

## Frequently Asked Questions Securitisation

These FAQs relating to "securitisation" replace the explanations on the practice of prudential supervision provided by the CSSF in its 2007 Annual Report on this matter, as well as the Frequently Asked Questions relating to securitisation published by the CSSF on 19 July 2012 and correspond to the latest editing. The main change to this version is the introduction of the new question 19. Another minor change was made to questions 4 and 7 as well as to the annexe. This document is aimed at securitisation undertakings authorised by the CSSF in accordance with Article 19 of the law of 22 March 2004 on securitisation (the "**2004 Law**").

### 1. What is the definition of "securitisation" under Luxembourg law?

Pursuant to Article 1 of the 2004 Law securitisation means "*the transaction by which a securitisation undertaking acquires or assumes, directly or through another undertaking, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties and issues securities, whose value or yield depends on such risks*". The 2004 Law set up a specific legal framework in Luxembourg governing asset securitisation in a broad sense, as defined in the 2004 Law<sup>1</sup>. The securitisation undertaking may assume those risks by acquiring the assets, guaranteeing the obligations or by committing itself in any other way. Thus, securitisation undertakings which meet the definition set forth in the 2004 Law and whose articles of incorporation or management regulations and/or the issue documents provide that they are subject to the 2004 Law benefit from a specific legal framework to carry out their activities.

The purpose of this document is any securitisation subject to the provisions of the 2004 Law. It is not meant to forbid the execution of securitisation transactions according to rules of common law by entities which are not subject to the 2004 Law. However, these entities cannot qualify as "securitisation undertakings" within the meaning of the 2004 Law and they shall not benefit from the 2004 Law regime the purpose of which is to provide both a safe and flexible securitisation framework.

Securitisation undertakings subject to the 2004 Law benefit from greater legal certainty because the 2004 Law expressly provides for limited recourse and non petition principles aiming to ensure the bankruptcy remoteness of the securitisation undertaking. Indeed, it provides that, on the one hand, investors and creditors of the securitisation undertaking may validly waive the right to take prompt implementing measures against the securitisation undertaking and to petition for bankruptcy thereof (non petition, cf. Article 64(1) of the 2004 Law) and it specifies, on the other hand, that the rights of investors and creditors of a securitisation undertaking are limited to the assets of the securitisation undertaking or the compartment to which they are attached (limited recourse, cf. Article 62(1) of the 2004 Law). Creditors and investors can accept to subordinate the repayment of their claims to that of other creditors, or certain investors.

The comment on the articles of the 2004 Law emphasises that "securitisation transaction" refers to traditional securitisation of claims as well as more modern forms of risk securitisation. The purpose of the first one is the assignment of one or several more-or-less homogeneous claims to an *ad hoc* structure, referred to as a securitisation undertaking, which acquires them using the funds collected within the context of an issue of securities. The transaction aims to release the original creditor from the risks inherent in these claims and must thus enable the creditor to remove these claims from its balance sheet. By gathering the claims together in a new structure, securitisation serves to isolate them from the other assets and liabilities of the assignor. This may value the claims, offering, in certain cases, a better guarantee than a recourse against the assignor. Similarly, the securitisation undertaking can, in certain

---

<sup>1</sup> Pursuant to the 2004 Law, all risks linked to claims, other assets or obligations assumed by third parties or inherent in all or part of the activities of third parties may be securitised.

cases, obtain financing under better conditions than the assignor could have obtained himself through a bond issue or a credit.

For investors who agree to subscribe for securities issued by the securitisation undertaking, the main feature of the transaction is the assumption of the risks associated with securitised debts, in particular those related to a temporary or permanent debtor default. The value and yield of their investment will directly depend on the risks transferred to the securitisation undertaking, though at least for the senior tranches, various techniques of credit enhancement are often used, such as partial oversizing of the portfolio or the guarantees provided by third parties.

As securitisation results in the transfer to the capital market of the risks that an undertaking assumes in connection with the holding of one or several claims, it appears from an economic point of view as "a transformation of claims into securities". As such, securitisation is however not limited to claims but is likely to apply to all types of risks which may be isolated in specific assets which will constitute the exclusive guarantee of the investors who had funded the transfer thereof. Within the context of such a securitisation, the transfer of risks to the securitisation undertaking no longer necessarily involves an assignment of claims or other assets. This can be done through the hedging offered by the securitisation undertaking to the debtor of the obligations under which the securitisation undertaking undertakes to assume ultimate responsibility. Many arrangements may be envisaged for such assumptions, starting from the traditional forms of guarantees and sub-participations up to the most recent financial techniques, such as credit derivatives.

Securitisation related to all or part of the business of a third party (whole business securitisation) is similar to a project finance under which the repayment of the credit facility granted to an undertaking is based on the income generated by the funded activity. The risk assumed by the securitisation undertaking within the context of such transactions is also related to the profitability of the activity carried out by the third party to which the undertaking provides its support. But, unlike a mainstream lender, the securitisation undertaking directly transfers this risk to investors.

The 2004 Law is thus open to securitisation of all kinds of risk, in the broadest sense, whether they are inherent in claims or any other types of assets or obligations or activities. It is also open to any risk transfer technique whether or not it is done by way of a transfer of assets or other types of hedging likely to satisfy the undertaking that wishes to be discharged thereof.

The definition provided for in Luxembourg law in respect of securitisation offers a wide range of possibilities to securitisation undertakings. However, it is clear from the parliamentary papers that the main purpose of a securitisation transaction under the 2004 Law must, in principle, always be an economic "transformation" of certain risks into securities through the acquisition or hedging of the first ones and the issue of the second ones.

The CSSF draws the attention of securitisation undertakings subject to its authorisation and supervision to the fact that the securitisation undertakings and the contemplated transactions should comply with both the legal definition of "securitisation" and the spirit of the 2004 Law and should not be used as a means to abuse the law. In particular, the implementation of Luxembourg securitisation should not be aimed to circumvent the application of more binding prudential provisions or to bypass restrictions which may exist as to the investment in underlying risks or as to their distribution. The CSSF reserves the right to request a legal opinion to establish compliance with these conditions. In light of this, the CSSF analyses, for the securitisation undertakings subject to its supervision, in particular the structure of the transaction as well as the origin and nature of the risk being securitised. In this respect, the application file must include all the relevant elements relating to the planned transactions and the applicants must be completely transparent *vis-à-vis* the CSSF (cf. Annexe - for the list of information to be provided to the CSSF).

### 2. What does "securitisation undertaking" under the 2004 Law mean?

Pursuant to Article 1(2) of the 2004 Law, securitisation undertakings are "*undertakings which carry out the securitisation in full, and undertakings which participate in such a transaction by assuming all or part of the securitised risks - the acquisition vehicles - , or by the issuing of securities to ensure the financing thereof the issuing vehicles and whose articles of incorporation, management regulations or issue documents provide that they are subject to the provisions of this law.*" A securitisation transaction consists thus of two parts executed by the securitisation undertaking: the assumption of risks and the issue of securities. The comment on the articles of the 2004 Law points out that the economic "transformation" of risks into securities indeed takes place at the level of the securitisation undertaking through the acquisition or hedging of the first ones and the issue of the second ones.

The securitisation undertaking makes it possible to create the necessary link between the value of the risks and that of the securities that have enabled the acquisition thereof. The aim of the securitisation is always to isolate in an *ad hoc* structure a set of risks to enable the issuance of securities whose value or yield depends on these risks. In the typical case of a transaction of one or several claims, it means that the investors' rights will, at any time, depend directly on the quality of the claims.

However, the 2004 Law does not require that the securitisation be carried out through the intermediary of one single securitisation undertaking. Indeed, it is very conceivable that the risks might be transferred to an undertaking which is separate from the one in charge of issuing the securities, provided only that the two link their respective interventions.

### 3. What securitisation undertakings are to be authorised by the CSSF?

Certain provisions of the 2004 Law apply to all securitisation undertakings, whether they are subject to the CSSF's supervision or not, while other provisions only apply to the securitisation undertakings subject to the authorisation requirement.

The 2004 Law specifies that securitisation undertakings which issue securities to the public on a continuous basis ("authorised securitisation undertakings") must be authorised by the CSSF to exercise their activities. If a securitisation undertaking intends to carry out transactions which are likely to meet each of the two criteria "on a continuous basis" and "to the public", it must first request (i.e. before starting an activity complying with these two criteria) the CSSF's authorisation (Article 19 of the 2004 Law). The securitisation undertaking must make this assessment under its own responsibility and then spontaneously contact the CSSF, where appropriate.

Securitisation undertakings which do not intend to issue securities to the public on a continuous basis are recommended to specify it in the constitutional documents, it being understood, however, that such a contractual provision is not sufficient to circumvent the authorisation requirement in the case where the requirements would however be subsequently fulfilled in practice.

Moreover, it should be noted that in a dual cross-border structure, where the acquisition vehicle is located in Luxembourg and the issuing vehicle abroad, the 2004 Law implies that the acquisition vehicle located in Luxembourg shall not be subject to the authorisation requirement, even if the foreign issuing vehicle issues securities to the public on a continuous basis.

Once authorised, the securitisation undertaking remains in principle under the supervision of the CSSF until the closing of its liquidation. However, if, at some point, the securitisation undertaking stops issuing new securities to the public on a continuous basis and provided that all the securities that the securitisation undertaking issued to the public while it was subject to supervision have matured and been

refunded, the securitisation undertaking may request the CSSF to be withdrawn from the official list of authorised securitisation undertakings.

#### 4. What do the criteria "on a continuous basis" and "to the public" mean?

The requirement to be subject to the prudential supervision of the CSSF is incumbent upon the securitisation undertakings whose securities are issued to the public on a continuous basis (Article 19 of the 2004 Law).

For the purpose of assessing whether an authorisation is required, the securitisation undertaking shall refer to the following presumptions which the prudential practice of the CSSF extracted:

- Issuance of securities on a continuous basis:

The issuance of securities is deemed to be carried out on a continuous basis when the securitisation undertaking undertakes more than three issues to the public per year. The number of issues to be taken into consideration is the total number of issues of all compartments of the securitisation undertaking.

Moreover, an issuance programme as such is not equal to an issue.

In order to determine the number of annual issues of a securitisation undertaking issuing securities under a programme, each series must *a priori* be regarded as a distinct issue, unless an examination of the nature of the programme and of the different series of issues reveals that the characteristics of these issues suggest that they constitute one single issue and not several separate issues.

- Issuance of securities to the public:

Concerning the issuance of securities to the public, the CSSF set down the following assessment criteria:

- issues to professional clients within the meaning of Annexe II to Directive 2004/39/EC (MiFID) are not issues to the public;
- issues whose denominations equal or exceed EUR 125,000 are assumed not to be issues to the public;
- the listing only of an issue on a regulated or alternative market does not ipso facto mean that the issue is to be considered as an issue to the public ;
- issues distributed as private placements, whatever their denomination, are not considered as issues to the public. Whether the issue can be regarded as a private placement must be assessed on a case-by-case basis according to the communication means and the technique used to distribute securities. However, the subscription of securities by an institutional investor or financial intermediary for a subsequent placement of these securities with the public constitutes a public offering. Moreover, where the issue of securities by the securitisation undertaking is structured for the purposes of marketing by means of a "wrapper" aimed at the public, then this issue is deemed to be placed with the public.

The "public" nature of the issues will be assessed in particular in connection with the target public to which the issued securities are offered and/or distributed. It goes without saying that the securitisation undertaking offering its securities or the entities which distribute them to or place them with investors, where appropriate, must ensure that they comply with all the legal provisions applicable in the different jurisdictions, and in particular those in respect of "offers to the public".

The assessment of the authorisation requirement must, where appropriate, reflect the distribution systems implemented for the issued securities (look-through approach). Indeed, certain securities may be offered to the general public on a continuous basis through distribution channels specifically aimed at retail investors.

### **5. What are the documents and information that the application file must contain to be submitted to the CSSF?**

The application for authorisation must contain all the data required for its scrutiny (cf. Annexe)<sup>2</sup>. Insofar as this information is available when the application is filed, it must include at least the elements listed in the annexe hereto and relating to the application for authorisation. The CSSF reserves the right to request any other information it deems necessary to review the application file.

Upon receipt of an application file for a new securitisation undertaking, the CSSF systematically invites the arranger of the securitisation undertaking's project to present his/its project in a meeting.

#### The constitutional documents

The CSSF approves the articles of incorporation or the management regulations of the securitisation undertaking and authorises, where applicable, its management company. This procedure also applies to existing securitisation undertakings that seek authorisation only after having made, for a certain period of time, securitisation transactions as non-supervised entities. In this case, information on the issues already carried out, as well as on the financial situation of the securitisation undertaking or the management company of a securitisation fund, respectively, should be attached to the application file.

#### Organisation and administration

The administrative and accounting organisation put in place through delegated functions, where appropriate, should ensure that the securitisation undertaking has an appropriate organisation and appropriate human and material resources to perform its activity properly and in a professional manner. The structuring of the technical aspects of the securitisation transactions may be delegated, including to foreign professionals. In that case, an appropriate information exchange mechanism between the delegated functions and the Luxembourg entity administering the securitisation undertaking must be set up as from the incorporation of the securitisation undertaking.

The organisational and administrative structure in Luxembourg of a securitisation undertaking subject to authorisation must enable the managers of the securitisation undertaking to perform their coordination and supervision role in relation to the delegated functions activity and the *réviseur d'entreprises* (statutory auditor) and the CSSF to perform their controls. Thus, all administrative information and all key information relating to the technical aspects must be in Luxembourg, i.e. the accounting documents and other documents which constitute the key documentation of the securitisation undertakings must be available upon the first request of the CSSF. The administrative substance of the company must thus be available in Luxembourg and the CSSF assesses the structure and the administrative management of the securitisation undertaking on a case-by-case basis.

#### Managers and shareholders

In order for the CSSF to assess the capacities of the persons involved in the structure, the securitisation undertaking must communicate to the CSSF the names of the arranger of the securitisation project, of its managers (i.e. the members of the administrative, management and supervisory bodies), and of the beneficial owner(s). Information on the names and powers of the representative of the debtholders is also to be provided, where appropriate.

The arranger of the securitisation project should be able to give comfort to the CSSF on the viability of the project, in particular by reference to the statutory requirement of the appropriate human and material resources. However, the arranger of the securitisation project is under no financial requirement or completion guarantee.

---

<sup>2</sup> Cf. Annexe: List of information to be provided to the CSSF for an authorisation as securitisation undertaking.

For the purpose of obtaining authorisation, Article 20(2) of the 2004 Law provides that natural persons, and in the event of legal persons "*The members of the administrative, management and supervisory bodies of a securitisation company or a management company of an authorised securitisation undertaking, as well as its direct or indirect shareholders which are in a position to exercise a significant influence over the conduct of the business of such a company must be of sufficiently good repute and have the experience or means required for the performance of their duties. To that end, the names of those persons, and of every person succeeding them in office, must be notified forthwith to the CSSF.*"

Professional standing shall be assessed on the basis of police records and of any evidence tending to show that the persons concerned are of good repute and offer every guarantee of irreproachable conduct.<sup>3</sup> This general requirement of irreproachable business shall in particular ensure the confidence of the public in authorised entities and ensure the Luxembourg financial centre's good repute. The presentation of all the guarantees of irreproachable business includes for instance all the personal and professional characteristics which allow an individual to properly manage a professional supervised by the CSSF. The past and present professional activities of a person are substantial elements to assess and evaluate the professional standing of this person when considering his future activities in the sector.

In respect of the directors of a securitisation undertaking or the management company of a securitisation fund which must be at least three, the CSSF requires that they have solid professional experience in the securitisation field in order to be deemed acceptable so that they can administer, in a professional way, the securitisation company or the management company of a securitisation fund, respectively. If there is no representative of the arranger of the securitisation project among the members of the board of directors, it is especially important that the directors of the securitisation undertaking have the experience, skills and means required to understand and to monitor independently all financial, legal and accounting techniques used in the context of such a securitisation.

The CSSF accepts that the directors' mandates are given to legal persons exclusively. In such case, the CSSF assesses the criteria regarding the directors' competence and professional standing as regards the legal persons and as regards the natural persons designated to represent the directors that are legal persons. Thus, the representatives of the directors must prove their professional standing and their professional experience.

Any director must be aware of the financial situation of the securitisation undertaking and must assume his responsibility *vis-à-vis* the investors and the CSSF.

---

<sup>3</sup> Cf. question 10 of "Questions and Answers on how to obtain authorisation as PFS" on the CSSF's website [http://www.cssf.lu/fileadmin/files/PSF/FAQ\\_PSF\\_101011.pdf](http://www.cssf.lu/fileadmin/files/PSF/FAQ_PSF_101011.pdf)

### 6. What are the techniques to assume securitised risks?

The purpose of the 2004 Law is to allow the securitisation of a large variety of risks relating to all types of assets, whether movable or immovable, tangible or intangible, as well as those relating to obligations assumed by third parties or inherent in all or part of third-party activities.

The assumption of risks by the securitisation undertaking may result from a transfer of assets, but also from other forms of risk transfer by which the securitisation undertaking notably provides hedging to the undertaking that wishes to be discharged thereof.

Consequently, (i) besides the traditional true sale securitisation under which assets are assigned to the securitisation undertaking, (ii) the 2004 Law provides for the "synthetic" securitisation, where only the risk linked to the assets is transferred (iii) as well as the whole business securitisation or partial business securitisation.

### 7. What are the various possible forms of debt securitisation?

The traditional securitisation of claims generally involves the acquisition of one or several claims from an originator.

The acquisition of claims generally takes the form of a true sale where the securitisation undertaking becomes the legal owner of the claims. However, the securitisation of claims can also consist in the synthetic securitisation where only the *risks* linked to the debt portfolio are transferred to the securitisation undertaking, for example by means of the issue by the securitisation undertaking of a guarantee or through credit default swaps.

In specific circumstances, the structures in which the securitisation undertaking itself expressly grants loans instead of acquiring them on the secondary market may, however, also be regarded as securitisation, provided that the securitisation undertaking does not allocate the funds raised from the public to a credit activity *on own account* and that the documentation relating to the issue, either clearly defines the assets on which the service and the repayment of the loans granted by the securitisation undertaking will depend, or clearly describes (i) the borrower(s) and/or (ii) the criteria according to which the borrowers will be selected, so that the investors are adequately informed of the risks, including the credit risks and the profitability of their investment at the time securities are issued. In both cases, information on the characteristics of the loans granted must be included in the issue documents. The CSSF will assess compliance with these conditions on a case-by-case basis. Moreover, the participants are responsible for ensuring that any other applicable legal provisions are complied with.

In this context, the CSSF would like to stress that the current international discussions on shadow banking are likely to have an impact on the laws and regulations applicable to this kind of activities.

In general, in view of the nature of a securitisation activity, the securitisation undertaking's action must be limited to a 'prudent man' passive management of the securitised debt portfolio, irrespective of whether or not this management is delegated to a professional acting on behalf of the securitisation undertaking. In certain cases, this management may include for example the re-negotiation of the schedule of the repayments or the credit terms in the event of financial difficulties of a debtor, but it can under no circumstances consist of either active management of the portfolio aiming to take advantage of short-term fluctuations of market prices and resulting in an ongoing activity of claim acquisition and assignment or, as mentioned above, a professional credit activity performed by the securitisation undertaking on own account.

### 8. What are the other types of assets and risks that a securitisation undertaking may assume?

Various types of securitisation transactions can be contemplated, provided that they comply with both the legal definition of "securitisation" and the spirit of the 2004 Law and are in line with the best market practices. In this respect, reference is made to the principles listed under item 1.

The examples of securitisable assets and risks set out below do not constitute an exhaustive list; it provides information on how the CSSF will review the specific application files which will, moreover, be examined on the basis of the detailed information to be submitted to the CSSF (cf. Annexe).

#### a) securitisation of assets/financial instruments

If the securitisation of a portfolio of financial assets is possible, it should be pointed out that the assets must be managed within the limits set by Article 61 of the 2004 Law to the extent of the freedom of management of the securitisation undertakings' investments.<sup>4</sup>

When financial assets are securitised, the articles of incorporation or the documents relating to the issue of securities must describe the selection criteria, as well as the composition of the securitised portfolio, where applicable, according to the classes of assets. They must also lay down the conditions and criteria according to which the assets composing this portfolio can be assigned, in accordance with Article 61 of the 2004 Law. The activities of the securitisation undertaking, in particular in connection with asset management but also as regards the frequency and conditions of repurchase of the securities issued by the undertaking must be such that they do not fall within the scope of the regulations governing the operation and management of undertakings for collective investment in transferable securities and alternative investment funds.

Transactions the main purpose of which is the repackaging of financial assets consist, in general, of the securitisation of one or several financial assets, often bond-type assets, certain characteristics of which, such as for example the issue currency or the interest rate standards are changed using the securitisation technique. The issue of securities the value or yield of which depends on the securitised financial assets but for which certain characteristics have been changed makes it thus possible to better accommodate the investors' preferences.

The repackaging transactions may be traditional or synthetic securitisation transactions in respect of the risk transfer technique. In certain cases, they may consist of the securitisation of equity indices or other financial assets, pools of shares or units of undertakings for collective investment in compliance with the above-mentioned conditions. The acceptability of the securitisation of shares or units of one single UCI will be assessed by the CSSF on a case-by-case basis.

#### b) securitisation of commodities

In respect, for example, of commodities (e.g. precious metals) or other goods of this type, a securitisation transaction can take the form of an acquisition of these goods, provided that such an acquisition aims to provide for a financing or refinancing, whereby the commodities or goods constitute a guarantee of repayment to third parties of the funds they have made available. The securitisation undertaking can under no circumstances engage in an activity which would involve being considered as an undertaking within the meaning of the EU law<sup>5</sup>.

<sup>4</sup> Article 61. (1) A securitisation undertaking cannot assign its assets, except in accordance with the provisions laid down in its articles of incorporation or its management regulations.

<sup>5</sup> Court of Justice of the European Communities (EJC), Höffner judgement, 1991: "the concept of undertaking includes any entity carrying out an economic activity regardless of the legal status of this entity and its financing mode."



However, the securitisation undertaking may also issue securities in the form of structured products providing the investor with an exposure on the price fluctuations of the underlying commodities. In this case, these are investment products. For this type of products, the managers of the securitisation undertaking will implement and communicate to the investors an exit strategy which will not force the securitisation undertaking to operate on a regular and significant basis through purchase and sale transactions on the markets.

### **9. By what means can a securitisation undertaking obtain financing?**

The securitisation undertaking shall be financed by issuing securities whose value or yield depends on the risks assumed by the securitisation undertaking or, where applicable, the acquisition vehicle where the securitised risks are held by an undertaking different from that issuing securities.

However, it is acceptable that securitisation undertakings use, on a transitional basis, borrowing or intra-group financing in order to pre-finance the acquisition of the risks to be securitised while awaiting to proceed with the issuance of securities to investors (warehousing) within an appropriate timeframe, taking into account market conditions.

In addition to financing through the issuance of securities, a securitisation undertaking may also use borrowing on a lasting but limited basis.

It should be noted that borrowing can only be used on an ancillary basis and/or in the case where a credit line would be temporarily necessary in view of the type of securitisation, while the main and determining purpose of the transaction will always be securitisation, i.e. the economic transformation of risks into securities. Borrowing may be used either when setting up the initial structure, e.g. where the arranger grants a subordinated loan, at the time the structure is set up, as an alternative to a direct investment in the equity tranche, or as a liquidity facility, notably where there is temporarily a lack of synchronisation between the financial flows relating to the securitised assets and the financial flows relating to the securities issued by the securitisation undertaking. Borrowing may also be used in order to improve investors' yield.

Borrowing is, however, only acceptable if the financing of the securitisation transaction also includes the issuance of securities for a proportionally substantial amount. Securitisation transactions including borrowing will be assessed by the CSSF on a case-by-case basis, taking into account in particular the characteristics of the securitisation transaction and the nature of the securitised risks.

In particular for securitisation undertakings whose securities are issued to the public, the CSSF expects that borrowing remains limited and is mainly used for structuring purposes.

Investors must, in any case, be sufficiently informed by the issue documents of the securities, of the additional risk they incur due to the securitisation undertaking's borrowing, of the possible existence of security interests provided in consideration of these financings, as well as of the limits imposed on indebtedness and of the credit terms.

### **10. What types of securities can the securitisation undertaking issue?**

In general, securities issued by authorised securitisation undertakings are debt securities and are often subject to foreign law. The articles of incorporation may nevertheless reserve the right for the securitisation undertaking to carry out securitisation through the issuance of shares. Some securitisation undertakings also have the possibility to issue warrants.

As regards the nature of the financing by issuing securities, the 2004 Law allows the securitisation undertaking to issue trackers, i.e. securities whose yield or value is linked either to one or several specific compartments, or to certain risks assumed by the securitisation undertaking regardless of the value and yield of the undertaking or of its compartments.

The securitisation undertaking may also issue subordinated securities using the technique of tranching, i.e. by issuing securities whose repayment is subordinated to the prior repayment of other securities, certain claims or certain classes of shares.

The 2004 Law also allows securitisation undertakings, including securitisation companies, to issue shares and bonds that do not have an equal value. In that case, the voting right must be proportionate to the portion of the share capital or bonds represented.

In accordance with the principle of *lex contractus* (for debt securities) and of *lex societatis* (equity-type securities) respectively under international private law, securities subject to foreign law which are recognised as "securities" under applicable law or which constitute securities within the meaning of the Markets in Financial Instruments Directive (MiFID) are deemed as securities under the 2004 Law.

Moreover, units and bonds issued by a securitisation undertaking set up as a *société à responsabilité limitée* (limited liability company) are also deemed as securities under the 2004 Law.

### **11. Under what circumstances can security interests be created?**

In respect of security interests which are likely to be created over assets, Article 61(3) of the 2004 Law provides that "*It may not, by any means whatsoever, create security interests over its assets or transfer its assets for guarantee purposes, except to secure the obligations it has assumed for their securitisation or in favour of its investors, their fiduciary-representative or the issuing vehicle participating in the securitisation*".

### **12. Should the securitisation undertaking manage its assets itself or should it entrust a third party with the management of these assets?**

The securitisation undertaking may, in principle, manage its assets itself or entrust third parties with the management of these assets, including the assignor, within the limits laid down by the 2004 Law.

This management is subject to Article 61 of the 2004 Law which notably requires that the constitutional documents of the securitisation undertaking provide for, at least in principle, the possibility and terms of sale of securitised assets and risks guaranteeing the investors' rights. However, the CSSF accepts that the constitutional documents refer to the issue documents that must provide for, in respect of each issue, both the decision-making procedure, as well as the terms of sale of securitised assets and risks.

### **13. What are the existing limits, in particular as regards management, to the activity of a securitisation undertaking?**

A securitisation undertaking shall be limited, in principle, to the administration of the financial flows linked to the securitisation transaction itself and to the 'prudent-man' management of the securitised risks, except for any activity likely to qualify the securitisation undertaking as an entrepreneur, such as for example the provision of services to third parties.

Any management by the securitisation undertaking of claims, assets or activities of third parties that creates an additional risk owing to the activity of the securitisation undertaking compared to the risk

attached to these claims, assets or activities or which aims to create additional assets or results in the commercial development of the securitisation undertaking's activities, is, in principle, incompatible with the purpose of the 2004 Law, notwithstanding the fact that the actual management of the assets, claims and activities has been delegated to an external service provider.

As regards in particular the activity of management during the securitisation of a portfolio of financial assets, this management must be made pursuant to Article 61(1) of the 2004 Law which provides that a securitisation undertaking cannot assign its assets except in accordance with the provisions laid down in its articles of incorporation or its management regulations. The principle and terms applicable during the securitisation of a portfolio of financial assets or the use of the financial techniques mentioned below must be described in the issue documents. The issue documents must specify for each issue how and by whom the decisions relating to the sale of assets will be made. Moreover, any possibility of transfer and re-employment of the assets by the counterparty of the securitisation undertaking (rehypothecation) must be described in the prospectus or the constitutional documents of the securitisation undertaking.

As regards the activities ancillary to the securitisation of a portfolio of financial assets, such as for example concluding transactions on financial instruments or forward transactions with a view to hedging risks or effectively managing the portfolio, or such as to perform repurchase agreements and securities lending activities to improve the return on securitised assets, the specialisation principle applying to securitisation undertakings implies that they must limit those activities to the strict minimum, i.e. where these activities are justified by the nature of the securitisation transactions.

### **14. What are the rules governing the compartment subdivision of a securitisation undertaking?**

The 2004 Law allows securitisation undertakings to create one or more compartments corresponding each to a distinct part of their assets and liabilities designated to receive the assets and liabilities linked to the transactions related thereto and that benefit from an independent management of its assets and liabilities.

The assets of a compartment are exclusively available to satisfy the rights of investors in relation to that compartment, and, between investors, each compartment shall be treated as a separate entity, except otherwise provided for in the constitutional documents. The 2004 Law provides for the mandatory segregation of compartments with regard to the third-party creditors of the securitisation undertaking by prohibiting third-party creditors whose claim has arisen in connection with the creation, the operation or the liquidation of a compartment to act on the assets linked to another compartment.

The possibility to create compartments must be laid down in the articles of incorporation or the management rules of the securitisation undertaking. The decision to create compartments lies with the board of directors or the management company and may be taken throughout the existence of the securitisation undertaking. The articles of incorporation of multi-compartment securitisation undertakings must, in principle, include a clause laying down how the general expenses of the securitisation undertaking, in its capacity as legal entity, that do not relate to a compartment, should be allocated.

Multiple-compartment securitisation undertakings are required to prepare financial statements including in particular a breakdown of their assets and liabilities per compartment. The annual accounts and the relating financial notes must clearly state the financial data for each compartment and the certificate of the *réviseur d'entreprises* will indicate whether the annual accounts comply with the true and fair view principle for both the company and its compartments.

### **15. In what form can investors be represented?**

Where a securitisation undertaking issues debt instruments, the 2004 Law provides the holders of those securities with the benefit of representation as set down by Articles 86 et seq. of the law of 10 August 1915 on commercial companies. The investors concerned can also choose another form of representation by entrusting the protection of their interests to a fiduciary-representative whose status is defined by the 2004 Law.

The CSSF also accepts the appointment of a trustee governed by foreign law acting for the benefit of investors, provided that the terms of this representation are laid down in the agreements relating to the issuance of securities. Where an authorised securitisation undertaking appoints a trustee governed by foreign law to represent investors' interests, this trustee must have an appropriate organisation and proper human, financial and material resources to perform its activity in a professional manner. Details as to this trustee are to be added to the application file.

As regards the representation regime, it is possible to depart in the articles of incorporation, the issuance agreements or the deed of appointment of the fiduciary-representative from the representation regime laid down in the Luxembourg law on commercial companies, whether or not the issue is subject to foreign law.

For authorised securitisation undertakings, the CSSF considers, for prudential reasons, that the application of Articles 86 to 97 of the law of 10 August 1915 should, in principle, be excluded only if another debtholder representation/decision-making mechanism is established.

In any event, any debtholder decision-making mechanism/representation mechanism chosen must be fully described in the issue documents.

### **16. What are the rules applicable to the winding-up and voluntary liquidation of a securitisation undertaking?**

Securitisation undertakings are deemed to continue to exist for the purpose of their liquidation. The liquidation of a compartment of a securitisation undertaking has no impact on the other compartments, i.e. a compartment can be liquidated separately. In the case of a securitisation company, the liquidation of the last compartment does not result in the liquidation of the company itself. On the other hand, the liquidation of the last compartment of a securitisation fund entails the liquidation of the fund itself, as a securitisation fund without legal personality does not consist of any other assets except of those formed by the compartments. The liquidators of authorised securitisation undertakings must be authorised by the CSSF and have the necessary professional standing and professional qualifications. The liquidation shall be subject to the supervision of the CSSF.

### **17. What information must be communicated to the CSSF on a regular basis and spontaneously?**

The prudential supervision exercised by the CSSF aims to ensure the fulfilment by the authorised securitisation undertakings of their statutory obligations under the 2004 Law as well as their contractual obligations. Any change to the constitutional documents of the securitisation undertaking, to its managing body or its *réviseur d'entreprises* must be notified forthwith to the CSSF and is subject to the CSSF's prior approval. Any change in control of the securitisation company or management company is subject to the CSSF's prior approval.

As soon as they are finalised, securitisation undertakings must provide the CSSF with the following documents:

- a copy of the final issue documents relating to any issue of securities, irrespective of a possible prior notification of those documents to the CSSF as competent supervisory authority of the financial markets for approval of the prospectus within the scope of an offer to the public or an admission to trading;
- a copy of the financial reports drawn up by the securitisation undertaking for its investors and rating agencies, where applicable;
- a copy of the annual reports and the documents issued by the *réviseur d'entreprises* within the context of the audits of the annual accounts regardless of a possible communication of these documents to the CSSF in its capacity as competent authority as regards transparency requirements. The CSSF requests the transmission of the management letter drawn up by the *réviseur d'entreprises* in the course of its audit, or where no such management letter has been issued, a written statement of the *réviseur d'entreprises* 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.

In addition, the authorised securitisation undertakings must also provide the CSSF with the following documents on a half-yearly basis within 30 days:

- a listing of the new issues of securities, of other outstanding issues and issues which matured over the period under review. This report must indicate for every issue the nominal amount issued and the nature of the securitisation transaction, the investor profile and, where applicable, the compartment concerned. In connection with every issue, information should be included regarding the initial issue price and the market price on the reference date (if available) in the case of outstanding issues, or on the redemption price in the case of matured issues, as well as information on any issues (or certain tranches of an issue) which have been restructured or for which the securitisation undertaking was not able to realise the projected yield rate or to guarantee the final redemption price that were initially scheduled. In such cases, details on the effective yield or redemption value are to be provided; and
- a summary of the financial situation of the securitisation undertaking, including notably a breakdown of its assets and liabilities as well as the profit and loss accounts, by compartment, where applicable.

On the financial year closing date, a draft balance sheet and profit and loss account of the securitisation undertaking, where applicable, by compartment is to be provided within 30 days.

The CSSF may also require any other information or perform on-site inspections and review any documents of a securitisation company, management company or credit institution in charge of safekeeping the liquid assets and securities of the authorised securitisation undertaking so as to verify compliance with the provisions of the 2004 Law and the rules laid down in the articles of incorporation or management regulations and agreements relating to the issue of securities, as well as the accuracy of the information that has been communicated.

The legal provisions reviewed by the CSSF during the scrutiny of the application file of the securitisation undertaking must necessarily be complied with throughout the exercise of the activities of the authorised securitisation undertaking.

### **18. What are the accounting rules applicable to multiple-compartment securitisation companies?**

As far as accounting is concerned, the CSSF confirmed that multiple-compartment securitisation companies must present their annual accounts, as well as the relating financial notes in such a form that the financial data for each compartment are clearly stated. It is possible however to group the notes to the financial statements for several compartments.

For the purposes of adequate investor information, the CSSF recommends a valuation of the underlying assets at their fair value, in particular for authorised securitisation undertakings intended for the public and whose purpose is the traditional or synthetic securitisation of one or several financial assets; the fair value valuation seems appropriate in particular where investors have call options.

### **19. What is the impact of the law of 12 July 2013 on alternative investment fund managers ("AIFM Law") on the securitisation undertakings within the meaning of the 2004 Law?**

The positions adopted by the CSSF hereafter are subject to any future development or clarification at European level.

- A securitisation undertaking which meets the definition of "securitisation special purpose entity" under the AIFM Law, cannot qualify as an alternative investment fund within the meaning of the AIFM Law ("AIF"), as Article 2(2)(g) of the AIFM Law provides that "securitisation special purpose entities" are excluded from the scope of the AIFM Law.

"Securitisation special purpose entities" are defined as entities whose sole purpose is to carry on a securitisation or securitisations within the meaning of Article 1(2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30) and other activities which are appropriate to accomplish that purpose (the "**ECB Regulation**").

According to the ECB Regulation, "securitisation" means "*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;"*

According to the clarifications provided by the European Central Bank in its "Guidance note on the definitions of 'financial vehicle corporation' and 'securitisation' under Regulation ECB/2008/30", point 4.1, page 3, a securitisation vehicle issuing "collateralised loan obligations" would indeed meet the definition of the ECB Regulation, so that these vehicles do not qualify as AIFs.

On the other hand, according to the same Guidance note (points 4.1 and 4.3, pages 3 and 4), securitisation undertakings whose core business is the securitisation of loans which they grant themselves (securitisation undertakings acting as "first lender")<sup>6</sup> do not meet the definition of the ECB Regulation and thus cannot benefit from the exclusion. The same applies to securitisation undertakings that issue structured products that primarily offer a synthetic exposure to assets other than loans (non credit-related assets) and where the credit risk transfer is only ancillary.

<sup>6</sup> Regarding this point, the CSSF refers to question 7 of these Frequently Asked Questions and notably draws the attention on the ongoing discussions at international level on shadow banking.

- Irrespective of whether or not they meet the definition of "securitisation special purpose entity" under the AIFM Law, securitisation undertakings that only issue debt instruments do not qualify as AIFs, as it seems that it was not the intention of the European legislator to qualify undertakings that issue such instruments as AIFs. In this respect, reference is made to the Questions and Answers of the European Commission of 25 March 2013 (Questions on Single Market Legislation/Internal Market; General question on Directive 2011/61/EU; ID 1169, Scope and exemptions), in which the European Commission considers that any type of instrument not representing an ownership interest in the securitisation undertaking should be excluded from the scope of Directive 2011/61/EU.
- Irrespective of whether or not they meet the definition of "securitisation special purpose entity" under the AIFM Law, securitisation undertakings that are not managed according to an "investment policy" within the meaning of Article 4(1)(a) of the AIFM Law do not qualify as AIFs. To determine whether they are managed according to an "investment policy" within the meaning of the AIFM Law, reference is made to the "Guidelines on key concepts of the AIFMD" published by ESMA on 13 August 2013<sup>7</sup>.

Subject to the criteria laid down in the ESMA Guidelines, securitisation undertakings that issue structured products offering a synthetic exposure to assets (e.g. shares, indices, commodities), based on a pre-established formula, and that acquire underlying assets and/or enter into swap agreements with the sole purpose of hedging their payment obligations under the issued structured products (hedging), may be considered as not being managed according to an "investment policy".

- It is recalled that each securitisation undertaking must perform a self-assessment in order to determine whether it qualifies as an AIF. Regarding this point, the CSSF notably refers to the Frequently Asked Questions published on the CSSF's website<sup>8</sup>.

<sup>7</sup> Cf. ESMA Guidelines on key concepts of the AIFMD, ESMA/2013/611 of 13 August 2013, page 7:

### IX. Guidelines on "defined investment policy"

20. An undertaking which has a policy about how the pooled capital in the undertaking is to be managed to generate a *pooled return* for the investors from whom it has been raised should be considered to have a defined investment policy in accordance with Article 4(1)(a)(i) of the AIFMD. The factors that would, singly or cumulatively, tend to indicate the existence of such a policy are the following:
  - (a) the investment policy is determined and fixed, at the latest by the time that investors' commitments to the undertaking become binding on them;
  - (b) the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking;
  - (c) the undertaking or the legal person managing the undertaking has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it;
  - (d) the investment policy specifies investment guidelines, with reference to criteria including any or all of the following:
    - (i) to invest in certain categories of assets, or conform to restrictions on asset allocation;
    - (ii) to pursue certain strategies;
    - (iii) to invest in particular geographical regions;
    - (iv) to conform to restrictions on leverage;
    - (v) to conform to minimum holding periods; or
    - (vi) to conform to other restrictions designed to provide risk diversification.
21. In paragraph 20(d), any guidelines given for the management of an undertaking that determine investment criteria other than those set out in the business strategy followed by an undertaking having a *general commercial or industrial purpose* should be regarded as 'investment guidelines'.
22. Leaving full discretion to make investment decisions to the legal person managing an undertaking should not be used as a mean to circumvent the provisions of the AIFMD.

<sup>8</sup> Frequently Asked Questions published on the CSSF's website, section Investment vehicles and managers, sub-section AIFM, FAQ, FAQ Alternative investment fund managers, Question 1.

### **20. Who to contact for further information?**

For further questions of a general nature, please send an email to the following address:

[opc@cssf.lu](mailto:opc@cssf.lu)

Luxembourg, 23 October 2013





### ANNEXE: APPLICATION FILE SECURITISATION UNDERTAKING

#### List of information to be provided to the CSSF for an authorisation as securitisation undertaking

##### A. Target entity

1. A general description of the names of the arranger of the securitisation project, including its articles of incorporation and the last audited financial statements.
2. The articles of incorporation and/or the management regulations of the securitisation undertaking or their drafts (including information on the shareholding structure of the securitisation undertaking or its management company for securitisation funds). For orphan structures, the articles of incorporation and/or constitutional documents of the shareholders and the names of their beneficial owners shall be transmitted.
3. A description of the origin and nature of the risks to be securitised as well as the asset valuation rules that the securitisation undertaking proposes to apply. Indication whether the assets are valued at fair value.
4. The types of securities to be issued by the securitisation undertaking.
5. The base prospectus as well as the draft documents relating to the first issue of securities or, for active securitisation undertakings, the agreements relating to the issue of securities and other documents relating to securities already issued.
6. A description of the degree of synchronisation between the financial flows relating to the securitised risks and the financial flows relating to the securities issued by the securitisation undertaking.
7. Information relating to the credit institution responsible for the custody of assets and the nature of the assets which will be deposited (liquid assets and/or securities).
8. Information concerning the administrative and accounting organisation of the securitisation undertaking.
9. The agreements or draft agreements with all service providers (including an organisation chart with the different functions).
10. An indication whether the securitisation undertaking carries out ancillary activities.
11. A description of the debtholder representation mechanism and, where appropriate, the contract (or the draft contract) with a fiduciary-representative or any other debtholders' representative.

##### B. Board of directors and human means

12. The composition of the board of directors, the management or supervisory bodies of the securitisation undertaking or, where appropriate, its management company as well as the names of the other managers of the securitisation undertaking or, where appropriate, of its management company and the *curriculum vitae* of these persons, dated and signed, (demonstrating their experience in respect of securitisation), recent extracts from the police records, a copy of their identity card, as well as their declaration of honour (cf. <http://www.cssf.lu/en/supervision/ivm/securitisation/forms/>).
13. Where applicable, the names and description of the persons/entities responsible for the representation of the investors (trustee etc.).
14. Where applicable, an indication of the persons likely to be assigned to administrative tasks.

##### C. Financing

15. A three-year financing plan including an exhaustive list of commissions, charges and income.

16. An indication of the names of the shareholders that are in a position to exercise a significant influence on the business conduct of the securitisation undertaking or its management company and their articles of incorporation.
17. A description of the investors targeted by the issued securities and, where appropriate, the distribution mechanisms.
18. An indication whether loan agreements were or will be signed by the securitisation undertaking and on the type of loans and their objects. Where applicable, an indication of the nature of the financing (banking or other) and the percentage of the amounts *vis-à-vis* the issued securities.

### **D. Réviseur d'entreprises (statutory auditor)**

19. An indication of the names of the *réviseur d'entreprises agréé* (approved statutory auditor) and a copy of the engagement letter signed with the *réviseur d'entreprises agréé*.

### **E. Prevention of money laundering**

20. For securitisation undertakings providing services to companies and trusts, an indication of the applied AML/TF procedures (fight against money laundering and terrorist financing).

