KPMG

EU Securitisation Regulation

Impact on the securitisation undertakings in Luxembourg

www.kpmg.lu

What are securitisation undertakings as per the Luxembourg law?

Article 1 (2) of the Law of 22 March 2004 on securitisation ('Securitisation law') defines as:

*"'**Securitisation undertakings**', within the meaning of this law, 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."*

Hence:

1. Undertakings that carry the securitisation (transaction), which is defined under Article 1 of the Securitisation law, together with the elaboration by the CSSF under frequently asked questions[1] as: **An economic 'transformation' of certain risks into securities through the acquisition or hedging of the first ones and the issue of the second ones;** and
2. by stating in the articles of incorporation, management regulation or other issue documents that they are subject to such a law, are considered as Luxembourg Securitisation undertakings.

EU Securitisation Regulation ('the Regulation')

The Regulation was published in the Official Journal of the European Union on 28 December 2017 as Regulation (EU) 2017/2402.

This represents a major milestone in the EU's Capital Markets Union (CMU) reform agenda. The Regulation came into force on 17 January 2018 and will be applicable as from 1 January 2019. This Regulation shall be binding in its entirety and directly applicable in all Member States.

What are securitisation undertakings as per the Regulation?

'Securitisation special purpose entity' or 'SSPE' *means a corporation, trust or other entity, other than an originator or a sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator.*

Whereas the securitisation is defined under the Regulation as:

Transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures (payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures) is tranched (the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme).

Also, the transaction or scheme does not create exposures especially to finance or operate the physical assets in accordance with the characteristics listed in Article 147(8) of Regulation (EU) No 575/2013.

Thus, based on the above definition, credit risk and tranching are the key components of securitisation under the Regulation.

[1] http://www.cssf.lu/en/supervision/ivm/securitisation/faq/

Which entities in Luxembourg are impacted by the Regulation?

In light of the broad definition of securitisation under the Luxembourg law, not all securitisation undertakings in Luxembourg meet the definition of securitisation under the Regulation (by securitising risks other than credit risk or by not tranching the securities issued) and thus the Regulation will not be applicable on these undertakings.

Whereas the SSPEs, which meet the above criteria under the Regulation and are also securitisation undertakings under the Luxembourg law, will be impacted by the Regulation and thus are obliged to comply with all the requirements mentioned below.

What is in the EU Securitisation Regulation ('the Regulation')?

The Regulation lays down a **general framework** for securitisation and a specific framework for simple, transparent and standardised ('STS') securitisation.

General framework: Provisions applicable to all the securitisations that are mentioned in Chapter 2 of the Regulation. Key requirements are:

1. Due diligence requirements for institutional investors (related to credit granting process, risk retention compliance, required information, risk characteristics) — *Article 5*

   Institutional investors are defined as:
   Both insurance and reinsurance undertakings;
   Institutions for occupational retirement provisions;
   - Institutions for occupational retirement provisions;
   - Alternative investment fund managers;
   - An undertaking for the collective investment in transferable securities (UCITS), both self-managed and managed by their management companies;
   - Credit institutions or investment firms.

2. Risk retention related to the originator, sponsor or original lender (retention of material net economic interest not less than 5% by one of the parties) — *Article 6*
3. Transparency requirements for originators, sponsors and SSPEs (sufficient information on a regular basis) — *Article 7*

Specific framework for simple, transparent and standardised ('STS') securitisation under Chapter 4 of the Regulation which requires i) simplicity (Article 20) — for portfolio and cash flows; ii) transparency (Article 22) — for availability of investor data; and iii) standardisation (Article 21) — of structural elements including risk retention, roles and responsibilities and remedial actions, etc.

Originators, sponsors and SSPEs may use the designation 'STS' or any other designation that refers directly or indirectly to those terms for their securitisation only when:

- they meet all the requirements of the EURegulation mentioned in Section 1 and Section 2 of Chapter 4 of the Regulation; **and**
- ESMA has been notified and such a securitisation is included in the list of STS securitisations maintained by ESMA.

In addition to the above, other key aspects of the EU Regulation include **criteria for credit granting, requirements for selling securitisations to retail clients, a ban on re-securitisation, requirements for SSPEs as well as conditions and procedures for securitisation repositories.**

Key benefits of the Regulation:

The Regulation applicable on the EU securitisation entities (SSPE and STS) is termed as a victory for the European securitisation industry and is perceived as particularly beneficial for the capital market, as this aims to:

- build the investors' confidence in the securitisation entities;
- help investors evaluate the risks related to securitisation, both within and across products;
- improve risk management especially with the risk retention regulation as mentioned above;
- bring in transparency and regular availability of information (including the investor reports and information related to underlying exposures);
- develop a new regime of STS which will provide a more risk-sensitive framework for securitisation transactions; and
- allow STS securitisation transactions to receive preferential capital treatment and benefit from other regulatory advantages such as a proposed exemption from clearing and a proposed relaxation of margin rules for derivatives entered by an SSPE.

Contact us

Muhammad Azeem

Associate Partner

T: +352 22 51 51 6504
E: muhammad.azeem@kpmg.lu

KPMG Luxembourg,
Société coopérative
39, Avenue John F. Kennedy
L-1855 Luxembourg
T: +352 22 51 51 1

www.kpmg.lu