LUX CMA
Luxembourg Capital Markets Association

ACCOUNTING & REPORTING

GUIDANCE NOTES FOR BOARD MEMBERS

ACCOUNTING FOR PERFORMING LOANS AND OTHER RECEIVABLES

WORKING GROUP | BEST PRACTICE

ACCOUNTING & REPORTING

DECEMBER 2022

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INTRODUCTION

The typical structure for such a securitisation transaction is a Luxembourg FVC issuing notes to its noteholders. With the proceeds received from the issuance of notes, the FVC purchases receivables or performing loans, individually or as a portfolio, which is recognized as asset on the balance sheet of the FVC. During the lifetime of the loans or receivables the FVC receives, on a regular basis, payments of principal amounts and interest which are passed on to the noteholders after deduction of the running expenses of the FVC.

A typical Performing Loans Securitisation is summarised in the following diagram:

For the below proposal of accounting treatments, we have taken the assumption that no affiliated parties are involved, neither regards receivables nor debt instruments.

In relation to the potential impact of ATAD interest limitation rules, we reference to the LuxCMA position paper "TECHNICAL POSITION PAPER ON THE DEDUCTIBILITY OF PAYMENTS BY SECURITIZATION COMPANIES FINANCED BY DEBT" dated October 2020.

Disclaimer: *While we believe the proposed accounting entries below are appropriate for a majority of performing loans and other receivable securitisation transactions, the legal terms and conditions of those securitisation transactions may contain specific legal clauses that may require any other treatment; in this case the described treatments below may partially or in full not be relevant*.

ACCOUNTING POLICY

The performing loans and receivables should be recognised as financial fixed assets, even if the initial or remaining maturity of the securitised loans and receivables is of a short-term nature.

The usual accounting policy applied to performing loans and receivables under LuxGAAP should be acquisition cost less impairment.

In accordance with this accounting policy, the performing loans or receivables are initially recognised at the purchase price (acquisition cost) and in subsequent period measured at acquisition cost less impairment for a diminution in value deemed permanent, if any. Acquisition cost will include all expenses incurred in direct connection with the purchase of the loans or receivables.

Discounts received or premiums paid, if any, and recognized within the acquisition cost can be amortised separately as income or expense over the lifetime of the loans or receivables. Income on the performing loans and receivables is recognized at accrual basis.

Impairments are recorded when the facts and circumstances imply that the loans and receivables cannot be repaid in full, e.g., when the expected cash flows will be permanently below acquisition cost. The impairment is presented in the profit and loss account as expense in the caption “Value adjustments in respect of financial assets and of investments held as current assets”, reversals of impairments are presented in the same caption as income.

ACCOUNTING TREATMENT OF INITIAL NOTES ISSUANCE AND RECEIVABLE PURCHASE

The FVC issues Notes at par (100) and in turn receives cash (the "Notes Issuance Proceeds").

eCDF	Debit	Credit
D. IV. Cash	100	
C. 1. b. Non convertible loans		100

The FVC invests the Notes Issuance Proceeds to purchase the financial assets.

eCDF	Debit	Credit
C. III. 6. Other loans	100	
D. IV. Cash		100

ACCOUNTING TREATMENT OF RECEIVABLE PRINCIPAL REPAYMENTS

The FVC receives principal repayments of 100 on its securitised financial assets.

eCDF	Debit	Credit
D. IV. Cash	100	
C. III. 6. Other loans		100

ACCOUNTING TREATMENT OF INTEREST INCOME AND EXPENSES

The FVC receives (or accrues especially at year end or interim reporting dates) interest income of 5 on its securitised financial assets:

eCDF	Debit	Credit
D. IV. Cash (payment) *or alternatively* D. II. 4. Other debtors (accrual)	5	
10. b) Income from other investments and loans forming part of the fixed assets, b) other income not included under a)		5

The FVC pays (or accrues) interest expenses (interest income of 5 less external expenses of 1, see provisions also in the waterfall or the T&Cs of the instruments) on its debt instruments (typically notes):

eCDF	Debit	Credit
14. b) Interest payable and similar expenses, b) other interest and similar expenses	4	
D. IV. Cash (payment) *or alternatively* C. 8. Other Creditors (accrual)		4

ACCOUNTING TREATMENT OF DISCOUNTS AND PREMIUMS

The FVC purchases the (eventually non-interest-bearing) securitized receivables at a discount, included in the acquisition cost, which can be considered an interest component. The following example is based on a discount of 3 and a financial asset term of 3 years. The standard method of treatment of such discount is to apply a linear amortization over the lifetime of the loans or receivables. An alternative method is the recognition of the discount as interest income in line with the repayment pattern of the respective receivables. It is also possible to treat the discount received under the effective interest method, which is described in paper dated March 2022 on NPLs.

- **Standard Method**:

eCDF	Debit	Credit
C. III. 6 Other loans	1	
10. b) Income from other investments and loans forming part of the fixed assets, b) other income not included under a)		1

Even if this is probably a rare case, but the vehicle could purchase the securitized receivables at a premium, included in the acquisition cost, which can be considered a negative interest component. The following example is based on a premium of 3 and a financial asset term of 3 years. The same methods as described above can be used to account for the premiums received.

- **Standard Method:**

eCDF	Debit	Credit
C. III. 6 Other loans		1
14. b) Interest payable and similar expenses, b) other interest and similar expenses	1	

ACCOUNTING TREATMENT OF UNREALISED AND REALISED GAINS AND LOSSES

As introduced in the previous sections, the financial assets have been acquired at cost of 100. In the following examples, we assume i) a permanent decline in value of 5, or ii) a sale of the financial assets at a sales price of 102, or iii) a sale of the financial assets at a sales price of 98.

The FVC recognizes value adjustments or **impairments** on its financial assets.

eCDF	Debit	Credit
13. Value adjustments in respect of financial assets and of investments held as current assets	5	
C. III. 6. Other loans		5

The FVC recognizes **gains realised** through sale of its financial assets.

eCDF	Debit	Credit
D. IV. Cash	102	
C. III. 6. Other loans		100
10. b) Income from other investments and loans forming part of the fixed assets, b) other income not included under a)		2

The FVC recognizes **losses realised** through sale of its financial assets.

eCDF	Debit	Credit
D. IV. Cash	98	
14. b) Interest payable and similar expenses, b) other interest and similar expenses	2	
C. III. 6. Other loans		100

The following entries present, based on the impairment described in the previous paragraph, the recording of equalisation provision on the issued Notes (situation 1), respectively its reversal in a subsequent period, when the reason for the impairment on financial assets has ceased to apply.

The FVC recognizes **unrealised** gains or losses (equalisation adjustments) from valuation of its Notes at economically repayable amount. Situation 1 reflects a decrease of economic Notes repayable value. Situation 2 reflects an increase of economic Notes repayable value.

- **Situation 1:**

eCDF	Debit	Credit
C. 1. b. Non convertible loans *(equalisation provision)*	5	
4. Other operating income		5

- **Situation 2:**

eCDF	Debit	Credit
8. Other operating expenses	5	
C. 1. b. Non convertible loans *(equalisation provision)*		5

The FVC recognizes **realised** gains or losses through redemption of its Notes at an amount different from its previous economic repayable Notes value. Situation 1 reflects a realised gain (following the sale of financial assets with a realised loss of 2) and Situation 2 a realised loss on redemption of Notes (following the sale of financial assets with a realised gain of 2).

- **Situation 1:**

eCDF	Debit	Credit
C. 1. b. Non convertible loans	100	
D. IV. Cash		98
4. Other operating income		2

- **Situation 2:**

eCDF	Debit	Credit
C. 1. b. Non convertible loans	100	
8. Other operating expenses	2	
D. IV. Cash		102

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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 by banks, law firms and services providers, amongst others.

Working Group – Best Practice

The aim of this working group is to find practical solutions (or answers) to practical problems. Capital market participants are often confronted with varying practices among the numerous practitioners active in Luxembourg, including when it comes to compliance, accounting, presentation of the financial statements, clearing, reporting, or general legal questions, and the purpose of the group will be to identify any recurring problems or inconsistencies in such practices and to analyse whether it is possible to work out practical recommendations and good market standards which address such issues.

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