

FINANCIAL SERVICES

# CAPITAL MARKETS UNION, SECURITISATION AND SMALL AND MEDIUM ENTERPRISES



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## INTRODUCTION

Across the European Union ("EU"), barriers exist that prevent small and medium-sized enterprises ("SMEs") from raising capital that is required for growth. Banks are lending less and less to SMEs, a trend that is only expected to continue in light of more stringent capital requirements. Regulatory changes, pending or enacted, have inhibited the raising of capital, rather than promoting it. For example, Venture Capital Trusts have been a long-standing provider of funding to SMEs but the recently enacted Finance (No. 2) Act in the UK has effectively restricted what Venture Capital Trusts can invest in. Furthermore, the introduction of MiFID II will result in certain investors being considered as retail rather than institutional, hence limiting what they can invest in.

The US economy is approximately the same size as that of Europe, but European equity and debt markets are less than half and a third of the respective US markets. US SMEs raise around five times as much funding from capital markets compared to their European counterparts<sup>1</sup>. The Capital Markets Union ("CMU") Action Plan that was published on 30 September 2015 by the European Commission ("EC") seeks to address this disparity. The CMU Action Plan outlines six objectives which are as follows:

1. Financing for innovation, start-ups, and non-listed companies
2. Making it easier for companies to enter and raise capital on public markets
3. Investing for long-term, infrastructure and sustainable investment
4. Fostering retail and institutional investment
5. Leveraging banking capacity to support the wider economy
6. Facilitating cross-border investing

The Action Plan outlines the means by which entities, including SMEs, can raise capital so as to meet these objectives. While a number of these means are relevant, a key focus of the Action Plan is on re-building<sup>2</sup> the securitisation markets to diversify funding sources. The EC seeks to overcome the stigma associated with securitisations following the financial crisis of the late 2000s in order to minimise the complexity associated with them. In order to do this, the EC is proposing to introduce a framework that makes securitisations more attractive to investors by creating criteria for "Simple, Transparent and Standardised" ("STS") securitisations. This is to make the use of securitisation a sustainable and 'safe' source of funding for investors. What constitutes STS is currently being discussed at a pan-European level as part of an EC legislative proposal for a new Securitisation Regulation and Directive.

### BDO and securitisations

The structuring of a securitisation can be complex and we envisage that the requirement to comply with STS criteria will add to the complexity. Care needs to be taken at the outset in order to ensure meeting of the criteria so to benefit from qualifying status. However, the benefits of capital raising for SMEs in an environment in which capital might not otherwise have been available should, more likely than not, outweigh any concerns regarding initial complexity and associated costs. The good news for SMEs is that BDO has significant expertise and experience in advising a wide range of clients on the structuring, implementation and operation of securitisations, with a particular focus on SMEs and the mid-market. In advising clients, BDO draws on its specialist corporate finance, accounting, regulatory, tax and audit teams based in offices across Europe and beyond. BDO has set up a cross-border Securitisation Team to support you and this is principally composed of partners and members of staff from its financial services practice given the widespread use of securitisations by financial institutions.

This publication represents the first form of assistance to SMEs from the BDO Securitisation Team. It starts by briefly outlining what a SME needs to know in terms of the CMU and provides some practical information on what a securitisation entails and the potential benefits it creates. It concludes by summarising the proposed STS criteria and outlining some likely future developments in relation to the EC's proposed STS framework. BDO's Securitisation Team can also provide you with direct assistance in structuring your securitisation, they can support you throughout its lifecycle or at specific points within it. It is to be noted that some of the proposed STS criteria require an independent third party to be engaged in order to verify compliance therewith, a role that BDO can fulfil. A list of your contacts is provided on page 15.

### Forthcoming publications

BDO is also preparing a publication entitled "Capital Markets Union, Securitisation and Financial Services". This will outline how the CMU generally, and more specifically securitisations, will impact financial institutions (including banks). It will also highlight the potential impact that securitisations used by financial institutions and SMEs would have on each other. Finally, the latter publication will identify various different forms of securitisations that an SME might consider implementing. It should be noted that most of the types of securitisation that are discussed in the "Capital Markets Union, Securitisation and Financial Services" publication will not meet STS criteria (such as those securitising assets that do not meet STS criteria, securitisations that invest in other securitisations and multi-seller conduits).

<sup>1</sup> As noted by the European commissioner for financial stability, financial services and capital markets union Jonathan Hill: "A stronger capital markets union for Europe", Financial Times, 29 September 2015.

<sup>2</sup> European Commission, Action Plan on Building a Capital Markets Union, November 2015, available at: [http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan\\_en.pdf](http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf), 4.

## RATIONALE BEHIND THE CAPITAL MARKETS UNION

A single European capital market is one of the core objectives of the EU<sup>3</sup>. The instruments to achieve this include the fundamental freedoms (goods, services, capital and people), European competition law and the alignment of national legislation. Currently, the free movement of capital is impaired by the continuing fragmentation of European capital markets across national borders and the culture of undue reliance placed on bank finance by European economies. As a result, the use of capital market based financing is not as widespread as it could be in Europe. This is also, arguably, a contributing factor to the magnitude and duration of the last financial recession in the late 2000s when bank lending tightened. The US economy, in contrast, recovered more quickly from its recession possibly because it has better and larger access to capital from non-bank sources. It has thus been less reliant on bank funding, or better put, the lack thereof.

This is why the EC wants to achieve a CMU, the aim of which is the integration of cross-border capital markets across equity and non-bank debt finance. A single market for capital should increase allocational efficiency and benefit all European businesses, but more importantly enable start-ups and SMEs to access capital on more favourable and less expensive terms. It is envisaged that this will support real economic expansion and growth. In relation to this, the Commission has stated that the CMU should:

*“create a situation, where SMEs can raise financing more easily than today; costs of investing and access to investment products converge across the EU; obtaining credit through capital markets is increasingly straightforward; and seeking funding in another Member State is not impeded by unnecessary legal or supervisory barriers.”<sup>4</sup>*

SMEs play a fundamental role in job creation, the generation of wealth via their direct investment, the creation of investment opportunities for investors and the fostering of economic development of the European economies. 99% of all companies in the EU are SMEs. SMEs generate 58% of the EU's gross domestic product (“GDP”) and account for 67% of employment within the EU. Since the financial crisis of the late 2000s it has become increasingly difficult for SMEs to secure funding within the EU<sup>5</sup>. It is therefore not surprising that the bringing down of barriers to financing SMEs has become a major concern of the EU and formed the centre of the EC's Green Paper<sup>6</sup> on the creation of a CMU.

As outlined in the introduction to this publication, this is reflected in the EC's objective to re-ignite European capital markets so that capital flows more freely across borders, doing so on a sustainable basis and in a manner that enhances investor confidence. This gave rise to the six key objectives outlined by the EC in the CMU Action Plan that it published on 30 September 2015 and associated measures that they envisage would result in the objectives being met. While the measures are widespread, the introduction of the STS legal framework for securitisations is expected to result in such structures being a funding source of interest to SMEs.

<sup>3</sup> Cf. Art. 3 (3) Treaty of the European Union.

<sup>4</sup> European Commission, Q & A on the Green Paper on building a Capital Markets Union, February 2015, available at [http://europa.eu/rapid/press-release\\_MEMO-15-4434\\_en.htm](http://europa.eu/rapid/press-release_MEMO-15-4434_en.htm), 1.

<sup>5</sup> Cf. European Commission, Annual Report on European SMEs 2013/2014 – A Partial and Fragile Recovery, July 2014, available at: [http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review/files/supporting-documents/2014/annual-report-smes-2014\\_en.pdf](http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review/files/supporting-documents/2014/annual-report-smes-2014_en.pdf), 6.

<sup>6</sup> European Commission, Green Paper: Building a Capital Markets Union, February 2015, available at: [http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper\\_en.pdf](http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf), 9.

## SECURITISATIONS EXPLAINED

The purpose of this section is to explain securitisations from a practical point of view and to warn users of their potential pitfalls. Securitisation is a complex financial practice, which may be difficult to comprehend by someone who has not encountered them before. Figure 1 below illustrates, at a high level, an overview of the lifecycle of a typical SME securitisation, including indicative timings for executing the securitisation. It is worth noting that obligations associated with the securitisation post its structuring are generally limited. This is because service providers are usually engaged up front to perform specific ongoing tasks, with the securitisation vehicle itself then running almost on 'auto-pilot'.

ONCE INITIATED, OBLIGATIONS RELATING TO SECURITISATION VEHICLES ARE GENERALLY LIMITED

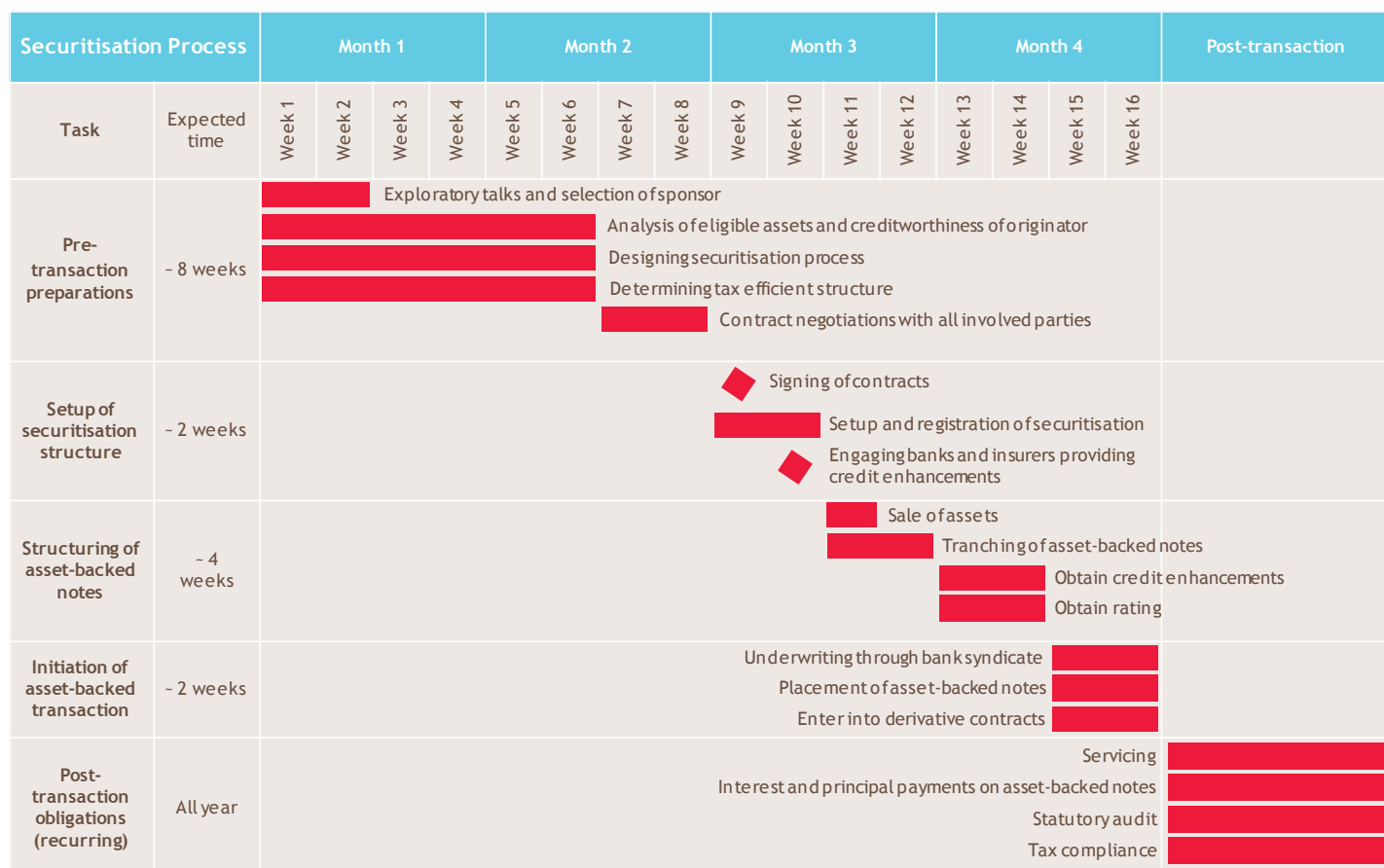


Figure 1: High level overview of a SME securitisation lifecycle with indicative timings.

### Basic premise

Securitisation<sup>7</sup> describes the financial practice of transforming a portfolio of assets, including loans, into rated 'notes' that are tradable in primary or secondary markets or via private placement so as to raise capital for the original owners of the portfolio of the assets. This is achieved by creating a separate legal entity from the party that 'sells' it the portfolio of assets. The legal entity is structured in a manner that makes it bankruptcy-remote from the 'seller' (ie if the 'seller' goes bankrupt then the separate legal entity is generally not made bankrupt as a result). It is to be noted that the converse also holds true as the assets are typically sold without recourse (ie the 'seller', after the point of sale, is not responsible for default of the asset). The notes pay interest as the return for the capital provided and are typically referred to as **asset-backed securities ("ABS")**. This is because the returns the noteholders receive are derived from and backed by the underlying portfolio of loans or other financial assets. The loans and other financial assets are jointly referred to as 'assets'. As one can see, post issuance of the asset-backed notes, securitisation structures become self-funding.

SECURITISATIONS AND THEIR ORIGINATORS ARE BANKRUPTCY-REMOTE FROM EACH OTHER

<sup>7</sup> For a legal definition, cf. Art. 4 (1) No. 61 CRR.

### Tranching of notes

During the securitisation process, the notes are generally structured to meet different investor risk profiles. The cash that is generated by the asset portfolio is paid in order of the priority of payments that is stipulated in the transaction documentation. Rating agencies (eg Standard & Poor's, Moody's or Fitch Ratings) typically assign the highest rating of AAA or a high rating of AA to the most senior tranche of notes. This indicates to potential investors that the notes are unlikely to be subject to default and that investors have priority over other tranches in the distribution of cashflows generated by the underlying assets. Other subordinated notes receive a lower investment grade rating (eg A or BBB), because only when senior obligations have been met are these more junior obligations paid. However, holders of those relatively riskier tranches are rewarded for this in the form of the higher rate of interest that is attached to their notes. The interest payments to the noteholders are usually based on interbank offered rates, such as EURIBOR or LIBOR, plus a spread to compensate for the credit risk associated with the tranche. The return could also be a straight fixed rate of interest as stipulated in the transaction documentation. Figure 2 below pictorially represents what a securitisation looks like when its notes have been tranced.

**JUNIOR, MORE RISKY  
TRANCHES OF NOTES ATTRACT  
HIGHER RATES OF RETURN**

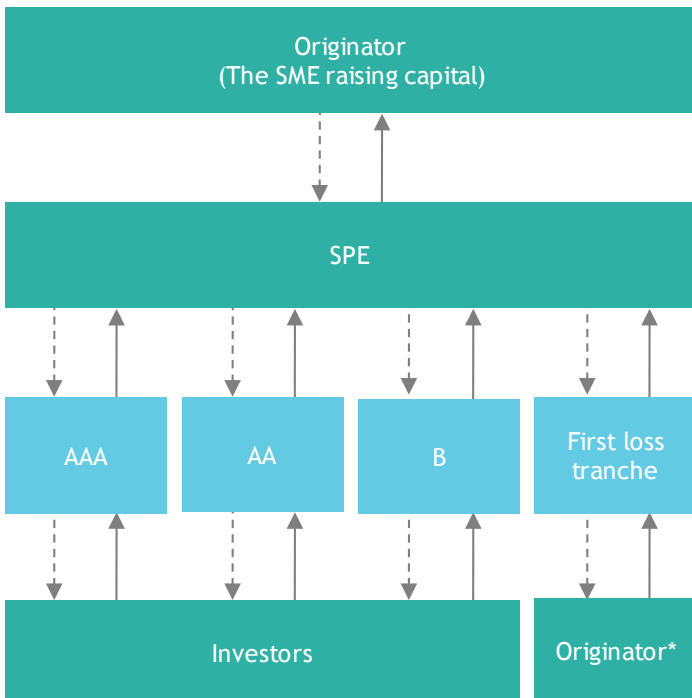


Figure 2: Tranching of notes issued by a securitisation structure.

\* = see Investor appetite section for a discussion of the first loss principle.

### Parties within and legal forms of a securitisation structure

Under a "true sale" securitisation, the owner of the assets, the **originator**, usually sells the assets to a **special purpose entity ("SPE")**. The sale of the assets to the SPE needs to be undertaken so that it is recognised as a true transfer as a matter of law. The

tax consequences arising on the sale of assets by the originator to the SPE are considered further in the Tax-related matters section. As stated under the Basic premise section, the SPE is a legal entity that is separate from the originator. It typically takes the form of a limited liability company (such as the English Limited Company, the German GmbH, the Irish Limited Company or the Luxemburgish S.à r.l.); however, member states can change the form required for an SPE<sup>8</sup>. The use of a SPE is intended to ensure remoteness for investors from any financial difficulty or bankruptcy of the originator, with the converse also holding true. The SPE finances the consideration paid to the originator by offering and selling the asset-backed notes on capital markets or via private placements. The cash flows of the transferred assets are then used to cover interest payments on the asset-backed notes and to repay the principal to investors.

**THE SPE IS A SEPARATE LEGAL  
ENTITY CREATED FOR THE SOLE  
PURPOSE OF SECURITISATION  
WITH ITS FORM BEING ESTAB-  
LISHED BY MEMBER STATES**

The securitisation process is conducted by the **sponsor**<sup>9</sup> (also referred to as the "arranger"). The sponsor (such as a bank or specialised financial services firm) typically initiates and organises the entire securitisation transaction. This involves establishing the SPE, selecting and valuing the assets that are to be securitised and subcontracting service organisations to administer the SPE and assist with its legal documentation. The sponsor may also act in a fiduciary capacity on behalf of the noteholders if it is licensed to act as trustee.

**SERVICE PROVIDERS ARE  
ENGAGED THROUGHOUT THE  
SECURITISATION PROCESS**

The sponsor or the originator may also provide credit enhancements (eg guarantees) or liquidity facilities so that the SPE will be able to meet interest and principal payments as and when they are due to its investors (even when the SPE is faced with temporary cash shortfalls). Credit enhancements are typically required when the originator targets a certain rating for the asset-backed notes and / or wants to cap related interest expenses. Nonetheless, the granting of credit enhancements or guarantees by the originator to the SPE may lead to undesired accounting outcomes (ie while credit enhancements have the benefits outlined above, their use may result in the originator controlling and thus having to consolidate the SPE – see Accounting-related matters section).

**GUARANTEES ARE ISSUED TO  
ENHANCE THE CREDIT QUALITY  
OF THE NOTES**

<sup>8</sup> For example, Ireland recently enacted a new Companies Act in 2014 under which Irish SPEs, other than PLCs which issue listed debt, must be established as a Designated Activity Company. Existing Irish SPVs that have issued listed debt need to be converted into a Designated Activity Company by 1 September 2016.

<sup>9</sup> For a legal definition, cf. Art. 4 (1) No. 14 CRR.

Since the SPE typically does not have any employees, it would also generally engage a **servicer**<sup>10</sup> (which can be the originator). The servicer executes the management of the assets, ie it ensures the inflow of cash. The servicer then forwards the cash flows from the portfolio of assets to the sponsor, who makes payments to the holders of the asset-backed notes. Figure 3 provides a simplified cash flow diagram of a securitisation structure and Figure 4 illustrates the relationship between the key parties involved in the process. Note that the SPE would typically need to own the assets prior to it being able to issue the notes, which it uses to finance them going forward. Accordingly, the SPE would, in such a scenario, need to borrow bridge financing from a third party, such as a financial institution, or the originator, in order to purchase the assets, which it will then repay with the proceeds of the notes issued.

**BRIDGE FINANCING IS OBTAINED AT INCEPTION UP UNTIL THE POINT AT WHICH THE SECURITISATION VEHICLE BECOMES SELF-FUNDING**

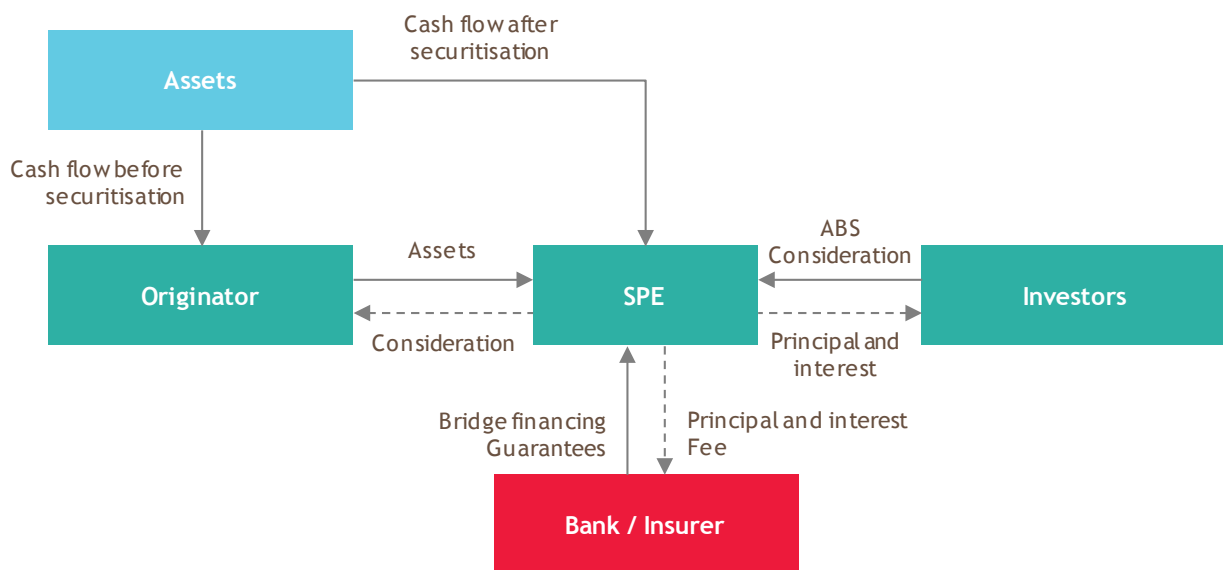


Figure 3: Cash flows in a securitisation structure.

<sup>10</sup> For a legal definition, cf. Art. 142 (1) No. 1 CRR.

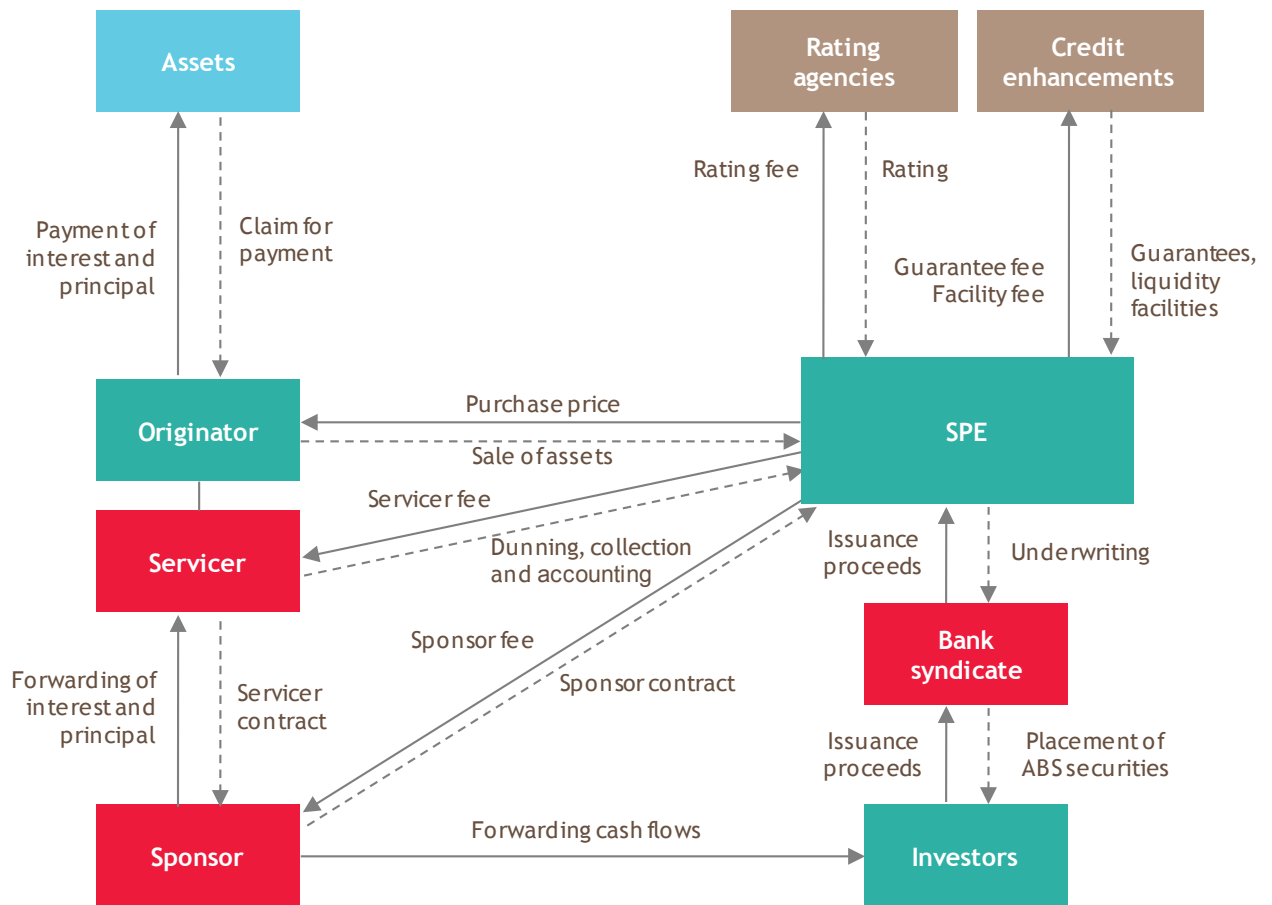


Figure 4: Key parties in a securitisation transaction.

### ABCP programmes

A special case of ABS transactions that may be of particular interest to SMEs are so-called asset-backed commercial paper ("ABCP") programmes. These differ to **term securitisations**<sup>11</sup> (ie those that have a life that matches that of longer-term assets, such as non-financial assets or long-term loans). Under an ABCP programme the SPE continuously buys assets, such as trade or lease receivables, from the originator. The SPE finances the consideration for the assets by the revolving issuance of commercial paper, which typically only have a maturity period of up to one year (ranging from 30 to 360 days). As the name suggests, the return on the commercial paper is derived from and backed by the trade or lease receivables that are purchased from the originator. **ABCP securitisations**<sup>12</sup> can meet the STS criteria outlined in the EC's Securitisation Proposal. However, it should be noted that the STS criteria that apply to ABCP securitisations differ to those that apply to term securitisations. This is a direct result of the nature of the underlying assets.

**ABCP SECURITISATIONS ARE USED TO FINANCE ASSETS THAT ARE SHORT TERM IN NATURE**

### Potential benefits of securitisations for SMEs

Securitisation transactions offer SMEs a number of potential benefits:

**BENEFITS ENCOMPASS LIQUIDITY, CAPITAL MANAGEMENT, LOWER COSTS, RISK MANAGEMENT AND ACCESS TO CAPITAL MARKETS**

**Liquidity:** Securitisations represent, first and foremost, a form of financing. The originating SME receives an immediate cash inflow upon sale of the assets and is able to reduce the operating / working capital requirements associated with such assets.

**Capital management:** The disposal of assets and cash inflow allow the SME to undertake other investments and thereby potentially increase its revenues even further. The proceeds from the sale of assets to the SPE may also be used to reduce an SME's gearing and improve its debt-equity ratio. This may in turn improve the SME's rating and lead to lower interest rate costs from alternative sources of finance. Moreover, the use of a securitisation may help the SME to meet contractual covenants as these typically stipulate a target (ie maximum) gearing ratio.

**Lower cost:** Securitisations typically lower the cost associated with the financing<sup>13</sup>. Due to credit enhancements the SPE is distinct from the default risk of the originating SME. The level of security provided by the higher rated notes may make them more appealing to investors than if the notes were issued by the SME itself. This should allow the SPE to issue notes at a lower rate of interest than if the SME were to directly issue what would be unsecured debt. As long as interest payments on the asset-backed notes and related transaction costs (eg those associated with the setting up of

<sup>11</sup> European Commission, Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation, September 2015, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1448996868990&uri=CELEX:52015PC0472>, 22.

<sup>12</sup> European Commission, Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation, September 2015, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1448996868990&uri=CELEX:52015PC0472>, 22.

<sup>13</sup> Cf. ECB, Monthly Bulletin October 2003, available at: <http://www.ecb.europa.eu/pub/pdf/mobu/mb200310en.pdf>, 55.



the SPE, legal fees, credit enhancement fees, facility fees, professional service fees et al) are lower than any alternative forms of financing, securitisations should result in cost savings.

**Risk management:** The disposal of the securitised assets to the SPE can lead to a reduction in the SME's exposure to market, credit and liquidity risks that are associated with the securitised assets.

**Access to capital markets:** Due to their size, SMEs typically do not have access to capital markets (either via an equity or debt offering). SMEs may also be reluctant to raise finance in this manner. However, securitisations enable such entities to indirectly participate in these markets. Having said this, nothing stops a non-financial institution from listing its ABS on a stock exchange via a primary offering. Securitisations also contribute towards diversification in funding sources and reduce the dependence of SMEs on equity and bank finance. This stimulates the competition between all forms of funding, which theoretically should lower the SMEs' cost of capital and make them more independent from third parties' interests.

### Investor appetite

In order to ensure investor appetite and the success of an ABS issuance, the originating SME should retain a minimum risk exposure on its books and bear the first losses. This is known as the **first loss principle**, which normally amounts to 5% to 10% of the total portfolio to be securitised. The rationale behind the first loss principle is simple: as the SME is liable before any third party investor, it has a vested interest in ensuring the quality of the underlying assets that are being securitised and to engage service providers that ensure that the quality of assets is maintained during the lifecycle of the securitisation. ABS issuances with a first loss principle effectively provide investors with a protection from unknown risks and thus represent a more attractive investment opportunity. However, SMEs should pay particular attention when considering such a retention as, while it has its benefits this may result in it controlling and thus having to consolidate the SPE – see Accounting-related matters section.

**THE FIRST LOSS PRINCIPLE HAS WIDE-RANGING IMPLICATIONS, IT ATTRACTS INVESTORS BUT CAN IMPACT ACCOUNTING FOR THE SECURITISATION**

### Accounting-related matters

Under IFRS, the relationship between the originating SME and the SPE is particularly relevant if the SME is able to exercise **control** over the SPE. Control is a result of power over the SPE (ie the power to direct the investee's relevant activities, exposure or rights to variable returns from its involvement in the investee and the ability to use its power to affect the amount of those returns) and makes the SPE a subsidiary of the SME<sup>14</sup>. All facts and circumstances need to be taken into account in determining whether the SME controls the SPE, such as whether:

- the activities of the SPE are being conducted on behalf of the originating SME according to the latter's specific business needs,
- an interest is retained in the SPE by the SME (for example, via owning the most junior tranche of notes), and / or
- credit enhancements and guarantees are issued by the originating SME to or on behalf of the SPE (in order to improve the rating of the asset-backed notes or spur investor appetite).

Similar requirements also exist in national GAAPs.

**ACCOUNTING REQUIREMENTS FOR SUBSIDIARIES AND TRANSFERS OF ASSETS ARE DIFFERENT TO LEGAL REQUIREMENTS**

If it is established that the SPE is controlled by the originator, the originator would have to consolidate the SPE. If it is concluded that the originator does not control the SPE, then whether the assets that have been legally sold to the SPE are to remain on the separate balance sheet of the originator for accounting purposes is dependent on whether certain de-recognition requirements have been satisfied.

The accounting requirements that result in an SPE to constitute a subsidiary of a SME and those surrounding the transfer of assets are different to legal requirements. The interpretation thereof can be complex depending on the body of facts and circumstances. The setup of a legally independent SPE and the subsequent legal sale of assets does not necessarily result in non-consolidation or full economic transfer for accounting purposes. With this in mind, SMEs would be well advised to maintain open communication with their external auditor or professional accountants acting in the capacity as advisors. This is to ensure that, as much as possible, the requirements under IFRS or national GAAP for consolidation of a subsidiary are not fulfilled while those relating to transfer of assets are.

On another note, tax-related matters may result in the need to recognise deferred tax in the SPE's financial statements if the carrying amount for accounting purposes differs from the tax base. See the Tax-related matters section for a discussion of such matters that are pertinent to originators and securitisations.

### Tax-related matters

From a tax perspective, the key objective of a securitisation is to ensure tax neutrality. In other words, the arrangements should ensure that, to the greatest extent possible, the overall tax liability does not exceed the liability that would have arisen had the assets not been securitised. This involves ensuring that the SPE can claim deductions for all expenses (including interest on the notes and fees incurred). The withholding tax position of the securitised assets must also be determined in order to ensure that payments on the assets can be made to the SPE without deductions on account of tax. This may mean that local tax advice needs to be obtained in every jurisdiction in which a withholding might be made. The structure should also ensure that interest on the notes can be paid free of withholding tax.

**TAX CONSIDERATIONS EXTEND TO BOTH THE ORIGINATOR AND THE SPE AND INVOLVE BOTH DIRECT AND INDIRECT TAX**

Any tax liabilities of the SPE will reduce its cash flows and inhibit the amount of debt it is able to raise. This will impact the return for the originator on the sale of its securitised assets. It is, however, accepted that the SPE can generate an appropriate level of profit on which the SPE will likely be subject to tax.

Potential tax liabilities arising within a securitisation (eg tax on the profit of the SPE) should be determined in advance and factored in to the deal structure so as to ensure that cash flows take into account all tax liabilities. Any tax clearances required from tax authorities should be obtained early in the process. Accordingly, it is crucial for any party that wishes to securitise assets to seek tax advice at an early stage.

Tax also plays a role in the rating of asset-backed notes. Rating agencies generally require a robust opinion from a reputable tax advisor that the SPE will not be subject to any unexpected tax charges before awarding the highest ratings.

For the originator, the transfer of assets to the SPE is likely to constitute a disposal for tax purposes and may therefore give rise to a taxable profit (if the assets are sold for consideration in excess of their tax base) and may also be subject to transfer taxes (such as stamp duty land tax, Value Added Tax ("VAT") or Goods and Sales Tax ("GST")). The tax treatment of the originator will depend on the domestic tax rules of its jurisdiction of residence,

<sup>14</sup> Cf. paragraphs 5 to 8 of IFRS 10, "Consolidated Financial Statements".

which can vary significantly. In some jurisdictions if the originator and the SPE form part of the same group for tax purposes, it is possible that any tax on the disposal of the assets may be relieved under relevant grouping rules for chargeable gains tax and transfer taxes (such as stamp duty land tax).

### Illustrative examples of ABS issuances

Examples of ABS issuances in the UK and Continental Europe are included below. The UK example is that of an issuance by a non-financial institution and relates to a term securitisation. The Continental European example is that of an issuance by a financial institution but relates to an ABCP securitisation. As outlined under the ABCP programmes section, such securitisations are not widely used by SMEs; however, they do constitute a viable form of finance when the assets are shorter in term. This has been acknowledged by the EC to the extent that its Securitisation Proposal was amended prior to its publication with STS criteria being included for ABCP securitisations. This is with the view to promote their use outside of financial institutions.

#### UK EXAMPLE OF ABS ISSUANCE

##### A2D Funding PLC – £150m funding issue

A2 Dominion, which owns and manages 34,000 homes, is offering the bonds through A2D Funding PLC and the proceeds will be lent back to the group. A2 Dominion will guarantee the unsecured retail bonds, which will pay an annual fixed rate of 4.75 per cent and mature on 18 October 2022. A2 Dominion has been rated AA- by ratings agency Fitch.

The total value of bonds issued was £150 million. The bonds were offered in multiples of £100 and have a minimum initial subscription of £2,000. Canaccord Genuity and Lloyds Bank acted as joint lead managers on the issue.

Dean Tufts, executive director at A2 Dominion, said: 'Our retail bond issue is part of our strategy to maximise our long-term funding opportunities and diversify our sources of funding.'

'The bond issue will support our provision of high quality housing services and allow us to further invest in both affordable homes and housing let on the open market.'

Source: <http://www.insidehousing.co.uk/finance/housing-association-offers-retail-bonds-to-raise-cash-for-new-homes/6528887.article>

#### CONTINENTAL EXAMPLE OF ABS ISSUANCE

##### Banque PSA Finance placed its second securitisation of German auto lease receivables

Regulatory News:

The €361 M€ Class A notes of the securitisation transaction "Auto ABS FCT Compartment 2013-1" have been successfully placed in the European capital markets on 2nd May 2013.

The transaction is a securitisation of German auto leases originated by Banque PSA Finance (Paris:UG) German Branch, securitised under French securitisation law with a new compartment of the existing AUTO ABS FCT as issuer. This is a landmark transaction backed by leases and residual values receivables.

Auto ABS FCT Compartment 2013-1 is the 17th transaction completed by Banque PSA Finance, wholly-owned by Peugeot S.A., the 5th backed by German assets, and the 2nd transaction for German auto lease receivables.

J.P. Morgan and HSBC, acting as Joint Arrangers and Joint Lead Managers, were able to price the Class A notes of €361 M€, expected to be rated AAA(sf) by Fitch and Aaa(sf) by Moodys, at par and in line with guidance at 1-month Euribor plus 80 basis points. The expected weighted average life of the rated notes is 2.7 years.

The oversubscribed order book included 14 high quality accounts from 6 countries, with strong support from core ABS buyers in UK and France. Banks, insurances and fund investors were the dominant account type.

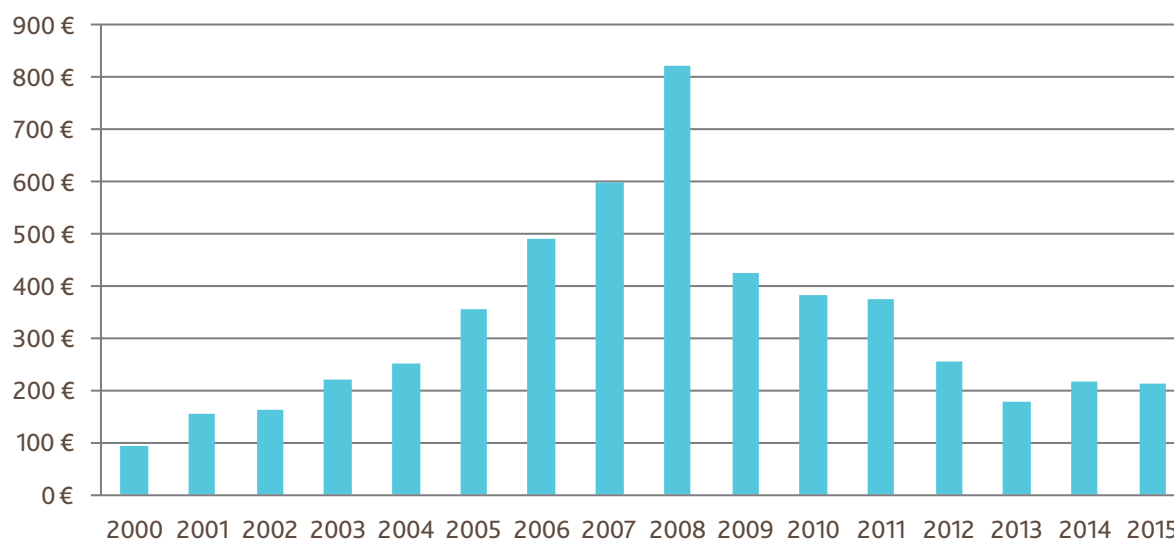
This transaction is part of the Banque PSA Finance strategy to ensure a broad diversification of its funding sources and an increase of its funding share made under its securitization program in order to support the sales development of PSA Peugeot Citroën Group.

Source: <http://www.reuters.com/article/2013/05/03/banque-psa-finance-idUSnBw035906a+100+BSW20130503#li2Yo6AMKakjSWxs.97>

## EU FRAMEWORK FOR SIMPLE, TRANSPARENT AND STANDARDISED SECURITISATION

### Status quo and objectives

After the US subprime mortgage crisis in 2007 and 2008, the European securitisation market suffered a harsh setback, from which it has not yet fully recovered. Issuances were roughly EUR 210 billion in 2015 as compared to EUR 820 billion in 2008 (see Graph 1 below), which represents a decrease in excess of 70%.



Graph 1: Total securitisation volume (in Euro billion) in Europe (Source: sifma, ECB).

### STS criteria for term and ABCP securitisations

By means of an EU-wide framework for simple, transparent and standardised ("STS") securitisation, the EC is seeking to alter the current trend in the market. The objective of the Securitisation Proposal (and associated Directive and Regulation<sup>15</sup>) is to provide banks and non-financial institutions (in particular, SMEs) with an effective, less expensive source of funding and allow for the efficient and effective transfer of risk. STS securitisations shall also help to regain investor confidence and increase the investor base, while limiting systemic risk<sup>16</sup>. Tables 1 and 2 below summarise the STS criteria for term securitisations and ABCP securitisations as they are currently contemplated in the EC's Securitisation Proposal.

Criteria	Details
Simple	<ul style="list-style-type: none"> <li>• The transfer of assets constitutes a true sale; and</li> <li>• The assets transferred: <ul style="list-style-type: none"> <li>– are not encumbered,</li> <li>– do not allow for active portfolio management on a discretionary basis,</li> <li>– are homogenous and have full rights of recourse,</li> <li>– do not take the form of tradeable securities (including those issued by securitisations),</li> <li>– are originated in a manner that is consistent with the originator's normal standards for originating such assets,</li> <li>– are not in default at the point of transfer, and</li> <li>– have made at least one payment at the point of transfer.</li> </ul> </li> </ul>
Standardised	<ul style="list-style-type: none"> <li>• The risk retention requirements are complied with by the originator or sponsor,</li> <li>• Interest rate and currency risk associated with the structure are mitigated (this can involve the entering into derivative contracts),</li> <li>• Interest on the assets and notes are representative of market rates (that is not leveraged),</li> <li>• Principal receipts from the assets shall be payable to the note holders when due in accordance with the structure's pre-established priority of payments and notes' seniority,</li> <li>• There shall be no provisions that require liquidation of exposures at their market value; and</li> <li>• The securitisation transaction documentation shall clearly specify: <ul style="list-style-type: none"> <li>– Triggers for early termination,</li> <li>– Contractual obligations, duties and responsibilities of the servicer, its management team, trustee and other ancillary service providers,</li> <li>– Definitions, remedies and actions relating to delinquency and default of the assets and the servicer,</li> <li>– Provisions that facilitate the timely resolution of conflicts between different classes of investors and their associated voting rights, and</li> <li>– Policies, procedures and controls for managing risk associated with the transaction.</li> </ul> </li> </ul>
Transparent	<ul style="list-style-type: none"> <li>• The originator, sponsor and SPE provide access to historical data on default and loss performance for substantially similar exposures to those being securitised to the investor before investing (for periods that are stipulated by law),</li> <li>• A sample of the underlying exposures are externally verified prior to issuance of the notes by an appropriate and independent party,</li> <li>• The originator or sponsor provide a liability cash flow model to investors (both before the pricing of the securitisation and on an ongoing basis), and</li> <li>• The originator, sponsor and SPE are jointly responsible for compliance with the documentation requirements over the lifecycle of the securitisation.</li> </ul>

Table 1: STS criteria for term securitisations.

<sup>15</sup> European Commission, Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation, September 2015, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1448996868990&uri=CELEX:52015PC0472>.

<sup>16</sup> Cf. Commission, Consultation Document: An EU framework for simple, transparent and standardized securitisation, February 2015, available at: [http://ec.europa.eu/finance/consultations/2015/securitisation/docs/consultation-document\\_en.pdf](http://ec.europa.eu/finance/consultations/2015/securitisation/docs/consultation-document_en.pdf), 5.

The STS criteria for ABCP securitisations fall in to two levels; transaction and programme level.

Level	Details
Transaction	<p>Certain STS criteria that are applicable to term securitisations apply at a transaction level. These include:</p> <ul style="list-style-type: none"> <li>• The assets transferred need to: <ul style="list-style-type: none"> <li>– be homogenous and have full rights of recourse,</li> <li>– have a remaining weighted average life of no more than two years,</li> <li>– not have a residual maturity of longer than three years,</li> <li>– not be secured by residential or commercial mortgages, and</li> <li>– be originated in a manner that is consistent with the originator's normal standards for originating such assets; and</li> </ul> </li> <li>• Interest on the assets and notes are representative of market rates (that is not leveraged),</li> <li>• Principal receipts from the assets shall be payable to the note holders when due in accordance with the structure's pre-established priority of payments and notes' seniority; and</li> <li>• The securitisation transaction documentation shall clearly specify: <ul style="list-style-type: none"> <li>– Triggers for early termination,</li> <li>– Contractual obligations, duties and responsibilities of the sponsor, servicer, its management team, trustee and other ancillary service providers,</li> <li>– Definitions, remedies and actions relating to delinquency and default of the assets , and</li> <li>– Policies, procedures and controls for managing risk associated with the transaction.</li> </ul> </li> </ul>
Programme	<p>Certain STS criteria that are applicable to term securitisations apply at the programme level. These include:</p> <ul style="list-style-type: none"> <li>• The risk retention requirements are complied with by the originator or sponsor,</li> <li>• The assets transferred shall not be notes issued by another securitisation vehicle,</li> <li>• The use of credit enhancements at a programme level shall not distort the tranching of notes,</li> <li>• The programme's sponsor shall be a credit institution that provides the securitisation with a liquidity facility that mitigates credit and liquidity risk and covers transaction and programme level costs,</li> <li>• The notes shall not include repayment or extension options,</li> <li>• Interest rate and currency risk associated with the structure are mitigated (this can involve the entering into derivative contracts); and</li> <li>• The securitisation transaction documentation shall clearly specify: <ul style="list-style-type: none"> <li>– Contractual obligations, duties and responsibilities of the sponsor, its management team, trustee and other ancillary service providers,</li> <li>– Definitions, remedies and actions relating to delinquency and default of the sponsor and servicer,</li> <li>– Provisions that facilitate the timely resolution of conflicts between the sponsor and different classes of investors and their associated voting rights, and</li> <li>– Policies, procedures and controls for managing risk associated with the transaction; and</li> </ul> </li> <li>• The originator, sponsor and SPE are jointly responsible for compliance with the documentation requirements over the lifecycle of the securitisation.</li> </ul>

Table 2: STS criteria for ABCP securitisations.

Given that the STS criteria are inherently narrow, SMEs would do well to consult professional advisors (including financial institutions, professional accountants, tax advisors and legal advisors) when contemplating entering into a securitisation transaction. This is so that it is structured in a manner that will result in these criteria being met and is thus being a qualifying securitisation that enjoys the benefits associated therewith, ie the ability to offer its notes to both institutional and retail investors. In order to comply with certain criteria, the SME would need to engage an independent third party to verify compliance therewith.

### Future developments

Other measures that are currently being discussed include the harmonisation of the structures used in securitisation transactions (ie the legal form of SPEs). This is intended to simplify the due diligence that is performed by investors so as to make it more time and cost-efficient, while at the same time enabling reasonable and informed decision-making. With respect to SME securitisations, the EC also wants to reduce the costs of ancillary services and improve secondary market trading, as well as resolve the problems of a lack of availability of information and the insufficient homogeneity of the underlying assets. While the STS criteria go some way to addressing these, the EC is also exploring other possible measures in this respect.

## ABOUT BDO'S SECURITISATION TEAM

BDO has a cross-jurisdictional team of experienced specialists, who have assisted clients with numerous securitisation transactions of varying sizes. This means that BDO is ideally placed to provide services at each of the five stages of the securitisation process, as explained in Figure 5 below.

Some of the proposed STS criteria that are contemplated in the preceding section require an independent third party to be engaged in order to verify compliance therewith. This is a role that BDO can fulfil.

Stage	BDO Services	Counterparty
01	Pre-transaction preparations <ul style="list-style-type: none"> <li>• Sponsor search and selection</li> <li>• Design of functioning securitisation structure</li> <li>• Accounting advice</li> <li>• Regulatory and legal advice</li> </ul>	Originator
02	Setup of securitisation structure <ul style="list-style-type: none"> <li>• Accounting advice on deal structuring</li> <li>• Tax advice on deal structuring (including provision of tax opinions and obtaining of necessary tax clearances)</li> <li>• Regulatory and legal advice</li> </ul>	Sponsor
03	Structuring of asset-backed notes <ul style="list-style-type: none"> <li>• Vendor due diligence</li> <li>• Selection of portfolio (to be securitised)</li> <li>• Valuation of assets (to be securitised)</li> <li>• Performance and risk analysis (in relation to assets)</li> <li>• Accounting advice on note structuring</li> <li>• Tax advice</li> <li>• Regulatory and legal advice</li> </ul>	Originator / Sponsor
04	Initiation of asset-backed transaction <ul style="list-style-type: none"> <li>• Investor due diligence (for private placements)</li> <li>• Reporting accountant's role (for listed offerings)</li> <li>• Assistance in listing and rating (of ABS securities)</li> <li>• Financial support (eg hedging on portfolio level)</li> <li>• Accounting advice on transaction initiation</li> <li>• Tax advice on implementation</li> <li>• Marketing</li> </ul>	Investors / Underwriter / SPE
05	Post-transaction obligations (recurring) <ul style="list-style-type: none"> <li>• Statutory audit</li> <li>• Accounting advice on reporting, compliance and change of standards</li> <li>• Tax advice on reporting, compliance and change of law</li> <li>• Internal audit</li> <li>• Regulatory and legal advice</li> </ul>	Sponsor / Lead Servicer / SPE

Figure 5: BDO securitisation service offerings.

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