024, the European Council adopted the Listing Act, a significant legislative package designed to make EU capital markets more attractive and accessible to companies, in particular to small and medium-sized enterprises (SMEs) and to enhance transparency, market integrity and investor protection. The Listing Act aims at harmonising the regulatory landscape across EU Member States, to reduce administrative burdens, and to support innovation and economic growth. Now (partly) in force, these legislative changes are expected to simplify access to capital, making it easier for companies, especially SMEs, to list and raise funds while ensuring a higher level of investor protection. The Listing Act includes a

series of measures to revise existing regulations, such as the Prospectus Regulation, Regulation (EU) No 596/2014 (MAR), Directive 2014/65/EU (MiFID II) and Regulation (EU) No 600/2014 (MiFIR), as well as introducing a new directive on multiple-vote share structures. In respect of the Prospectus Regulation the following changes were made (non-exhaustive list):

- Eased Prospectus requirements, such as the introduction of a standardised format and sequencing of the prospectus, the further simplification of the EU Follow-on and the EU growth issuance prospectus

- Changes to exemptions from the obligation to publish a prospectus, The Listing Act now tends to apply a uniform small offer exemption regime across the EU, through a dual-threshold system: i) a principal harmonised threshold of EUR 12,000,000 per issuer over a 12-month period; and ii) an optional lower threshold of EUR 5,000,000, allowing uniformity across the Member States as to the lower threshold. From now on, the EUR 12,000,000 threshold will apply as general rule with the possibility for Member States to apply at their discretion the lower EUR 5,000,000 threshold.

The Prospectus Law differentiates three different prospectus regimes: a "public offer of securities" and/ or an "admission of the securities to trading 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, any communication to persons in any form and by any means presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities will constitute a "public offer" and, consequently, require a prospectus to be published. The same applies to securities admitted to listing on an EU-regulated market as well as placements of securities through one financial intermediary.

However, according to Article 4 (1) of the Prospectus Law and Article 1 (4) of the Prospectus Regulation, the obligation to publish a prospectus does not have to be met, for example, for the following distribution forms, which should be considered as "private placements":

- offers with a total consideration in the EU of less than EUR 8,000,000 (now updated to EUR 12,000,000 by the Listing Act);

- 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

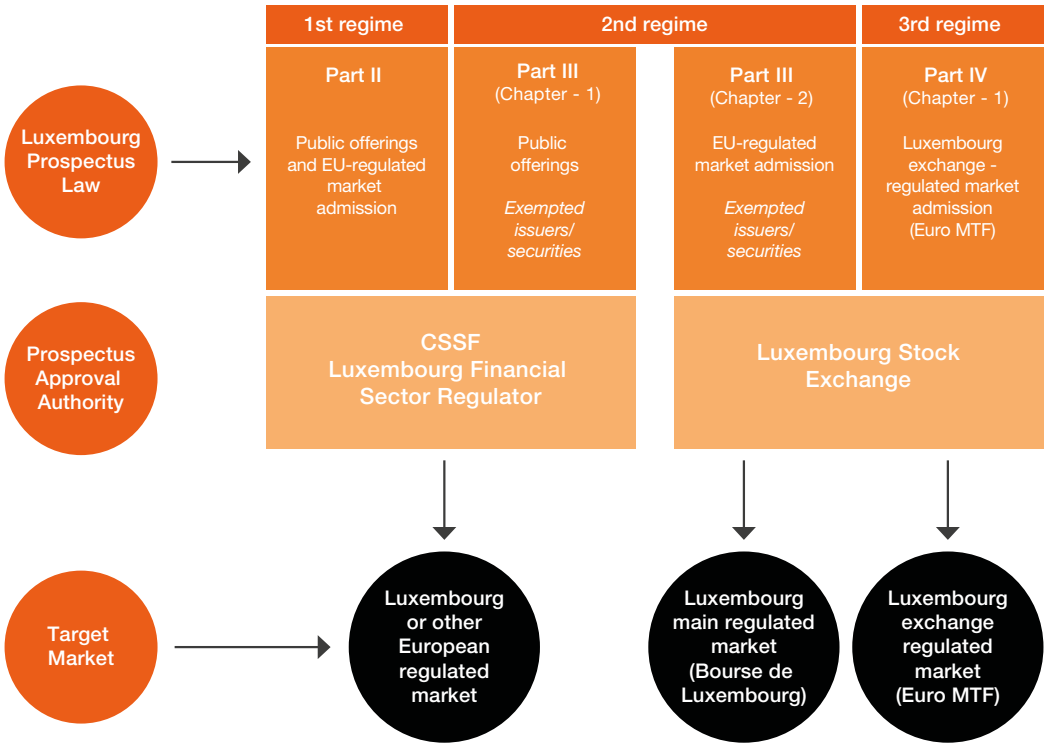
- offers where each security has a nominal value of at least EUR 100,000.

In connection with private placements, there are no further requirements described in the Luxembourg Prospectus Law.

Concerning the information required to be made available to potential investors within private placements, the Luxembourg 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 (summarised in Figure 35):

Figure 35: Prospectus Law requirements



1. The first regime applies to "public offers" of securities within the scope of the Prospectus Regulation 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 of the LuxSE. In this case, the CSSF is the competent authority to ensure that the provisions of the Luxembourg 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. 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.

2. The second regime applies to

   i. "**offering of securities and admissions to trading outside the scope of the Prospectus Regulation**". In case of public offering of these exempted securities, simplified prospectuses have to be drawn up (however with the same private placement exceptions as described above). 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 1 million) and certain debt securities issued by credit institutions for a total amount of less than EUR 75 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 the approving of simplified prospectuses and any related supplement to the prospectuses. Simplified prospectuses, however, do not benefit from the European passport.

ii. In case of admission to trading of these exempted securities on a Luxembourg regulated market, the LuxSE is the competent authority for approving simplified 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.

3. 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, 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.

6.6 Securitisation and CSRD

The Corporate Sustainability Reporting Directive (CSRD) is in the process of being transposed into Luxembourg law. This directive, alongside its national implementation, seeks to enhance and harmonize sustainability reporting standards across the European Union. Expanding on the framework established by the Non-Financial Reporting Directive (NFRD), the CSRD introduces more rigorous and detailed disclosure requirements for companies.

Based on the opinion from the State Council, dated 26 November 2024, the implications for securitisation vehicles are expected to be minimal. The CSRD primarily targets large companies, EU Public Interest Entities (PIEs), and third-country entities with significant business activities within the EU. While certain securitisation vehicles may initially appear to fall within the scope of the directive, clarifications based on the criteria set forth in the Accounting Directive generally exclude them from reporting obligations. Specifically, although many of these vehicles meet the balance sheet threshold of EUR 25,000,000, they typically neither satisfy the employee requirement nor, the net turnover considerations (since the financial income features - commonly constituting the primary revenue stream for securitisation vehicles - is expected not to qualify as net turnover). Consequently, such entities are generally exempt from the sustainability reporting obligations imposed by the CSRD.

6.7 Transposition of the NPL directive into Luxembourg law

The NPL Directive establishes a European framework for the transfer of a creditor's rights under a non-performing loan ("NPL") (more than 90 days past due or terminated). It allows credit institutions to offload NPLs that weigh on their balance sheets, promoting overall financial stability and encouraging new lending activity.

Key features are:

- **Transfer of NPLs:** The NPL Directive facilitates the transfer of NPLs by credit institutions to credit purchasers. This helps reduce the burden of NPLs on banks.
- **Credit Servicers:** A new category of professionals, called credit servicers, manages and enforces NPL-related rights and obligations on behalf of credit purchasers.
- **Disclosure Obligations:** Credit institutions must provide specific pre-contractual information to credit purchasers before entering into NPL purchase agreements.
- **Supervision:** The CSSF supervises credit servicers, ensuring compliance with the directive.

On 18 July 2024, NPL Law was published in the Official Journal of Luxembourg. This NPL Law aims to transpose the NPL Directive into national law. The new regime introduces a new type of specialised professional in the financial sector (PFS) in Luxembourg, known as the credit servicer, and brings significant amendments to the Financial Sector Law.

The NPL Law covers the transfer of creditor's rights under an NPL agreement, or the transfer of the NPL agreement itself, issued by a credit institution established in the EU, from a creditor to a credit purchaser and applies to:

- Credit purchasers: Individuals or entities (excluding credit institutions) who buy creditor's rights under an NPL or the NPL itself during their trade, business, or profession;
- Credit servicers: Legal entities managing and enforcing creditor's rights of an NPL on behalf of credit purchasers and conducting servicing activities;
- Credit service providers: Third parties to whom credit servicers may delegate certain credit servicing tasks.

Exempt from the NPL Law are:

a. credit institutions;

b. authorised or registered alternative investment fund managers (AIFM);

c. investment companies authorised in accordance with the Fund Law;

d. lenders within the meaning of Article L.224-2, point (a) of the Consumer Code which are not credit institutions or lenders other than a credit institution within the meaning of Article L.226-1, point 20, of that Code, subject to the supervision of a competent authority in accordance with Article L.224-21 or Article L.226-1 of that Code;

e. Notaries, bailiffs and lawyers where they carry out servicing activities in the context of their profession.

The NPL Law implements the harmonised licensing regime for credit servicers under

the form of a new specialised PSF supervised by the CSSF. One of the key advantages is, that authorised credit servicers benefit from the European “passport” enabling them to provide services across the EU without the need to obtain additional authorisations in other Member States.

While Luxembourg currently has a limited number of credit servicers, and there is currently minimal interest from new loan servicers due to the relatively small volume of non-performing loans, the regulatory framework could still yield positive effects on the Luxembourg securitisation market. The introduction of this regulation may encourage increased NPL transactions using Luxembourg securitisation vehicles.

07

Governance aspects

Governance aspects

7.1 Anti-Money Laundering obligations

The anti-money laundering and counter-terrorist financing ("AML/CTF") regulatory landscape continues to evolve every year. The expectations of the public for more transparency and the requirements set by the regulators have increased the pressure on the financial professionals operating on the Luxembourg market. With the vote of the EU AML Package set to take effect by 10 July 2027—including wide-ranging EU AML Regulations, Directives, and Guidelines—this trend shows no signs of slowing down. Regulatory and reputational risks remain major concerns for an increasing number of company board members.

Sanctions and fines are still regularly imposed by national supervisory authorities and judges for not respecting anti-money laundering and anti-terrorist financing duties. The risk of damage to the reputation of financial players is considered a priority on the agenda of directors and stakeholders. To regain reputation and trust, governments, regulators, and financial players worldwide have launched important initiatives to control financial systems more efficiently.

In Luxembourg, the regulatory landscape is mainly composed of:

a. the Law of 12 November 2004 (the "AML Law"), amended on 25 March 2020 to transpose the 5th EU AML Directive and lately in July 2022;

b. the CSSF Regulation N° 12-02 of 14 December 2012 amended in August 2020;

c. the Grand-Ducal Regulation of 1 February 2010 amended in October 2022;

d. the CSSF Circular 17/650 issued in 2017 as amended by CSSF Circular 20/744 and addressing the tax crimes as primary offences;

e. the Law of 13 January 2019 ("RBE Law") introducing the national central register of beneficial owners (so-called "RBE");

f. comprehensive guidelines for the establishment of an appropriate risk-based approach, as suggested by the European authorities, are also part of this framework (CSSF Circular 21/782).

Securitisation vehicles are in scope of the AML Law (Art. 2, 6b), but only in cases where they carry out service providers' activities with regard to trust and company service.

In particular, securitisation vehicles "acting as, or arranging for another person to act as, a fiduciaire in a fiducie, a trustee of an express trust or an equivalent function in a similar legal arrangement" are considered to act as "fiduciaires in a fiducie" in line with Article 1(8)(d) of the AML Law and are indeed in scope of the AML Law.

For the securitisation vehicles in the scope of the AML Law as per the above definition, they then need to have a comprehensive AML/CTF framework in place, including among others an AML/CTF Policy, an AML/CTF risk appetite, an AML/CTF risk assessment, and to designate a RC (Responsible of the Compliance) and a RR (Responsible of the Respect).

As a reminder, the RC is the compliance officer in charge of the control of compliance with the securitisation vehicle, i.e. the person who shall implement AML/CFT. The RR is the person responsible for compliance with the professional obligations. The RR is either a member of the Board of Directors, or the Board of Directors as a whole is responsible for the fight against money laundering and terrorist financing.

All the other types of securitisation vehicles, except the ones described above, are excluded from the scope of the AML Law. Most Luxembourg securitisation vehicles do not carry out such service provider activities. In contrast, they themselves receive services from service providers.

Nevertheless, many service providers of securitisation vehicles, like domiciliation agents, paying agents, auditors, etc., must comply with the AML regulations and identify the securitisation vehicles' beneficial owners, as well as analyse business connections and investigate the sources of funds. For example, companies who have their registered offices at third-party addresses may conclude a domiciliation contract with a domiciliation agent. The domiciliation agent is responsible for identifying the Board, the shareholders, and the ultimate beneficial owners, as well as monitoring transactions and checking the names of the persons identified against blacklists.

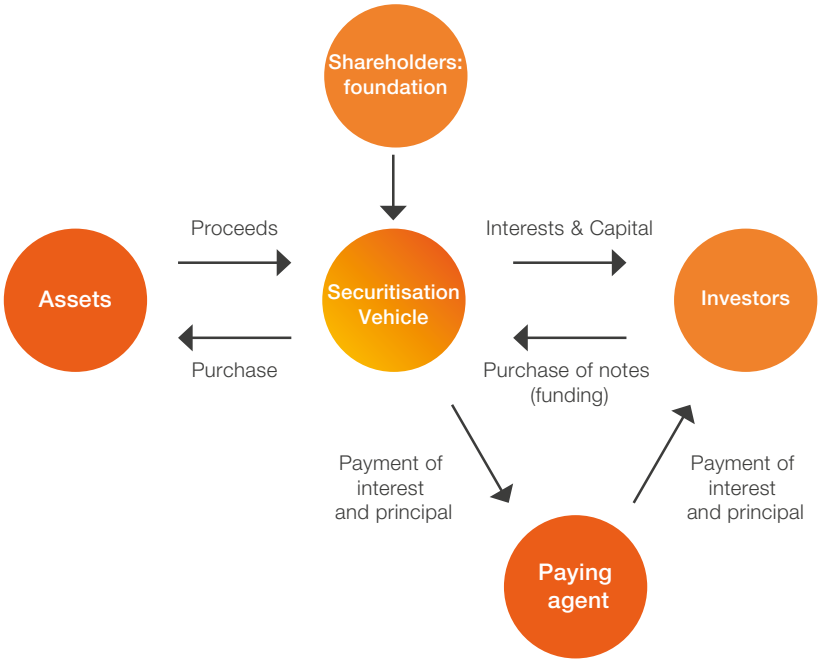
Who are the beneficial owners of a securitisation vehicle?

Or, to put it another way, who are the natural persons who directly or indirectly own or control a securitisation vehicle? 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 with all parties involved in the transaction. Since the RBE Law entered into force, professionals are also required to report such natural persons to the RBE. However, the usual techniques for identifying ultimate beneficial owners often fail for securitisation vehicles, as the shareholder(s) by design typically have no economic interest.

More specifically, the AML Law states that the beneficial owner is a natural person "who ultimately owns or controls" the entity. This definition uses a threshold approach with first an indicative shareholding threshold of 25% or the control via a "sufficient percentage of the shares or voting rights or ownership interest", and second the identification of any person who controls the legal entity via other means. Where no natural person could be identified using these criteria, and after having exhausted all possible means to determine them, provided there are no grounds for suspicion, it is not possible to identify a beneficial owner, the beneficial owner will be "any natural person who holds the position of senior dirigeant (manager)".

Usually, securitisation vehicles are only capitalised with the required minimum capital, which is 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 flow from an economic perspective (refer to Figure 36 for an illustration of the cash flow and involved parties of a typical securitisation transaction). Such vehicles, where the share capital is neither held by natural persons, nor commercial companies, are also referred to as orphan securitisation vehicles.

Figure 36: Cash flow of a typical securitisation transaction



Regarding the noteholders, notes are debt securities and hence cannot be considered as equity. Noteholders do not have any direct or indirect control over the securitisation vehicle and due to the legal nature of the Notes, they have in principle no voting rights.

However, while most securitisation vehicles operate under Lux GAAP, there is one specific situation to consider regarding the noteholders in case IFRS rules are used.

Under IFRS 10, the question of control is to understand when an investor must consolidate an investment in its financial statements.

Therefore, if there are any UBOs who own or control the Noteholder, which consolidates the financial statements of the securitisation vehicle as a whole in its books—these UBOs should be considered by the Board members of the securitisation vehicle as potential UBOs of the entire structure.

Should the consolidation of one or several compartments represent 50% or more of the securitisation vehicle, LuxCMA recommends that the Board members consider that the Noteholder as a dominant individual could be, at the discretion of the Board members, considered as a UBO via control by other means.

In some other cases, the originator of the securitisation transaction might also be considered as the beneficial owner as he will indirectly control and benefit from the transaction. Finally, following the definition of beneficial owners, the board members – being senior managers – might be considered as the beneficial owners of the vehicle.

In certain rare circumstances, for example when using the securitisation vehicle for private family wealth inheritance management, one may consider verifying, if there is any natural person(s) on whose behalf a transaction or activity is being conducted, for the purposes of defining the UBO.

The CSSF Circular 19/732 relating to clarifications on the identification and verification of the identity of ultimate beneficial owner(s) ("UBO(s)") aims to provide guidance to all professionals subject to the AML supervision of the CSSF on the practical implementation of the identification requirements of UBOs, as well as on the reasonable measures that should be taken to verify the identity requirements.

Securitisation can be a complex set-up involving several participants: arranger, originator, securitisation vehicle, custodian, paying agent, etc. There are ongoing discussions on the market on who should be identified as the UBO.

Therefore, it is important that the analysis of the role and the risk associated with each participant is 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, are fulfilled.

Who else may have to be identified from an AML/ KYC perspective?

From a risk-based approach perspective, the securitisation vehicle must be analysed on a case-by-case basis. In particular, it is not only a question of strictly defining individuals who respond to the legal definition of beneficial owners, but also above all identifying and (if applicable) verifying the identity of any persons or entity who could potentially benefit from a money laundering scheme by using the securitisation vehicle for illegal means.

As explained above, noteholders might not be considered as persons exercising control as they invest in debt, do not contribute to the share capital and have no voting rights. As such, they would not meet the legal definition of a beneficial owner. However, applying a risk-based approach would require the service providers of the securitisation vehicle to perform AML/KYC checks on the noteholders considering the money laundering risk related to their role in a securitisation transaction being the main provider of finance.

Who has to be reported as UBO in the Luxembourg beneficial owner register?

All corporate and other legal entities including the securitisation vehicles incorporated in Luxembourg are required to upload information on their beneficial owners in this national central register. The filing is to be done electronically via the website of the LBR ("Luxembourg Business Register") and can be done in French, German, or Luxembourgish. Typically service providers such as the domiciliation agents of the securitisation vehicle will have to provide the required information to the RBE. It is the responsibility of the affected entities themselves, their beneficial owners, or any of their representatives to register the beneficial owners of the entities and provide required information: first and last names, nationalities, date and place of birth, country of residence, address, identification number, nature and extent of the beneficial interests held.

The above listed information in the RBE, previously accessible to anyone without specific conditions, is now only accessible to professionals within the meaning of Article 2 of the amended AML Law.

There is no standard solution on who to report to the RBE and only a case-by-case analysis will show whether the Senior Managing Officials, the charitable shareholder, the shareholders at compartment level, UBOs of noteholders, or maybe other transaction parties should ultimately be reported to the RBE. In any case, it is necessary that the Board members of the securitisation vehicle demonstrate that a proper analysis was conducted and documented considering all the relevant information in order to identify the UBO for the purpose of RBE filing.

7.2 Responsibilities and liabilities of the Board of Directors/Managers

The Luxembourg Securitisation Law does not define specific duties or responsibilities for the members of the management body or Board (e.g., "Board of Directors" for an SA or "Board of Managers" for an SARL; together referred to hereafter "Directors") of the securitisation companies or management companies of securitisation funds (both referred to as "Entity" hereafter). Therefore, their responsibilities are governed by general rules, mostly defined by commercial company law, commercial and civil law and, of course, the statutes/management regulations of the Entity.

The core responsibility of Directors is to take any action necessary or useful to realise the corporate objectives, within the powers vested by law and by the individual statutes or management regulations of each Entity. The protection of the noteholders is equally of essence. Whilst the noteholders may not be known in most cases, their rights, needs and interests must be at the centre of the Board's attention. In addition, the Entity will be represented vis-à-vis to third parties and in legal proceedings by the Directors. Regarding the day-to-day management of the business of the Entity and the power to represent the Entity, 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, under certain conditions, to advisors or other transaction parties, e.g., the paying agent. There are also oversight obligations on the Board to ensure that delegated tasks are performed properly, and that appropriate policies, procedures and escalation procedures exist. Regarding transaction management, the Directors usually approve and sign all transaction documents. Thus, they need to understand the structure, the expected cash flow, 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 Directors are also responsible for the proper preparation of the annual accounts/financial statements and any other reporting obligations (BCL, CSSF, interim accounts, transparency reporting under the EU Securitisation Regulation, as applicable). This compromises an appropriate assessment of the valuation of the underlying assets, either to determine the fair value or to assess the need for an impairment. An auditor

would usually request the preparation of a comprehensive impairment assessment. To prepare the Entity's financial statements, the Directors need to have a broad knowledge of the different accounting principles used, like IFRS and LuxGAAP.

As such, the Directors are exposed to several liabilities. They are jointly liable for all damages adversely affecting the Entity and third parties resulting from breaching the commercial company law or the statutes. In addition, Directors are liable for all possible avoidable administrative mistakes and/or failures made by management.

The Directors can delegate certain tasks like accounting, asset servicing or valuation to third parties. However, the responsibility always remains with them and control and assessment of the third party's work would be required.

Therefore, the 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 might be necessary, e.g., back-testing, checking of input parameters and variation analysis of third-party valuations.

7.3 Requirement to establish an Audit committee

Under the EU Audit Legislation, each EU Public Interest Entity ("EU PIE") shall establish an audit committee. If certain criteria are met, Article 52 (2) allows for the delegation of the tasks of the audit committee to the administrative or supervisory body. Furthermore, Article 52 (5c) of the Audit Law states that any EU PIE whose sole business is to act as an issuer of asset backed securities is exempted from the requirement to establish an audit committee. However, if the exemption is used, the securitisation vehicle shall explain to the public the reasons why it considers that it is not appropriate for it to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee. The Audit Law does not prescribe where or to whom the securitisation vehicle shall make this disclosure. We recommend appropriate disclosure in the management report or in the corporate governance statement. Alternatively, the disclosure to the public can be made through other means such as publication in the RCSL or through the website of the securitisation vehicle. Such disclosure would normally not be made in the notes to the annual accounts.

Below is a summary of the measures that relate to the role and responsibilities of audit committees of EU PIEs:

- inform the directors of the EU PIE about the outcome of the statutory audit and explain its contribution to the integrity of the financial statements;
- monitor the financial reporting process;
- monitor the effectiveness of the internal quality control and risk management systems;
- monitor the process of the audit of statutory financial statements, mainly covering the findings and conclusions;
- oversee the statutory auditor's compliance with additional reporting requirements in the audit report and the report to the audit committee;
- pre-approve permissible non-audit services ("NAS") following an assessment of the threats to independence and the safeguards that the statutory auditor will apply to mitigate or eliminate those threats;
- being responsible for the procedure for the selection of the statutory auditor or audit firm.

08

Other aspects

Other aspects

8.1 Green and Sustainable Securitisation

To make the EU climate-neutral by 2050, the EU27 would require total (i.e. ongoing plus additional) investment of around EUR 1 trillion per year in the 2021-2050 period. However, the European economy is largely bank-financed and the banks alone will not be able to provide the necessary funding. Therefore, the banks will need greater support from the capital markets in order to finance the transition (particularly post implementation of Basel III reforms – banks will be challenged by regulatory capital requirements).

Green securitisation can help address this financing challenge. In addition, securitisation may play an important role in financing environmental, social and governance ("ESG") investments. Such sustainable securitisation transactions apply minimum environmental or social standards with regards to the collateral, the use of proceeds or the originator / sponsor.

The potential advantages of green securitisation are numerous:

- There are a broad range of green assets / exposures that could be securitised – residential and commercial mortgages, car loans and leases, renewable energy project finance, SME loans etc.;
- Securitisation allows the aggregation of small, illiquid exposures into liquid, tradable securities or other financial instruments;
- Unlike conventional green bonds, securitisation allows tranching of risks / returns to the needs of a wider universe of potential investors;
- Securitisation eases banks' capital needs and sectoral concentration risks; and
- It can offer the long tenors needed for pension and insurance companies with long-dated liabilities.

Compared with the USA or China, however, European green securitisation has played a limited role in mobilising finance for sustainable investments. One reason for this may be the stronger policy support in other regions for securitisation in general, and green securitisation in particular. For example, green securitisation is strongly supported in China and in the USA, where there are major issuance programmes by Freddie Mac and Fannie Mae. In contrast, securitisation in Europe has not recovered to the same extent since the financial crisis.

Another reason may be the lack of specific standards for green securitisation, which has been a deterrent particularly for some European investors and issuers, given the tighter regulations and greater perceived reputational risks in Europe around ESG disclosures.

However, as mentioned above, sustainable securitisation could have a key role in (i) improving funding access to sustainable projects, (ii) increasing the ability to originate sustainable loans, (iii) expanding the pool of investors in sustainable projects, (iv) limiting sector exposures to the green industry and (v) helping investors' liabilities to match with tenors' assets.

A 2022 study on ESG Transformation of the Fixed Income Market by PwC Luxembourg and Strategy& Luxembourg suggests strong further potential for growth - 88% of investors that we surveyed were planning to increase their allocations towards GSS bonds or green securitised products in the next years - with three out of four investors targeting allocation increases of over 5%.

Two other developments around standards may also provide positive impetus to the market:

First, in July 2022, the International Capital Market Association (ICMA) provided new guidance on green securitisation and other secured structures in an appendix to its Green Bond Principles, a move that may help to foster growth through greater standardisation.

Second, on 25 October 2023, the European Commission and the European Council have adopted and released the long-awaited EU Green Bond Regulation, introducing the EU Green Bond Standard (EUGBS), which will enter in force as from 21 December 2024 and will provide guidance for sustainable securitisation, as opposed to the development of a new dedicated sustainable securitisation framework.

EU Securitisation Regulation

The EU Securitisation Regulation currently only imposes a limited obligation to publish sustainability information. Indeed, for STS securitisations, the sellside party must publish available information relating to the environmental performance of assets financed by residential real estate loans or car loans or leases. The modifications added to the Regulation in order to support the SIU after the Covid-19 crisis, entitled the originator to publish instead available information on major adverse impacts on sustainability factors of assets funded by the underlying exposures.

The publication of information according to sustainability would add a supplemental value to investors who could de facto measure their own share of investment in environmental, social and governance matters, in order to inter alia assess ESG risks.

With regards to the report published on 2 March 2022 by the EBA analysing the recent developments and challenges of introducing sustainability in the EU securitisation market, the EBA emphasises the fact that the EU sustainable securitisation market is still at an early stage of development. Furthermore, the application of sustainability requirements in securitisation appears to require further clarification[4].

The Commission agrees with the EBA's view that, at least in the short to medium term, there is no need to create a specific sustainability label for securitisations, particularly given the insufficient volume of sustainable assets available to date for securitisation and the lack of proper standards and definitions.

Accordingly, the Commission invites the European Parliament and the Council to take the EBA recommendation (the "EBA Recommendation") into consideration in the context of the ongoing negotiations on the European standards for green bonds ("EUGBS")[5] and stands ready to contribute to the work defining securitisation more precisely in the context of these EUGBS[6].

EU Green Bond Standard

The EU Green Bond Regulation, introducing the EUGBS (which will enter in force on 21 December 2024) aims to establish a voluntary framework for green bonds, including those issued by a securitisation entity in the context of securitisation transactions. To obtain the EUGBS label, the issuer must commit to using the proceeds resulting from the issuance of the European Green Bond to one or more of the following categories: (a) fixed assets that are not financial assets; (b) capital expenditure that falls under point 1.1.2.2. of Annex I to Delegated Regulation (EU) 2021/2178; (c) operating expenditure that falls under point 1.1.3.2. of Annex I to Delegated Regulation (EU) 2021/2178 and was incurred no more than three years before the issuance of the European Green Bond; (d) financial assets that were created no more than five years after the issuance of the European Green Bond; (e) assets and expenditure of households; or (f) a portfolio of fixed assets or financial assets in accordance with the taxonomy requirements

According to the EUGBS, the EUGBS label can be used by the issuer for green bonds if the following conditions are met, namely:

(i) use 100% of its proceeds to finance EU taxonomy compliant investments by the time the bond matures;

[4] EBA Report on developing a framework for sustainable securitisation dated 2 March 2022 available on **https://www.eba.europa.eu/eba-recommends-adjustments-proposed-eu-green-bond-standard-regards-securitisation-transactions**

[5] Proposal for a regulation of the European parliament and of the council on European green bonds dated 6 July 2021 and available on **https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0391**

[6] European Commission, Report from the Commission to the European Parliament and the Council on the Functioning of the Securitisation Regulation dated 10 October 2022 available on **https://eur-lex.europa.eu/legal-content/FR/TXT/?uri=CELEX:52022DC0517**

(ii) comply with the EUGBS disclosures frameworks; and

(iii) appoint an external reviewer, which is registered with and supervised by the ESMA, for their pre-issuance (EU Green Bond Factsheet) and post-issuance documentation (Allocation report).

The concept of the use of proceeds is an important factor for the EUGBS. The European Green Bond securitisation market currently faces growth constraints due to a shortage of taxonomy-aligned assets suitable for securitisation. In response, the European Supervisory Authority (European Banking Authority) suggests applying the use-ofproceeds requirement to the securitisation originator rather than the SSPE (Special Purpose Entity) as a practical approach during the transition phase. This approach is deemed suitable until a sufficient volume of taxonomy-aligned assets is available in the Union economy, as recommended in the report on 'Developing a Framework for Sustainable Securitisation'[7].

[7] Regulation (EU) 2023/2631 of the European parliament and of the council dated 22 November 2023 and available on **https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R2631**

Sustainable Finance Disclosure Regulation (SFDR)

The Sustainable Finance Disclosure Regulation (SFDR) aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make precontractual and ongoing disclosures to end investors when they act as agents of those end investors (principals).

In order to comply with their duties under those rules, financial market participants and financial advisers should integrate in their processes, including in their due diligence processes, and should assess on a continuous basis not only all relevant financial risks but also including all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment or advice.

To enhance transparency and inform end investors, access to information on how relevant sustainability risks are integrated, whether material or likely to be material, in the investment decision making processes, including the organisational, risk management and governance aspects of such processes, and in the advisory processes, respectively, should be regulated by the requirement to maintain concise information about the policies on their websites.

Securitisation vehicles and securitisation exposures do not directly fall within the scope of SFDR. There may be the requirement of a so-called "ESG" reporting which provides data that are required by investors to comply with their SFDR requirements.

Outlook

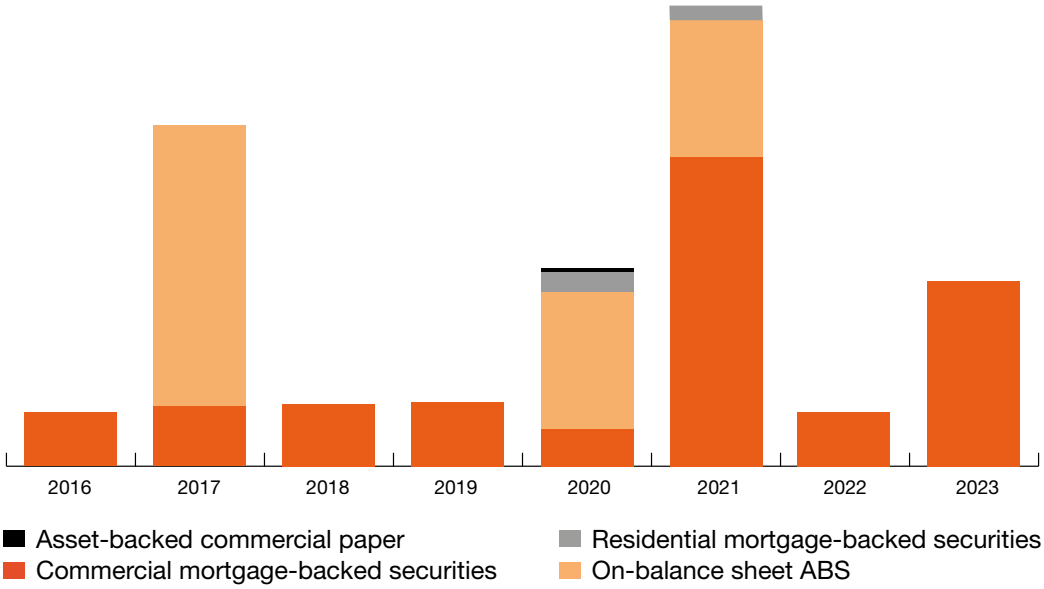
The growing policy support – and investor demand – for green securitisation represents a significant opportunity for Luxembourg and its securitisation market:

- Luxembourg is a leading centre for securitisation and structured finance vehicles, with the Luxembourg Stock Exchange and Green Exchange as pioneers in MBS and green bonds in Europe;
- The flexibility and security offered by the Luxembourg Securitisation Law ensures innovation and legal certainty - Luxembourg already offers a very wide definition of assets and risks that can be securitised;
- EU Securitisation Regulation and STS framework are successful and increasingly used for large investment projects and fully compliant with Luxembourg (Securitisation) Law; and
- There is a strong outlook for Luxembourg's securitisation industry, in face of the SIU and European securitisation market development.

At the same time, the financial services sector needs to work closely together to seize the opportunity. For example, Luxembourg-based green labelling and eligibility criteria for green securitisation could be developed to complement the EU Securitisation Regulation even in advance of – and to complement – the finalisation of the EU Green Bond Standard.

There is also room for promoting the development of green mortgage-based securitisations out of Luxembourg. The EU Taxonomy, the EU Securitisation Regulation and the Energy Efficient Mortgage Action Plan create the opportunity of a standardised "green mortgage" across the EU. Luxembourg should continue to actively market its issuance and trading platforms to European investors in this regard.

Figure 37: European green securitisation issuance by asset class (EUR billion)



Source: AFME ESG Finance Report Q4 2023

8.2 Blockchain and securitisation

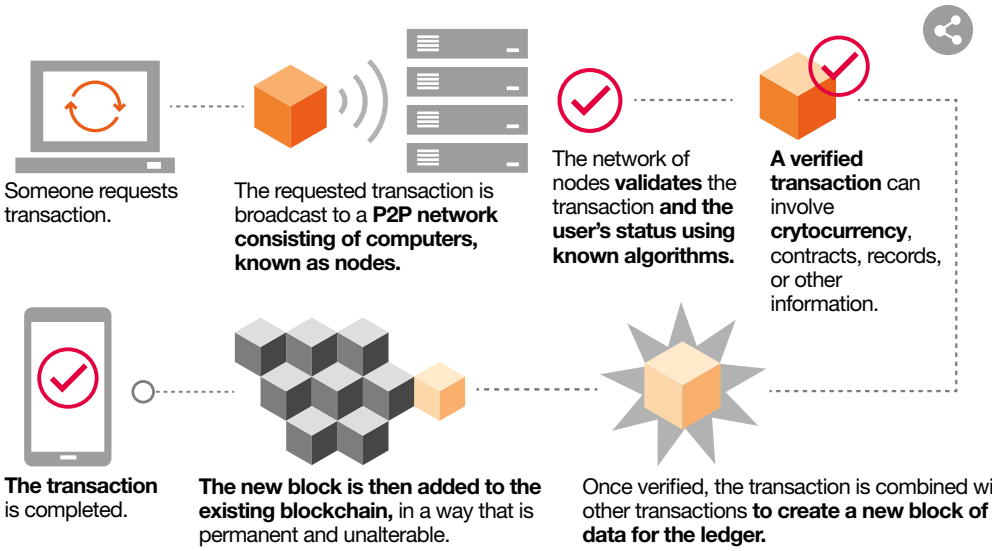
Over the past years, there has been growing interest in the use of blockchain, or distributed ledger technology more broadly speaking, within financial markets. While the evolution of blockchain along with smart contracts for capital markets may still be at a relatively early stage and tokenisation has just started to demonstrate tangible benefits, it promises that securitisation is one of the areas in capital markets that could benefit from the transformation enabled by these technologies.

Blockchain together with smart contracts have the potential to change the role of the parties involved in securitisation transactions, from the originator up to the investor including regulators and auditors. It can also bring significant advantages through streamlined processes, lower costs, increased transaction speed, enhanced transparency and improved security.

Blockchain basics

In simple terms and generically speaking, blockchain is a type of distributed ledger technology ("DLT") that allows simultaneous access, validation, and records updates of transactions across a network of participants. Please refer to Figure 38 for an illustrative example of a blockchain transaction.

Figure 38: Illustrative example of a blockchain transaction



There is not only one type of blockchain but rather a diversity of blockchains which entail a set of common features as well as key design differences, including level of decentralisation, privacy or degree of permissioning for example.

The common features are:

- Trustless network of participants (nodes);
- Decentralisation;
- Records transparency and immutability;
- Consensus mechanism;
- Smart contract integration;
- Access to the network and data ledger.

Smart contracts

Smart contracts are programmable business logic (codes) that enable the automation of contract execution between multiple parties on a blockchain infrastructure. In simple terms, smart contracts autonomously trigger the execution of a defined action upon the occurrence of a predefined event (e.g., interest payments or waterfall computation). They are automated rule-based agreements that require limited, to no, human interaction.

Tokenisation and security tokens

Tokenisation is the process of issuing or converting an asset into a digital form - a token - that is stored on, and transferred over, a blockchain-based infrastructure. The major types of tokens include utility tokens, security tokens, and payment tokens.

The case of security tokens is of particular interest in a securitisation context. Security tokens refer to financial instrument-backed tokens which combine the

technological advancements provided by blockchain and smart contracts with an established regulatory framework since they are expected to fall under existing securities laws and financial instruments regulations.

Tokenisation brings many tangible benefits, some of them include:

- Fractional ownership and enhanced investability;
- Transferability 24/7;
- Shorter settlement time;
- Improved efficiency through programmability features (investors eligibility, restrictions, compliance, etc.).

How can blockchain improve the securitisation lifecycle?

Even though constant improvements of efficiency could be ascertained over the last years in the securitisation lifecycle, there still exists a significant amount of error-prone manual interventions, inefficiencies, and opacity from origination up to the trading of the securities issued.

Origination process

The asset related data within the origination process such as contractual terms, borrower credit profiles and collateral information are rarely standardised between the different parties involved in the process (e.g. originator, asset servicer, trustee, investors, rating agencies) and still include a considerable amount of paperwork. Even the digital champions under the originators are obliged to keep some documents on paper, such as deeds and appraisals. Moreover, the involved parties usually store the same type of data in different formats in each of their own data warehouses. While this provides extra security, it also comes with a lot of manual input in the reconciliation processes, giving rise to potential inconsistencies among the parties and leading to inefficiencies, time lags and additional costs in the entire process which reduces the market efficiency.

While blockchain will not directly impact the standardisation of underlying asset data, it can serve as a distributed infrastructure within which each stakeholder can contribute data according to a predefined framework and ensure consistency, availability and safety of the data. Doing so will create a single version of the truth available to all participants and significantly reduce the risk of inconsistency as well as the need for reconciliations. As a result, risk or errors are reduced, processing times are improved and workflows between the different parties involved are made more efficient.

Structuring of the security

Setting up a Special Purpose Vehicle (“SPV”) and structuring the security is considered to be a complex exercise, but there is a lot of duplicating work. While all the different parties use the same offering documents of an SPV, servicers, investors, accountants, trustees, and any other party involved, use their own independent systems to calculate the waterfall of payments for the same securitisation structure and may arrive at different results due to the different interpretation of the terms of transaction.

The distributed environment provided by blockchain significantly improves the traditional siloed and sequenced context under which transactions are taking place. The way information is stored, available and secured increases data consistency, and consensus mechanisms amongst network participants can reduce the risk of different interpretations.

Another focus lies on the risk of fraud. Investing in assets that may not exist, or assets which were double pledged, can lead to serious financial losses for the investors. Investing in trade receivables, for example, gives rise to an increased risk regarding the existence of the asset.

Mitigation of this risk comes with an increased cost, under the form of lengthy and costly due diligence. Blockchain technology will help to reduce this risk of fraud. Indeed, any member of the designed ecosystem (and the general public in the case of public blockchain) will be able to view the assets on the blockchain as well as the owner address. Moreover, it is not possible to have two owners for the same asset. The tokenisation of underlying assets could provide full transparency over assets' underlying data and more importantly could reduce the risk of fraud by ensuring assets' existence and pinpointing any pledge already in place, solving double pledging issues. The transparency added by this type of technology combined with a diligent data audit will bring further trust to the securitisation market.

Servicing and trading the security

After the transaction is concluded and the security hits the primary market, the participants involved incur a multitude of costs (research, due diligence) in order to gather reliable information about it. Usually, due to time lags, investors and rating agencies have to make decisions without having the full picture, while the asset servicer can provide accurate information only after the final payments are made to investors.

While these costs and delays may be considered small for individual entities, they are important for the securitisation market in aggregate. The review of the currently existing heterogeneous asset related data which is stored in multiple locations comes with high costs especially for the asset servicers, but also other parties involved.

Tokenisation of the security could greatly improve the transparency of underlying data (from assets' origination to security issuance) and create a data rich environment where the token holder could have access to all underlying security data made available at any time. This would reduce information asymmetry and would improve market efficiency.

Furthermore, smart contract integration could allow for builtin compliance, ensuring that investors' eligibility and/or any defined security rules are enforced autonomously at token level.

Secondary market trading

Secondary market are mainly related to liquidity constraints and different level of information between the investors. Compared with the primary market, where all the players have the same level of information regarding the asset classes in which they want to invest, on the secondary markets, some investors with closer relationships to brokers/dealers may get information faster and more accurately. Whilst this would represent an advantage for them, for the market as a whole this is negative, due to the limitation on the number of investors. The limited access to data or delays in accessing the information about the underlying asset, may raise questions about the quality of the asset, for all the investors.

Similarly to primary issuance, blockchain has the potential to improve data transparency and to provide for programmability features (including post issuance security events).

In addition, security tokenisation would provide for the digitisation of the shareholder/noteholder register (i.e. any transactions would be automatically reflected in the register, ensuring continuously up-to-date ownership data) as well as enhanced transferability of the security.

Legal and regulatory developments

While regulatory clarity has improved over the last years, and technological neutrality is more often than not a key design principle of new laws and regulations, the regulatory framework around DLT and security tokens is still a work in progress. The developments regarding the recognition of tokenised securities as financial instruments or the Pilot Regime support the developments of DLT market infrastructures. They open the door for organised and regulated markets for security tokens. It will be particularly important to closely monitor the progress of the legislative processes and to ensure a clear understanding of the ins and outs of upcoming texts.

Luxembourg's legal framework

Following the successful implementation of Blockchain Laws I, II, and III, Luxembourg has taken the next step in modernising its financial sector with the adoption of the Blockchain Law IV on 19 December 2024. The previous legislative developments progressively integrated Distributed Ledger Technology (DLT) into the securities market, ensuring the legal recognition of DLT-based transactions, enabling the issuance and transfer of dematerialised securities, and aligning Luxembourg's framework with EU-wide regulations on digital finance. With each iteration, Luxembourg has reinforced its position as a global leader in financial innovation.

The adoption of the Blockchain Law IV, marks a next significant step in modernising the securities market by enhancing the use of DLT for securities management, trading, and reconciliation. The law strengthens legal certainty, efficiency, and transparency, further reinforcing Luxembourg's position as a financial innovation hub.

A key feature of the law is the introduction of a control agent for issuers opting to use DLT for dematerialised securities. This agent, which can be an investment firm, credit institution, or settlement system, is responsible for keeping issuance accounts, tracking the chain of ownership, and reconciling issued securities in real time. This new model is an alternative to the existing model that requires the establishment of a two-tier custody chain between the central account holder and the secondary account holders. The role of the control agent improves market efficiency and security by ensuring that transactions are transparent, reducing administrative burdens, and lowering operational risks.

The law amends key existing regulations, including the DS Law and the Financial Sector Law. These amendments define the technical and governance requirements for control agents and introduce a notification requirement to the CSSF for those engaging in such activities. Furthermore, the law expands the role of banks and investment firms, allowing them to act as central account keepers for non-listed debt and equity securities.

By embracing DLT and adapting its regulatory framework, Luxembourg cements its status as a leading European financial center for digital securities, setting a precedent for innovation while ensuring regulatory security and investor confidence.

Outlook

The future of blockchain and tokenisation in securitisation looks promising, with ongoing regulatory developments and technological advancements paving the way for greater adoption. The ability of DLT to enhance transparency, reduce manual inefficiencies, and mitigate fraud risks will continue to drive interest from issuers, investors, and regulators. As the Pilot Regime progresses and tokenised securities become more integrated into financial market infrastructures, the securitisation market will likely see a shift toward digitalisation, automated transactions, reducing operational costs and improving market efficiency. However, for widespread adoption, challenges such as regulatory clarity, interoperability between blockchain networks, and standardisation of token protocols must be addressed.

8.3 Securitisation in the context of the Luxembourg toolbox

	Securitisation vehicle	UCI Part II	SIF	ELTIF	RAIF
Background	Highly flexible, mainly unregulated multipurpose investment vehicle transforming assets or risks into financial instruments Governed by the Securitisation Law	The classic regulated alternative investment fund publicly distributed in Luxembourg Governed by «Part II» of the Fund Law	Regulated and flexible multipurpose investment fund regime for institutional investors Governed by the SIF Law, which is split in two sections (general provisions and those applicable to AIFs only)	All vehicles that qualify as an alternative investment fund (AIF) under the AIFM Law can qualify as ELTIF, provided they fulfil the requirements established by the ELTIF Regulation.	Very flexible, multipurpose alternative investment fund without (direct) supervision by the CSSF on product level Governed by the RAIF Law, oriented at SIF and SICAR regimes
Legal form	Securitisation Company, in the form of SA, Sarl, SCA, SCoopSA, SNC, SCS, SCSp and SAS Securitisation Fund, in the form of co-ownerships or fiduciary estate, managed by an unregulated management company Segregated sub-funds/ compartments possible	Fonds Commun de Placement (FCP) Société d'Investissement à Capital Variable (SICAV), in the form of a SA Société d'Investissement à Capital Fixe (SICAF), in the form of SA, Sarl, SCA, SCS or SCSp Segregated sub-funds/ compartments possible	FCP SICAV/SICAF, in the form of SA, Sarl, SCA, SCS, SCSp or SCoopSA Segregated sub-funds/ compartments possible	An ELTIF may have any legal form available to an AIF. The legal forms available in Luxembourg for include (without limitation): - Corporations (SICAV or SICAF in various legal forms, Soparfis); - Mutual funds (FCP); - Partnerships (SCS, SCSp, SCA).	FCP SICAV/SICAF, in the form of SA, Sarl, SCA, SCS, SCSp or SCoopSA Segregated sub-funds/ compartments possible
Minimum capital requirements	Securitisation Company: depending on legal form (e.g. SA: EUR 30k, Sarl: EUR 12k, Partnerships: none) Securitisation Fund: none (but for management company depending on legal form)	EUR 1.25 million to be reached within twelve months of authorisation	EUR 1.25 million to be reached within twenty four months of authorisation	EUR 1.25 million to be reached within twenty-four months after set-up	EUR 1.25 million to be reached within twenty four months after set-up
Supervision	No supervision by CSSF (except if continuously issuing to the public) Luxembourg Securitisation Vehicles do normally not qualify as AIF (see CSSF FAQ)	Supervised by the CSSF Qualify as AIF as per Law of 12 July 2013 ("AIFM Law") and require an authorised Alternative Investment Fund Manager (AIFM)	Supervised by the CSSF Most SIFs qualify as AIF and require an authorised AIFM	Supervised by the CSSF and require an authorised AIFM	RAIF itself not supervised by CSSF but has to be managed by an authorised AIFM All RAIF qualify as AIFs and require an external authorised AIFM
Investment restrictions	No restriction of eligible investments (but no entrepreneurial activity) No risk diversification requirement No restriction of investor types (but CSSF supervision if continuously issuing to the public)	No restriction of eligible investments (but prior approval of investment objective and strategy by CSSF) Some risk diversification required (max. 20% of NAV per investment) No restriction of investor types	No restriction of eligible investments Some risk diversification required (max. 30% of NAV per investment) Well-informed investors only, i.e. institutional, professional investors or high net-worth individuals	55% the ELTIF's net assets need to be comprised of eligible enterprises (equity or quasi-equity, debt instruments and loans). If set up for private investors, risk spreading is required (concentration limit of maximum 30%).	No restriction of eligible investments Some risk diversification required similar to SIF, except if exclusively invested in risk capital (no diversification required) Well-informed investors only

	Securitisation vehicle	UCI Part II	SIF	ELTIF	RAIF
Valuation of assets (LuxGAAP)	Securitisation Company: at (i) cost less impairment, (ii) lower of cost or market, or (iii) fair value option Securitisation Fund: at realisable value estimated in good faith (if not provided for differently in management regulations/ constitutive documents)	At realisable value estimated in good faith (if not provided for differently in management regulations/constitutive documents)	At fair value (if not provided for differently in management regulations/constitutive documents)	At fair value (if not provided for differently in management regulations/constitutive documents)	At fair value (if not provided for differently in management regulations/ constitutive documents)
Tax status	Securitisation Companies: fully taxable while exempt from net wealth tax (except for minimum net wealth tax). In addition, distributions to investors/creditors are fully tax deductible, i.e. reducing the tax base Securitisation Fund: tax-exempt from direct taxes (income and net wealth tax) Neither Securitisation Company nor Securitisation Fund subject to subscription tax Subject to VAT but exemption on management services	Tax-exempt from direct taxes (income and net wealth tax) Subscription tax (taxe d'abonnement) of 0.01% or 0.05% of NAV p.a. Subject to VAT but exemption on management services	Tax-exempt from direct taxes (income and net wealth tax) Subscription tax of 0.01% of NAV p.a. Subject to VAT but exemption on management services	This depends on the regulatory regime that will be applicable to the AIF, which was set up as an ELTIF. There is currently no special tax treatment available for ELTIFs.	Tax-exempt from direct taxes (income and net wealth tax) like a SIF as long as not invested exclusively in risk capital. In that case, taxation like SICAR and subject to the minimum net wealth tax Subscription tax of 0.01% of NAV p.a.; exempt if taxed like SICAR Subject to VAT but exemption on management services
Treaty status	Securitisation Company: may have access to several Luxembourg DTT Securitisation Fund: generally have no access to DTT	FCP generally have no access to DTT SICAVs and SICAFs may have access to several Luxembourg DTT	FCP generally have no access to DTT SICAVs and SICAFs may have access to several Luxembourg DTT	FCP generally have no access to DTT SICAVs and SICAFs may have access to several Luxembourg DTT	RAIFs under SICAR tax regime and in corporate form may have access to several Luxembourg DTT FCP and partnerships generally have no access to DTT SICAVs and SICAFs (non-SICAR regime) may have access to several Luxembourg DTT
Withholding tax	Distributions from an SV are not subject to Luxembourg WHT	Distributions from a UCI Part II are not subject to Luxembourg WHT	Distributions from a SIF are not subject to Luxembourg WHT	Distributions from an ELTIF are not subject to Luxembourg WHT	Distributions from a RAIF are not subject to Luxembourg WHT

09

Glossary

Glossary

This Glossary provides you with a list of terms and definitions help you understand technical vocabulary and legal references used in this brochure in alphabetical order. It was compiled with the use of AI.

The Glossary is split into three parts: (i) Luxembourg Laws, (ii) EU Regulations and Directives and (iii) Securitisation Terms.

We have decided to include in the Securitisation Terms section not only terms mentioned in this brochure, but also other terminology generally used in the context of securitisation transactions. As such, you can use it as a general reference guide whenever you need a quick definition of a term.

Please note that the legal acts referred to in this brochure are understood to be the acts in their version currently in force. Furthermore, the definitions provided below may deviate from those used in regulatory texts like the EU Securitisation Regulation. For regulatory purposes the definitions of the Regulation shall prevail. Also, when referring to "Securitisation Vehicle" or "SV" in the definitions below, in the Luxembourg context this may apply to each of the individual compartments of an SV rather than of the company or fund as a whole.

Luxembourg Laws

Accounting Law	Law of 19 December 2002 on the trade and companies register and the accounting and annual accounts of companies
AIFM Law	Law of 12 July 2013 on alternative investment fund managers
Audit Law	Law of 23 July 2016 concerning the audit profession
Blockchain Law I	Law of 1 March 2019 amending the law of 1 August 2001 on the circulation of securities
Blockchain Law II	Law of 22 January 2021 amending the modified law of 5 April 1993 on the financial sector and the law of 6 April 2013 on dematerialised securities
Blockchain Law III	Law of 15 March 2023 implementing the EU Regulation 2022/858 on a pilot regime for market infrastructures based on distributed ledger technology
Blockchain Law IV	Law of 20 December 2024 amending the amended law of 6 April 2013 relating to dematerialised securities, the amended law of 5 April 1993 relating to the financial sector and the amended law of 23 December 1998 establishing a financial sector supervisory commission
Commercial Law	Law of 10 August 1915 on commercial companies
DAC 6 Law (or MDR Law)	Law of 25 March 2020 on reportable cross-border arrangements
DS Law	Law of 6 April 2013 on dematerialised securities
Financial Sector Law	Law of 5 April 1993 on the financial sector
Fund Law	Law of 17 December 2010 on undertakings for collective investment
Income Tax Law	Law of 4 December 1967 on income tax
Luxembourg Securitisation Law	Law of 22 March 2004 on securitisation
NPL Law	Law of 15 July 2024 on the transfer of non-performing loans
MDR Law (or DAC 6 Law)	See DAC 6 Law
Prospectus Law	Law of 16 July 2019 on prospectuses for securities
SIF Law	Law of 13 February 2007 relating to specialised investment funds
Transparency Law	Law of 11 January 2008 on transparency requirements for issuers

EU Regulations and Directives

AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010
Anti-Tax Avoidance Directives (ATAD)	A set of EU directives implementing minimum standards for preventing tax avoidance practices: (i) Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD 1); (ii) Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (ATAD 2); and (iii) Procedure 2021/0434/CNS: COM (2021) 565: Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU (ATAD 3)
Capital Requirements Regulation (CRR)	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
Corporate Sustainability Reporting Directive (CSRD)	Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting
EU Audit Legislation	A set of EU directive and regulation on audit requirements (i) Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts; and (ii) Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC
EU Securitisation Regulation	Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012
European Green Bond Standard (EUGBS)	Regulation (EU) 2023/2631 of the European Parliament and of the Council of 22 November 2023 on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds
Listing Act	A set of EU regulations and directives published on 14 November 2024: (i) Regulation (EU) 2024/2809 of the European Parliament and of the Council of 23 October 2024 amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises; (ii) Directive (EU) 2024/2810 of the European Parliament and of the Council of 23 October 2024 on multiple-vote share structures in companies that seek admission to trading of their shares on a multilateral trading facility; and (iii) Directive (EU) 2024/2811 of the European Parliament and of the Council of 23 October 2024 amending Directive 2014/65/EU to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises and repealing Directive 2001/34/EC
NPL Directive	Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU
Pilot Regime	Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU
PRIIPs Regulation	Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)
Prospectus Regulation	Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC
Solvency II Directive	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)
Sustainable Finance Disclosure Regulation (SFDR)	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability related disclosures in the financial services sector
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Securitisation Terms

Arranger	The party (often an investment bank) that has the idea for and puts in place the securitisation transaction. It brings together the investors and the pool of assets. The arranger evaluates the assets, determines the characteristics of the securities to be issued, assesses the need for specific structuring and arranges for distribution of the securities issued to the investors
Asset-Backed Commercial Paper (ABCP)	Short-term debt instruments (so-called commercial papers) issued by a SV and backed by a pool of underlying assets, mostly trade or lease receivables. The term of the ABCP is typically between 90 and 270 days in duration. The SV may be established for a single seller of receivables or for a pool of sellers (multi-seller ABCP conduit). ABCPs are used by seller companies to meet short-term liquidity needs at relatively low borrowing costs. With a generally high credit quality and short maturity, they are an attractive investment for investors
Asset-Backed Securities (ABS)	General term used for securities issued by an issuer vehicle, which are backed by a pool of various types of assets (such as loans, leases, or receivables). The payment obligations of the issuer vehicle are linked to, but also limited to, the cash flows generated by these assets. Inter alia, ABS allow for transforming illiquid assets into tradeable securities
Asset servicer	An asset servicer is an entity responsible for managing and administering the asset portfolio on behalf of the SV. This typically includes monitoring of the assets, their valuation and the respective reporting. The asset servicer may be a third party or the seller / Originator of the assets. In certain, pre-agreed circumstances, the SV can nominate a backup servicer to replace the Asset servicer. A backup servicer steps in to manage the servicing duties of the portfolio if the primary servicer is unable to perform its responsibilities (e.g. due to events like bankruptcy, default, or failure to meet performance metrics). This ensures that collections and payments continue smoothly
Bankruptcy-remote	A legal structure designed to protect an entity or asset pool from the risk of bankruptcy. It ensures that in the event of bankruptcy, the assets held by the SCV (or similar structure) remain separate and unaffected by the originator's financial distress
Beneficial interest	Beneficial interest means the right to benefit from cash flows independent of the legal title. In a securitisation transaction, the receivables, the legal title over cash flows or the security interest thereon are legally held by the SV or trustee. However, the SV has the obligation to distribute the cash flows to the investors in a pre-defined manner. The investors are thus ultimately benefitting from the investment
Calculation agent	An independent third-party responsible for calculating and reporting to the investors on certain items like interest, principal repayments, profit participation (if applicable), etc
Cash collateral	The cash collateral comprises funds and assets held as security to mitigate potential credit risk. The SV may post or receive such cash collateral depending on its position in the securitisation transaction. For example, the Originator may deposit some cash into the SV's bank account to enhance the creditworthiness of the pool of assets for the investors. The cash collateral is not normally used by the SV to acquire receivables but kept as a buffer to protect against potential losses. The cash collateral is held as reserve fund on the Cash Collateral Account (CCA)
Cash manager	The party managing the cash flows as agent of the SV by administrating the transaction account and the funding account in accordance with the applicable terms and conditions. The cash manager ensures that payments are made according to the cash flow waterfall and that all parties receive their due allocations
Clean up or buyback call	A mechanism in some securitisation transactions where the originator or a specified party have the option to repurchase or call back the remaining assets once the principal outstanding has been amortised below a certain threshold. This often leads the early termination of this securitisation transaction
Collateral	Assets legally owned by the SV but pledged by a borrower (or the noteholders) to secure a loan or other financial transaction. In the case of default, the collateral can be seized by the borrower to satisfy the debt
Collateral manager	The entity responsible for managing and overseeing the collateral in a securitisation transaction. The collateral manager's duties may include selecting, monitoring, and maintaining the quality of the collateral pool
Collateralised Bond Obligations (CBO)	A type of structured financial product that pools various bonds and issues different tranches of securities to investors based on the risk and return profile of the underlying bonds
Collateralised Debt Obligations (CDO)	A structured financial product that pools a variety of debt instruments (e.g., loans, bonds) and tranches them into different levels of risk and return for investors

Collateralised Fund Obligations (CFO)	Similar to a CDO, but the underlying assets are typically equity and debt funds, which are then structured and sold to investors in tranches
Collateralised Loan Obligations (CLO)	A type of CDO that specifically involves pooling and securitising a portfolio of loans, usually leveraged loans. CLOs allow investors to gain exposure to corporate loans while diversifying the risk across multiple borrowers
Collateralised Mortgage Obligations (CMO)	A type of Mortgage-Backed Security (MBS) that divides a pool of mortgages into tranches based on their risk and maturity profiles, allowing for a tailored investment approach to different investor preferences. The securities issued are usually structured and served in accordance with investors' objectives and risk profiles
Commercial mortgage-backed securities (CMBS)	A type of mortgage-backed security that is backed by commercial real estate loans. These loans are typically used for office buildings, shopping centers, and other commercial properties
Conduit	A special purpose vehicle (SPV) used in securitisation to hold and manage assets. Conduits often issue asset-backed commercial paper (ABCP) and other securities to fund their operations
Covenant	A clause in a financial agreement (e.g., loan, bond) that imposes specific requirements or restrictions on the borrower or issuer (here: the SV), such as maintaining certain financial ratios or limits on additional debt
Credit Default Swap (CDS)	A financial derivative that provides (or gives) protection against the default of borrower or issuer (or a pool of borrowers/issuers). The buyer of a CDS makes periodic payments in exchange for a payout if the underlying reference entity defaults (based on pre-defined criteria). A SV can act as protection buyer as well as protection seller.
Credit enhancement	Techniques used to improve the creditworthiness of a financial instrument, e.g. the notes issued of a SV. These techniques include over-collateralisation, guarantees, or insurance. They help to make the financial instrument more attractive to investors, e.g. by an improved rating. Credit Enhancement devices can be differentiated as structural credit enhancement (e.g. tranching), originator credit enhancement (e.g. overcollateralisation) and third-party credit enhancement (e.g. credit insurance). The former two are internal credit enhancements while the latter would classify as external credit enhancement
Credit Linked Note (CLN)	A financial instrument that links the credit risk of a reference entity to the performance of the note issued by the SV. In a CLN, the issuer agrees to pay a return to the investor unless a predefined credit event (such as a default) occurs, in which case the investor may lose part or all of its investment
Deferred purchase price	The portion of the purchase price in a transaction, such as in the asset purchase of a securitisation transaction, that is not paid immediately but is instead deferred to be paid at a later time or contingent upon the performance of the underlying assets. As such, it may serve as credit enhancement
Derecognition	The process of removing an asset or liability from the balance sheet, typically when the risks and rewards of ownership have been transferred to another party. In securitisation, derecognition refers to the removal of assets (like loans or receivables) from the Originator's balance sheet after they are sold or transferred to a SV. The criteria for (de-)recognition may differ for different accounting standards
Eligibility criteria	The set of rules or conditions that an asset must meet to be included in a securitisation pool. These criteria ensure that only assets that meet certain quality standards are securitised, thus protecting investors. The eligibility criteria are usually stated in the receivables sale agreement with a provision that a breach of the criteria would oblige the originator to buy back these receivables
Excess spread	The difference between the yield on the underlying assets in a securitisation and the cost of funding the transaction. Excess spread can be used as an additional credit enhancement or to absorb potential losses
Expected maturity	The anticipated time for the full repayment of the financial instruments issued by the SV, based on the projected cash flows of the underlying assets. The expected maturity is usually not equal to the legal final maturity. It is often used as a reference for pricing and investment decisions
Extension risk	The risk that the maturity of the underlying assets in a securitisation will be extended due to slower-than-expected prepayments. This could affect the timing of cash flows to investors, i.e. later-than-expected return of principal, and increase the duration of the investment. Opposite of Prepayment Risk

First-loss risk	The risk borne by the first tranche or layer of a securitisation, which absorbs the initial losses in the event that the underlying assets default or underperform. This tranche is typically the most risky and offers higher returns to compensate for the risk. It is often called “Junior” or “Equity” tranche and receives the highest possible return
Future-flows securitisation	A securitisation structure where the assets being securitised are future cash flows rather than existing assets. For example, future receivables or contractually agreed payments that will arise in the future only are securitised to generate capital upfront. For exaple, an Originator sells its expected future receivable to a SV to obtain upfront financing from investors. Such type of securitisation is more risky than the securitisation of existing assets
Investment grade	A rating that indicates a low risk of default on an investment, typically given to securities that meet certain financial and creditworthiness criteria. Investment-grade securities are typically considered safer investments and often have lower yields. 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 Baa3 or higher
Issuer	The entity that creates and sells the securities or financial instruments in a securitisation transaction. The Issuer is typically a special purpose vehicle (SPV) or a trust created to facilitate the securitisation process. In Luxembourg, usually an entity subject to the Luxembourg Securitisation Law (a SV) is used
Junior bonds	Bonds that are subordinate to other bonds in a securitisation structure. Junior bonds carry higher risk but offer higher yields, as they are the first to absorb any losses in the event of defaults or underperformance of the underlying assets. They are also referred to as “First-loss” or “Equity” tranche
Legal final maturity	The final maturity by which a financial instrument issued 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	A financial instrument issued by a bank or financial institution that guarantees payment to a creditor if certain conditions are met. In securitisation, a letter of credit can serve as (external) credit enhancement to protect investors against default or underperformance.
Limited recourse	A clause in a financial agreement (or, in the case of Luxembourg, by law) that limits the ability of creditors or investors to pursue claims beyond the assets or collateral specifically pledged in the transaction. In securitisation, this clause ensures that investors’ claims, i.e. their right of recourse, are restricted to the assets in the securitised pool or compartment
Liquidity facility	A line of credit or other financing arrangement provided by the Sponsor to support a securitisation or asset-backed commercial paper (ABCP) program. The liquidity facility ensures that funds are available in case of liquidity shortfalls or if investors demand early repayment
Liquidity provider	An entity that provides a liquidity facility, ensuring that a securitisation or investment product has sufficient funds to meet obligations as they arise. Liquidity providers help maintain the stability of the transaction and support investor confidence
Listing agent	The Listing Agent is an intermediary between the SV, its Arranger, its legal advisor and a stock exchange when listing is intended, Usually, a financial institution or advisor acts as Listing Agent and is responsible for managing the listing process of the issued securities on a stock exchange. The listing agent ensures that all necessary requirements are met for the securities to be officially listed and available for trading
Mezzanine bonds	Bonds issued in the middle tier of a capital structure in a securitisation. In the Priority of Payments, they rank after senior bonds, but before junior bonds and offer a respective yields and risk profile
Mortgage-Backed Securities (MBS)	Securities that are backed by a pool of mortgages, typically residential (RMBS) or commercial (CMBS). MBS allow investors to receive income from mortgage payments. The risk and return depend on the performance of the underlying mortgages pool
Non-petition clause	A clause in a securitisation agreement (or, in the case of Luxembourg, by law) that prevents investors from petitioning for the bankruptcy of the issuer or special purpose vehicle (SPV or SV) that holds the assets. This clause ensures the stability of the securitisation structure and reduces legal risks by protecting the SV against the actions of individual investors
Originator	In the context of securitisation, an Originator is the entity that initially owns the assets or loans that are being securitised. Typically, this is a lender, such as a bank or financial institution, that has underwritten and issued the loans. The Originator transfers these assets to a Special Purpose or Securitisation Vehicle (SPV or SV), which then issues financial instruments backed by these assets to investors. The originator often benefits from securitisation by removing these assets from its balance sheet, thereby freeing up capital and potentially achieving a lower cost of funding. This process also helps in diversifying funding sources and managing risks more effectively

Prepayment Risk	Prepayment risk in securitisation refers to the risk that borrowers will repay their loans earlier than expected. This can also affect the cash flows of the financial instruments issued which are backed by those loans, such as mortgage-backed securities (MBS). Investors then receive their principal back sooner than anticipated. Consequently, they may need to reinvest at lower, less favourable interest rates. Managing prepayment risk is crucial for investors to ensure predictable returns and mitigate the impact of fluctuating interest rates. Opposite of Extension Risk
Priority of Payments (or Waterfall)	The Priority of Payments refers to the order in which payments are distributed among various parties in a financial transaction or agreement. It determines how cash flows from the underlying assets are allocated to different tranches of securities
Securitisation Vehicle (SV)	The SPV used in a securitisation transaction. In Luxembourg, the concept of a securitisation undertaking is defined in the Luxembourg Securitisation Law
Sponsor	In the context of securitisation, a Sponsor is the entity that organises and initiates the securitisation transaction (often also referred to as Arranger). This involves selling or transferring assets, either directly or indirectly, to the SV that issues the asset-backed securities (ABS). The Sponsor plays a crucial role in structuring the transaction and ensuring the quality of the assets being securitised. Within the framework of the EU Securitisation Regulation, the Sponsor is also one party potentially responsible for retaining at least a 5% portion of the credit risk associated with the securitised assets, in order to align their interests with those of the investors
Special Purpose Vehicle (SPV)	A legal entity created specifically to carry out a particular securitisation transaction, isolating the assets and liabilities from the Originator's balance sheet. SPVs are used to hold the underlying assets, issue the securities or other financial instruments, and manage the cash flows from the assets. 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. In the context of this brochure, we rather use the term "Securitisation vehicle" (SV) to illustrate that we discuss a SPV involved in a securitisation transaction
Structural credit enhancement	A form of credit enhancement that is built into the securitisation structure, such as through the creation of subordinated tranches or excess spread. These enhancements are designed to protect senior investors by absorbing potential losses before they affect more senior tranches
Subordination	A mechanism used in securitisation to rank different classes of securities and other financial instruments by priority of repayment. Subordinated tranches are paid last and absorb losses first, providing credit protection to senior tranches. Subordination is commonly used in structured products like CDOs and MBS
Synthetic transaction	A transaction that replicates the economics of a traditional transaction (such as a loan or bond) but without the actual transfer of legal ownership of the underlying asset. Synthetic transactions often use derivatives to create the same risk and return profile as the original asset. As such, instead of selling an asset (pool) to the SV, the Originator buys protection through credit derivatives or guarantees from the SV. Therefore, the SV (and ultimately the investors) is exposed to the risk profile of the asset pool without legally owning it. These transactions are typically undertaken to transfer credit risk and to reduce regulatory-capital requirements

Tax-transparent entity	A legal entity where the income or profits generated by the entity are passed directly to the investors or stakeholders, who are then taxed on that income, rather than the entity itself being taxed. This structure is sometimes often used in securitisations to avoid double taxation
Third-party credit enhancement	Credit enhancement provided by an external third party, such as a guarantor or insurance company, to improve the creditworthiness of a securitisation. This form of enhancement helps to reduce risk for investors and improve the ratings of the securities
Tranche	A portion or class of financial instruments issued by a SV that is distinguished by its risk and return characteristics. Tranches are typically divided by seniority, with senior tranches having priority in payment over subordinated (junior) tranches. Tranches allow investors to select the level of risk they are willing to take
True sale transaction	A legal term in securitisation that indicates a complete transfer of legal and beneficial ownership of the underlying assets from the Originator to the SV, i.e. the Originator no longer holds any significant interest or liability in the assets. A true sale is important for ensuring that the assets are removed from the Originator's balance sheet and insulated from its financial risks
Trustee	A third-party entity, often a specialist trust corporation or part of a bank, that acts on behalf of the investors in a securitisation. The trustee's responsibilities typically include overseeing the administration of the transaction, ensuring compliance with the terms of the deal, managing the distribution of cash flows, and acting as a liaison between the issuer (SV) and the investors
Underwriter	An institution or individual that helps facilitate the issuance of securities in a securitisation transaction. The underwriter works with the Arranger or Sponsor to structure the deal, price the securities issued, and sell them to investors. The underwriter often takes on the risk of buying (part of) the securities issued and reselling them to the market
Waterfall (or Priority of Payments)	See Priority of Payments

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How we can help

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 in Luxembourg, as well as developing ideas for the future of the industry together with you.

In this context, PwC Luxembourg has created a multi-disciplinary Securitisation Core Group ("SCG"). It is composed of experts and professionals of all relevant lines of service, bringing together an extensive knowledge of securitisation and structured finance, and multiple years of experience in implementing these into practice.

Furthermore, we are in close contact with the PwC securitisation experts in all the main jurisdictions around the world. Together with PwC professionals across Europe, the USA, and Asia, our network provides clients with advice, in-depth market insight, and pre-eminent transaction support in securitisation and structured finance deals. Let us also assist you in your securitisation and structured finance transactions.

We provide services in the following areas:

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 & LuxGAAP 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.

Your securitisation contacts

Should you have any questions, please do not hesitate to contact us:

Assurance Services

Holger von Keutz
Partner, Securitisation Leader,
PwC Luxembourg
holger.von.keutz@pwc.lu
+352 49 48 48 2383

Markus Zenz
Partner, PwC Luxembourg
markus.zenz@pwc.lu
+352 49 48 48 2647

Regulatory Services

Xavier Balthazar
Partner, PwC Luxembourg
xavier.balthazar@pwc.lu
+352 49 48 48 3299

Christoph Himmelmann
Director, PwC Germany
christoph.himmelmann@pwc.com
+49 160 536 3774

Tax Services

Luc Petit
Partner (Direct Tax),
PwC Luxembourg
luc.petit@pwc.lu
+352 49 48 48 3148

Marie-Isabelle Richardin
Partner (Indirect Tax),
PwC Luxembourg
marie-isabelle.richardin@pwc.lu
+352 49 48 48 3009

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At PwC, we help clients build trust and reinvent so they can turn complexity into competitive advantage. We're a tech-forward, people-empowered network with more than 370,000 people in 149 countries. Across audit and assurance, tax and legal, deals and consulting we help build, accelerate and sustain momentum. Find out more at www.pwc.com and www.pwc.lu.