LUX CMA
Luxembourg Capital Markets Association

GUIDANCE NOTE FOR BOARD MEMBERS

ACCOUNTING FOR STRUCTURED PRODUCTS

WORKING GROUP | BEST PRACTICE
ACCOUNTING & REPORTING

FEBRUARY 2024

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INTRODUCTION – ACCOUNTING FOR STRUCTURED PRODUCTS

In structured product transactions, the securitisation vehicle (hereinafter the "**FVC**"), is set up to issue financial products. This type of transaction is often referred to as a "synthetic" securitisation.

The exact nature of the **Underlying Asset** used to offer structured products can vary, ranging from portfolios of reference assets to derivatives (typically swaps) or deposits linked to index performance, etc.

In a broader sense, structured product transactions refer to complex financial instruments that are created by combining various financial assets into a single product. These products are typically designed to meet specific investors´ investment goals or fit to their risk tolerance.

Structured products are often offered by financial institutions to investors seeking specific risk/return profiles or who have a particular set of investment objectives.

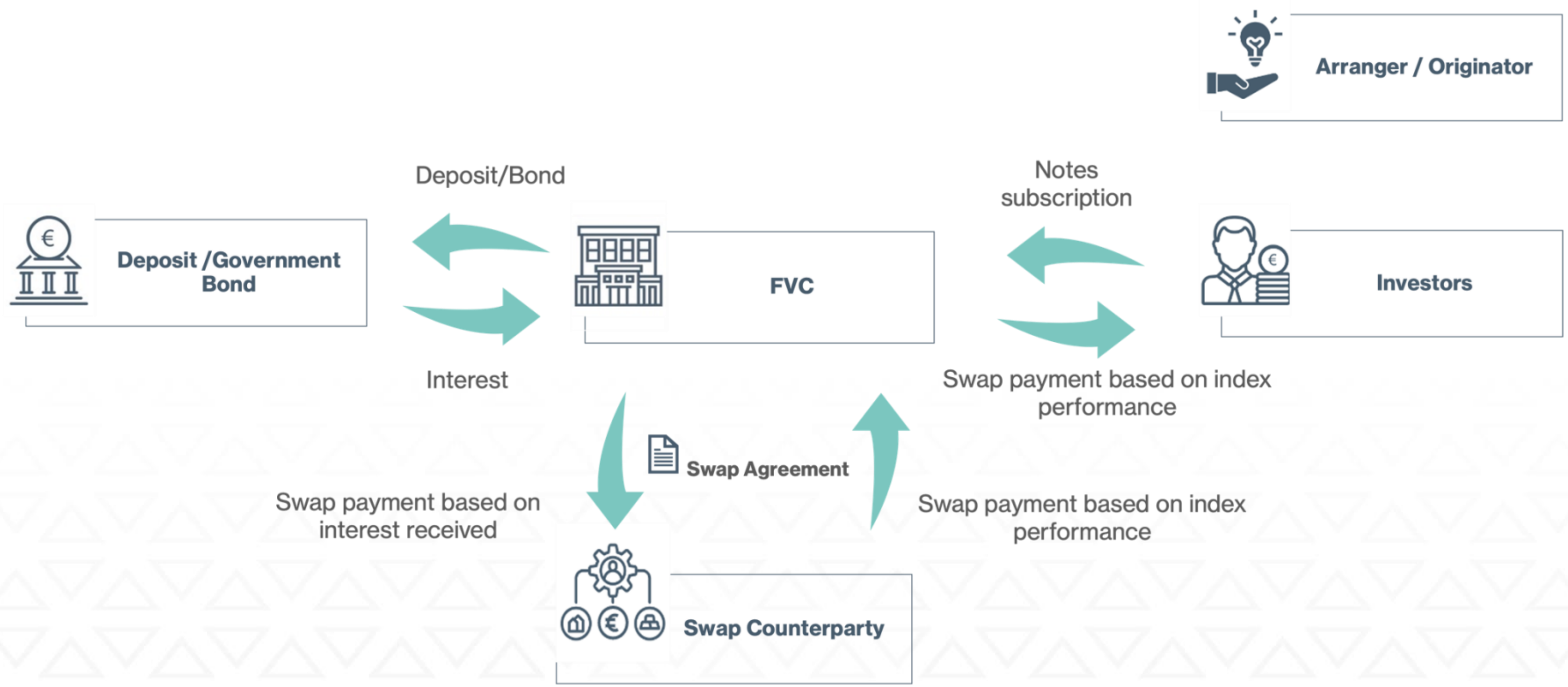
These transactions can be organised in various forms.
The principal parties involved in the structured products transaction are defined below in particular, but not in an exhaustive manner:

- The **Originator** – creates the structured products to offer investment opportunities for interested investors. The Originator is often a financial institution, such as a bank or investment firm.
- The **Investor** – purchases the structured product with the intention to receive higher returns, portfolio diversification and seeks broader combinations of yield, risk and maturity.
- The **FVC** - or a compartment of the FVC, created for the special purpose to issue structured products.
- The **Swap Counterparty** - is a party that enters into a hedging arrangement with the FVC, as permitted by the terms of the **Swap Agreement**, to exchange or "swap" cash flows, typically being interest payments or cash flows related to, but not limited to, other variable transactions such as interests or currencies.

Terms and abbreviations used in this publication are defined in the glossary at the end of the document.

TYPICAL STRUCTURED PRODUCTS STRUCTURE ILLUSTRATION

Example below is following structured product offering exposure to index performance.



ACCOUNTING POLICY FOR FINANCIAL ASSETS – FAIR VALUE OPTION ("FVO")

The FVC must comply with the Luxembourg Law of 19 December 2002 on the Register of Commerce and Companies and the Accounting and Annual Accounts of Undertakings that sets up the Luxembourg accounting principles ("**LUX GAAP**" and/or the "**Accounting Law**").[1]

Under LUX GAAP, the FVC can opt to choose from different accounting frameworks for the initial and subsequent accounting treatment of the valuation of the assets.

In an FVC dealing with structured products, the financing issuance documents specify the payments of the notes issued being linked to the performance of the underlying assets, which may result in a negative as well as a positive impact on the repayment amount of the notes issued upon maturity.

Therefore, the FVC which is set up to issue structured products mostly opts for the LUX GAAP valuation model using the **FVO**, as this methodology is the most appropriate to ensure a true and fair view of the financial statements. Hence the example of accounting entries below illustrates the application of the FVO by the FVC.

Following the requirements of the Accounting Law, the value of the underlying asset and the issued notes is subject to:

Initial recognition

Under the FVO, the underlying asset is initially valued at its purchase price including expenses incidental thereto, while the notes issued are recognised at the amount received.

Subsequent accounting

At the financial period / year end, the valuation assessment of the product is made to determine fair market value of underlying assets, swaps and, accordingly, the issued notes.
Board of Directors determines fair value using valuation models and/ or any other acceptable valuation methods.

[1] Financial Vehicle Corporation may also opt for the application of the International Financial Reporting Standards (**IFRS**).

INITIAL RECOGNITION / SETTLEMENT

Issuance of the notes

eCDF	Debit	Credit
Cash	100	
C.1.b Debenture loans		100

Acquisition of underlying assets (bond, swap)

eCDF	Debit	Credit
C.III.5. Financial assets - investments held as fixed assets	100	
Cash		100

TREATMENT OF INCOME, EXPENSES (INTEREST, DIVIDENDS, SWAP)

Regular payments

- **Interest received from underlying asset (bond/deposit)**

eCDF	Debit	Credit
Cash/Receivable (accrual basis)	5	
10.b) Income from other investments and loans forming part of the fixed assets b) other income not included under a)		5

- **Dividend received in case of equity collateral (share/fund)**

eCDF	Debit	Credit
Cash	5	
10.b) Income from b) other investments and loans forming part of the fixed assets b) other income not included under a)		5

- **Interest paid under the swap**

eCDF	Debit	Credit
14.b) Interest payable and similar expenses b) other interest and similar expenses	5	
Cash/Payable (accrual basis)		5

- **Income received under the swap**

eCDF	Debit	Credit
Cash/Receivable (accrual basis)	8	
10.b) Income from other investments and loans forming part of the fixed assets b) other income not included under a)		8

- **Interest paid to noteholder**

eCDF	Debit	Credit
14.b) Interest payable and similar expenses b) other interest and similar expenses	8	
Cash/Payable (accrual basis)		8

Unrealised gains and losses

- **Unrealised gain from valuation of underlying asset (resp. swap) at FVO at year-end**

eCDF	Debit	Credit
C.III.5. Financial assets - investments held as fixed assets	5	
13. Value adjustments in respect of financial assets and of investments held as current assets		5

- **Unrealised loss from valuation of underlaying asset (resp. swap) at FVO at year-end**

eCDF	Debit	Credit
13. Value adjustments in respect of financial assets and of investments held as current assets	7	
B. Provisions 3. Other Provisions		7

- **Unrealised gain from valuation of notes at repayable amount at year-end (equalisation provision)**

(unrealised loss: 8. Other operating expenses)

eCDF	Debit	Credit
C.1.b Debenture loans	2	
5. Other operating income		2

Realised gains and losses

- **Realised gain from sale of underlying asset (resp. swap)**

eCDF	Debit	Credit
Cash	102	
C.III.5. Financial assets - investments held as fixed assets		100
10.b) Income from other investments and loans forming part of the fixed assets b) other income not included under a)		2

- **Realised loss from redemption of notes**

eCDF	Debit	Credit
C.1.b Debenture loans	100	
8. Other operating expenses	2	
Cash		102

TREATMENT IN CONNECTION WITH ATAD IMPLICATION

Regarding the potential impact of the **ATAD 1** interest limitation rules, we refer to the LuxCMA Technical Position Paper on the Deductibility of Payments by Securitisation Companies Financed by Debt.

GLOSSARY AND ABREVIATIONS

This paper is part of a series of guidance notes for Board Members and we encourage you to read the additional papers focusing on different types of transactions and underlying assets available on our website.

A	**Accounting Law**	means the Luxembourg Law of 19 December 2002 on the Register of Commerce and Companies and the Accounting and Annual accounts of Undertakings, as amended, which sets out the accounting and disclosure requirements for Luxembourg companies.
	ATAD 1	means Anti-Tax Avoidance Directive and refers to the 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, as amended. ATAD 1, adopted in 2016, addresses certain tax avoidance practices that directly impact the functioning of the internal market within the EU.

E	**eCDF**	stands for "électronique de Collecte des Données Financières" and refers to the Luxembourg platform for electronic gathering of financial data. Its main purpose is to provide a central and neutral platform for the preparation, the validation and the electronic transmission over the Internet of financial data that must be provided to the State (all types of periodic and annual declarations, annual accounts, chart of accounts,...).

F	**FVC**	means Financial Vehicle Corporation. This term, used in other LuxCMA publications, is defined by the European Central Bank ("ECB") as engaging in "securitisation", where securitisation is defined as "*a transaction or scheme whereby an entity that is separate from the originator […] and is created for or serves the purpose of the transaction or scheme issues financing instruments to investors, and one or more of the following takes place: an asset or pool of assets, or part thereof, is transferred to an entity that is separate from the originator and is created for or serves the purpose of the transaction or scheme […].*" It therefore implies that there is a transfer of assets from the originator to the securitisation entity for the entity to qualify as "securitisation" under the Regulation (EC) N° 24/2009 of the ECB and for the Securitisation Vehicule ("SV") to qualify as a FVC.
	FVO	stands for Fair Value Option. The fair value option allows entities to elect to measure a financial instrument at fair value on initial recognition, with subsequent changes in fair value recognised in the income statement. This is in contrast to the traditional accounting approach, under which financial instruments are initially recognised at cost or amortised cost and changes in fair value are often recognised in other comprehensive income or not recognised until realised.

I	**IFRS**	stands for International Financial Reporting Standards. These are a set of accounting standards developed by the International Accounting Standards Board (IASB), an independent, private-sector body based in London. IFRS aims to provide a common global language for business affairs, ensuring that financial statements are transparent, comparable, and understandable across different countries and industries.
	Investor	means an individual or entity that purchases securities created through the process of securitisation. Investors in securitisation transactions assess the risk and return characteristics of these securities based on factors such as credit quality, payment structures, and the performance of the underlying assets.

L	**LuxCMA**	means the Luxembourg Capital Markets Association, a not-for-profit association created on 1 March 2019 which represents the common interests of all stakeholders of the primary capital markets industry of Luxembourg.
	LUX GAAP	means Generally Accepted Accounting Principles in Luxembourg, applicable to the circumstances as of the date of determination, consistently applied.

O	**Originator**	means the party assigning assets to the FVC/SSPE in a securitisation transaction.

S	**Swap Agreement**	refers to a financial contract or derivative instrument used to manage certain risks associated with the cash flows of the underlying assets or securities. Specifically, interest rate swap agreements are commonly employed in securitisation to help mitigate interest rate risk. The purpose of the swap agreement is to exchange or "swap" cash flows or payments between the parties based on predetermined terms and conditions.
	Swap Counterparty	means the counterparty to a derivative contract, i.e. the swap agreement, entered into with the FVC when the Notes are issued. The parties to the contract agree to exchange the cash flows of the underlying asset, which are then channeled through the swap counterparty, allowing parameters such as interest rate, payment frequency, currency, maturity, etc. to be changed. The purpose of the swap agreement is to ensure that the investors receive the interest defined in the terms of the notes issued by the FVC.

U	**Underlying Asset**	refers to the specific asset or group of assets on which the transaction is based. It is the asset or assets that generate the cash flows or value that are ultimately packaged and sold to investors through the issuance of repackaged notes. The underlying asset can be any financial instrument such as loans, mortgages, bonds or derivatives. The repackaging note transaction involves pooling these assets and then issuing repackaged notes backed by the cash flows or value generated by the underlying assets.

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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, which is composed by banks, law firms and services providers, amongst others.

Working Group I Best Practice – Accounting & Reporting

The aim of this working group is to find practical solutions (or answers) to practical problems. The Accounting & Reporting sub-group brings together the main players in the Luxembourg corporate services and accounting community to address various issues related to capital market accounting and reporting. Capital market participants are often confronted with different practices among the numerous practitioners active in Luxembourg with regard to accounting, financial statement presentation and reporting.

The purpose of the group is to identify any recurring issues or inconsistencies in such practices and to analyse whether it is possible to develop practical recommendations and good market standards that address such issues and harmonise the market approach among the various players.

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