LUX CMA
Luxembourg Capital Markets Association

EU SECURITISATION REGULATION POSITION PAPER

By LuxCMA Task Force – Securitisation

NOVEMBER 2021

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ABSTRACT

The LuxCMA[1], constituted on 1 March 2019, has set up specific working groups dealing with securitisation questions, especially with the rules and regulations currently affecting the Luxembourg securitisation market. This position paper is written by the Securitisation Task Force and addresses certain specific issues raised by the Securitisation Regulation, which applies as from 1 January 2019 to securitisation transactions carried out on or after that date and is closely linked to market practices.[2]

The definition of "securitisation" set out in Article 2(1) of the Securitisation Regulation lays down a general framework for securitisation and creates a specific framework for STS. The topic of this paper will be the application of the Securitisation Regulation with a specific focus on tranching, risk retention and contamination, while the STS framework will not be addressed explicitly in this paper.

We will discuss the four main criteria that a securitisation transaction should meet to fall under the scope of the Securitisation Regulation. Furthermore, we will analyse what "tranching" means in practice and will conclude that the assessment of such criteria should be made from the perspective of the securitisation undertaking and not from the investor's point of view. Consequently, tranching will also arise in a scenario in which one single investor holds all securities with different tranches, notably given the fact the securitisation undertaking cannot control any subsequent transfers of the securities by the initial investor.

Accordingly, the application of the Securitisation Regulation is limited by, among other things, the requirement that the securitised credit risk be divided into tranches, which need to be a contractually established segment of credit risk, hence subordinated to each other. Conversely, if the subordination does not determine the distribution of losses, the transaction is not covered by this definition and will consequently not fall under the Securitisation Regulation. Furthermore, investors and external parties might enter arrangements which would de facto have the economic effect of creating a subordination between tranches. Examples are e.g. external credit enhancements, the granting of guarantees, the entry into credit default swaps, subordination agreements, agreements among lenders, and many more. For a structure which was not originally set up as a tranched securitisation transaction, it does not seem to be reasonable to impose the resulting obligations on the securitisation undertaking / the originator / the

[1] www.luxcma.com

[2] All statements are explicitly not intended to give any advice to readers, especially no legal or financial advice.

sponsor or original lender, if the tranching / subordination arrangements result from actions outside their direct control and they did not intend this.

Where a securitisation transaction falls under the Securitisation Regulation, we address the subject of "contamination": each compartment created under the Securitisation Law represents a separate, legally ring-fenced part of the securitisation undertaking that is clearly segregated from the assets and liabilities of other compartments. Applying the concept of segregation consequently means the Securitisation Regulation applies only to those compartments which concurrently meet the four aspects required to fall under the Securitisation Regulation.

For each transaction, the originator, the sponsor, and the original lender should agree on the risk retainer. If no agreement is achieved, the Securitisation Regulation states that the originator will bear the risk retention. The entity qualifying as originator is often the risk retainer in practice.

Because of its importance and the issues that usually arise with the determination of who the originator is, we dedicate a specific subsection to this topic. Regarding the valuation of the risk to be retained, the rules under Article 6 of the Securitisation Regulation specify that such interest will be measured at the origination and determined by the then current notional value of the assets.

Furthermore, as soon as a securitisation transaction falls under the Securitisation Regulation, several due diligence requirements for institutional investors and substantial transparency requirements for originators, sponsors and SSPEs arise, which we will address in detail in this paper.

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About the LuxCMA – Luxembourg Capital Markets Association

Created on 1 March 2019, the LuxCMA is a not-for-profit association (a.s.b.l.), registered at the RCSL (F12205), whose registered office is 6 rue Jean Monnet, L-2180 Luxembourg. The LuxCMA today represents memberships detailed on LuxCMA's website (www.luxcma.com), which is composed of banks, law firms and services providers, amongst others.

Task Force – Securitisation

The main purpose of the Securitisation task force is to finalise and amend the position paper on the EU Securitisation Regulation, deal with additional questions related to the Regulation and comment on the new draft Luxembourg Securitisation Law, which will be published soon.

For more information, please contact info@luxcma.lu

LuxCMA – Luxembourg Capital Markets Association

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