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Securitization
Regulatory and market updates:
Main challenges for the Luxembourg market

10 February 2022

Introduction



Papa Saliou Diop
Associate Partner
Assurance, Banking & Capital Markets
Securitization Leader

AGENDA

10 FEBRUARY 2022

Securitization

Regulatory and market updates: Main challenges for the Luxembourg market

- 1 Introduction
- 2 Main regulatory updates
- 3 Valuation insights: Main areas of focus and challenges
- 4 Tax: Hot topics
- 5 Sustainability reporting experiences
- 6 Luxembourg Market review
- 7 ESG Decarbonisation – net zero impact
- 8 Final remarks

Main regulatory updates



Papa Saliou Diop
Associate Partner
Assurance, Banking & Capital Markets
Securitization Leader

02

Securitization main regulatory updates

EU Regulation 2021/557 amending 2017/2402



Covid 19 impact

Securitization Regulation (EU) 2017/2402: Performing Assets

- Credit granting criteria
- Risk retention requirements (“skin in the game”)
- Transparency requirements
- Due diligence for Institutional investors
- Ban of re-securitization
- Sales to retail investors
- STS securitizations (Simple, Transparent and Standardized)
- Privileged treatment for capital and solvency req. for STS

- Transparency
- Eligibility criteria for STS
- Strong supervision
- Protection of investors

Securitization Regulation (EU) 2021/557: NPEs and Synthetic Sec.

- Credit granting criteria not relevant on NPEs – DD on pricing and exposures
- Risk retention: Calculation and detention
- Capital requirements calibration for NPE exposures
- On balance sheet Synthetic Securitization - STS criteria
- Restriction of credit risk transfer, protection of investors and originators
- Tax avoidance . Notification to local authority
- AML restrictions on SSPEs locations
- Sustainability framework and reporting requirements (Article 45a)

- Non Performing Exposures
- Synthetic Securitization - STS
- Protection of investors and originators
- Implementation of a sustainability framework and transparency on ESG reporting

02 Securitization main regulatory updates

EU Regulation 2021/557 amending 2017/2402

Article 45a - Development of a sustainable securitization framework

EBA report should assess:

Disclosures

- The introduction of sustainability factors and the implementation of proportionate disclosure
- Due diligence requirements relating to potential positive and adverse impacts of the assets financed by the underlying exposures on sustainability factor
- Content, methodologies and presentation of information in respect of sustainability factors in relation to positive and adverse impacts on ESG matters
- Possible effects of a sustainable securitisation framework on the financial stability, the scaling up of the Union securitisation market and of banks' lending capacity

Transparency on ESG reporting

- Sustainability risk policies
- Adverse sustainability impacts at the entity level
- Adverse sustainability impacts at financial product level
- Remuneration policies in relation to the integration of sustainability risks
- Integration of sustainability risks
- Promotion of ESG characteristics in pre-contractual disclosures
- Sustainability investments in periodic reports

02 Securitization main regulatory updates

EU Regulation 2021/557 amending 2017/2402

Transparency requirements (EU Regulation 2019/2088 on sustainability-related disclosures on the financial sector)

Transparency of sustainability risk policies (Art 3.)

- Financial market participants to publish on their websites information about policies on integration of sustainability risks in investment decision-making process
- Financial advisors should publish on their websites information about the policies on integration of sustainability risks in their investment advice or insurance advice

Transparency of adverse sustainability impacts at the entity level (Art 4) and at financial product level

- Financial market participants shall consider the principal adverse impacts to integrate in their processes and how these risks are addressed and monitored
- Financial market participants shall describe their due diligence processes in place to identify and assess the relevant financial risks
- Made available for each financial product the principal adverse impact on sustainability factors

02 Securitization main regulatory updates

EU Regulation 2021/557 amending 2017/2402

Transparency requirements (EU Regulation 2019/2088 on sustainability disclosure on the financial sector (continued))

Transparency of the remuneration policies in relation to the integration of sustainability risks

- Provide qualitative and quantitative information on remuneration policies evidencing that the structure of remuneration does not encourage excessive risk-taking with respect to sustainability risks and is linked to risk-adjusted performance.

Transparency of the integration of sustainability risks

- Market participants and financial advisors shall include descriptions of pre-contractual disclosures, the manner in which sustainability risks are integrated into the investment decisions and the results of assessment of the likely impacts of sustainability risks on the returns of the financial products available.

Transparency of the promotion of ESG characteristics in pre-contractual disclosures

- Perform analysis on how designated indexes are aligned with objectives or deviated with market benchmark
- Clear description of methodologies used for the calculation of indices and benchmarks
- On case of carbon reduction objective indicate the objective of low carbon exposure in view of achieving the LT global warming objectives of the Paris agreement

Q2

Securitization main regulatory updates 2004 Law proposed amendments

Modernization of the Luxembourg Securitization Law (main proposed amendments)

Loan financing

- Reference is now made to financial instruments and no longer to securities – more available financing means

Active management

- Possibility given to SV to actively management their debt portfolio (Collateralized Loan Obligation) – CLOs as long as no issuance of financial instruments is made to the public

Available legal forms

- Introduction of additional legal forms being available to setup securitization companies (SNC, SCA, SCS)

Compartment rules

- Clarification that for the financial statements of equity financed compartments approval should be done by the respective shareholders. Decision to allocate legal reserve remains at the compartment level

Guarantees

- Possibility given to provide securities/guarantees to third-party creditors whilst maintaining high protection for the investors adding further flexibility in structured financing

Regulation

- Definition of SVs which are supposed to be CSSF authorized into the Securitization Law

Q2 Securitization main regulatory updates European Single Electronic Format ("ESEF")

European Single Electronic Format ("ESEF")

Amendments of the Transparency Directive

- Harmonization of transparency requirements for listed companies in European Union (EU) regulated markets
- Setting-up new requirement for issuers to prepare their annual financial reports (AFRs) in a single electronic reporting format starting from 2020
- Audit requirements of the financial reports
- Possibility to use the 1 year delay implementation and start the reporting for financial years starting on or after 1 Jan 2021

CSSF Q&A 57

Exemption under article 7 of the Transparency Law to publish annual financial reports in ESEF format

Article 7. Exemptions:

- A State, a regional or local authority of a State, a public international body of which at least one Member State is a member, the European Central Bank (ECB), the European Financial Stability Facility (EFSF) established by the EFSF Framework Agreement.
- An issuer exclusively of debts securities admitted for trading on a regulated market, the denomination per unit of which at least EUR 100.000 or, in the case of debt securities denominated in a currency other than euro, the value of such denomination per unit is, at the date of the issue, equivalent to at least EUR 100.000.

Valuation insights: Main areas of focus and challenges



Christophe Vandendorpe
Partner
Strategy and Transaction Leader



Noor Muazeem Aly Sahabun
Senior Manager
Assurance, Banking & Capital Markets,
Securitization

Tax: Hot topics



Anja Taferner
Executive Director
International Tax and
Transaction Services

04 Tax: Hot Topics

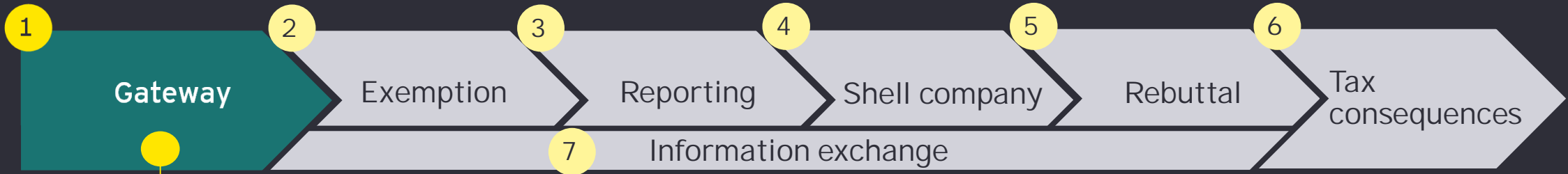
Something old and something new

1. Interest limitation rules

- Future of exemption for SPPEs covered by EU Regulation?
- Alternatives for impacted SVs?

2. ATAD 3/UNSHELL Draft Directive

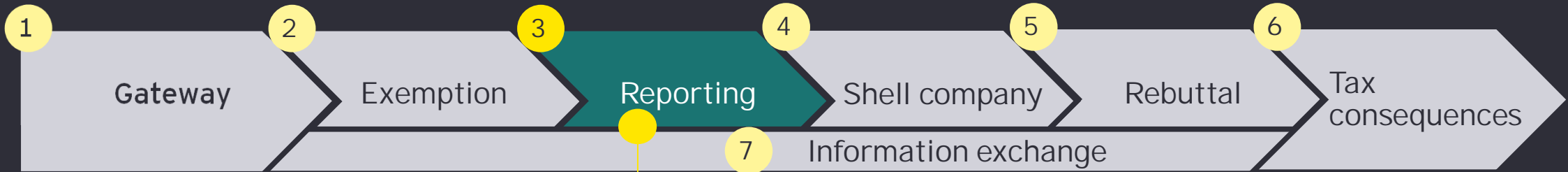
ATAD 3/UNSHELL: Seven-step approach - "At risk entities"



SVs possibly "at-risk entity":

1. "Cross-border activities"
2. Activities in scope
3. Entity (partly) outsources its **day-to-day administration** and **decision-making** on significant functions
4. No exclusion applies, e.g.:
 - Security traded or listed on recognized exchange
 - Regulated financial undertaking (AIF, UCITs, SSPE, etc.)
 - Five full-time equivalent employees
 - Entity with holding activities with "undertaking's shareholders" tax resident in same jurisdiction

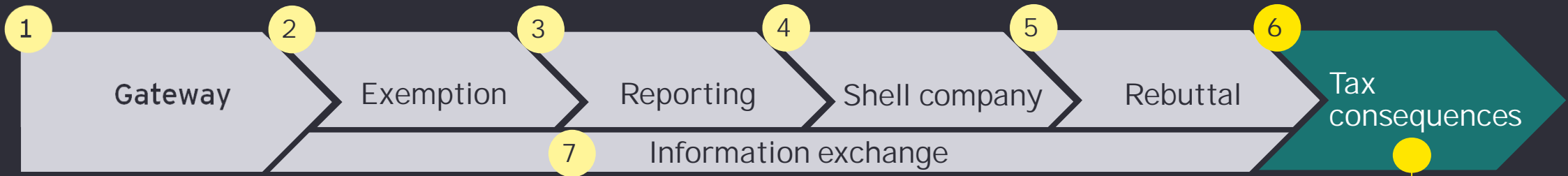
ATAD 3/UNSHELL: Seven-step approach - Documentation requirements



“At-risk” entities have to report and document their substance (three cumulative elements):

- Premises available for exclusive use
- At least one bank account in the EU
- At least one director and/or the majority of relevant employees resident close to its undertaking

ATAD 3/UNSHELL: Seven-step approach - Tax consequences



In Member State of shell residence:

- No tax residency certificate for shell company
Or
- Only tax residency certificate with a warning statement

In EU States making payments to EU shell or receiving payments from EU shell:

- Do not apply tax treaties and directives to shell company
- Look through shell company
 - Non-resident capital gains tax, withholding tax, etc.

04 Impact on securitization companies

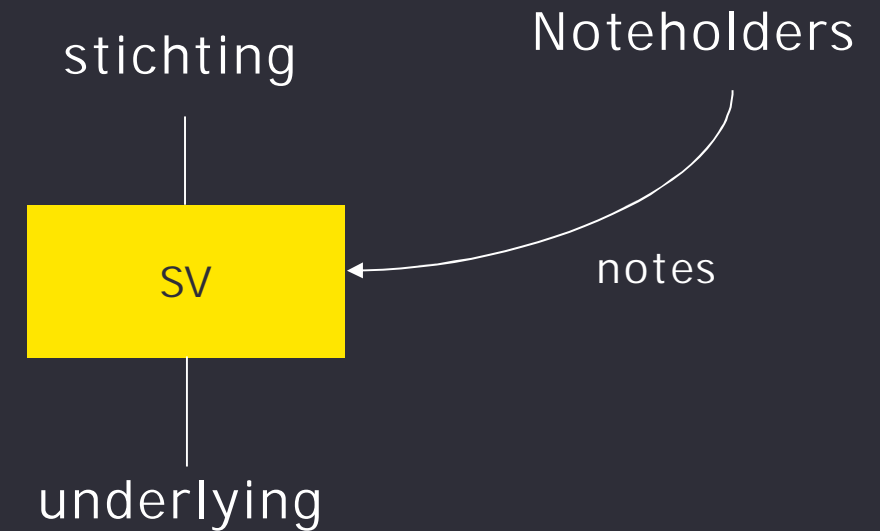
Is Lux SPV “at risk” of being a shell:

- ✓ Holding and financing activity
- ✓ Cross-border activity
- ✓ Entity (partly) outsources its **day-to-day administration** and **decision-making** on significant functions

Application of an exclusion?

- ? Security traded or listed on recognized exchange
- ? Regulated financial undertaking (AIF, UCITs, SSPE, etc.)
- ? Five full-time equivalent employees

- Determine if being a shell would be problematic
- Remedies



Sustainability reporting: Sharing experiences



Léna Le Gal
Associate Partner,
Non-Financial Reporting Assurance



Sheroff Shafi Shaikh
Senior Manager,
Assurance, Banking & Capital Markets,
Securitization

Luxembourg Market review

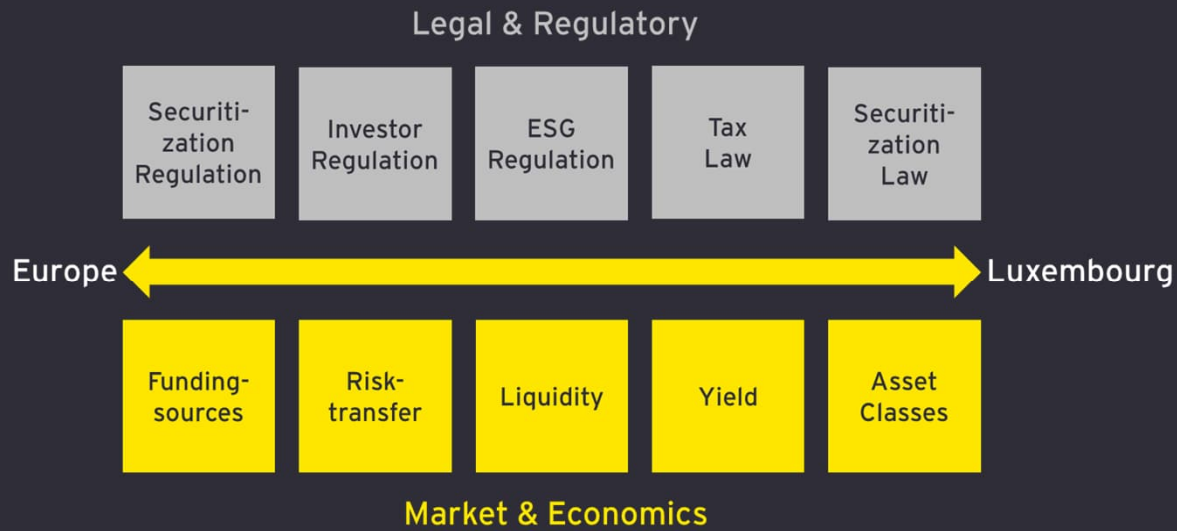


Oliver Cloess
Associate Partner
Assurance, Banking & Capital Markets
Securitization & Structured Finance

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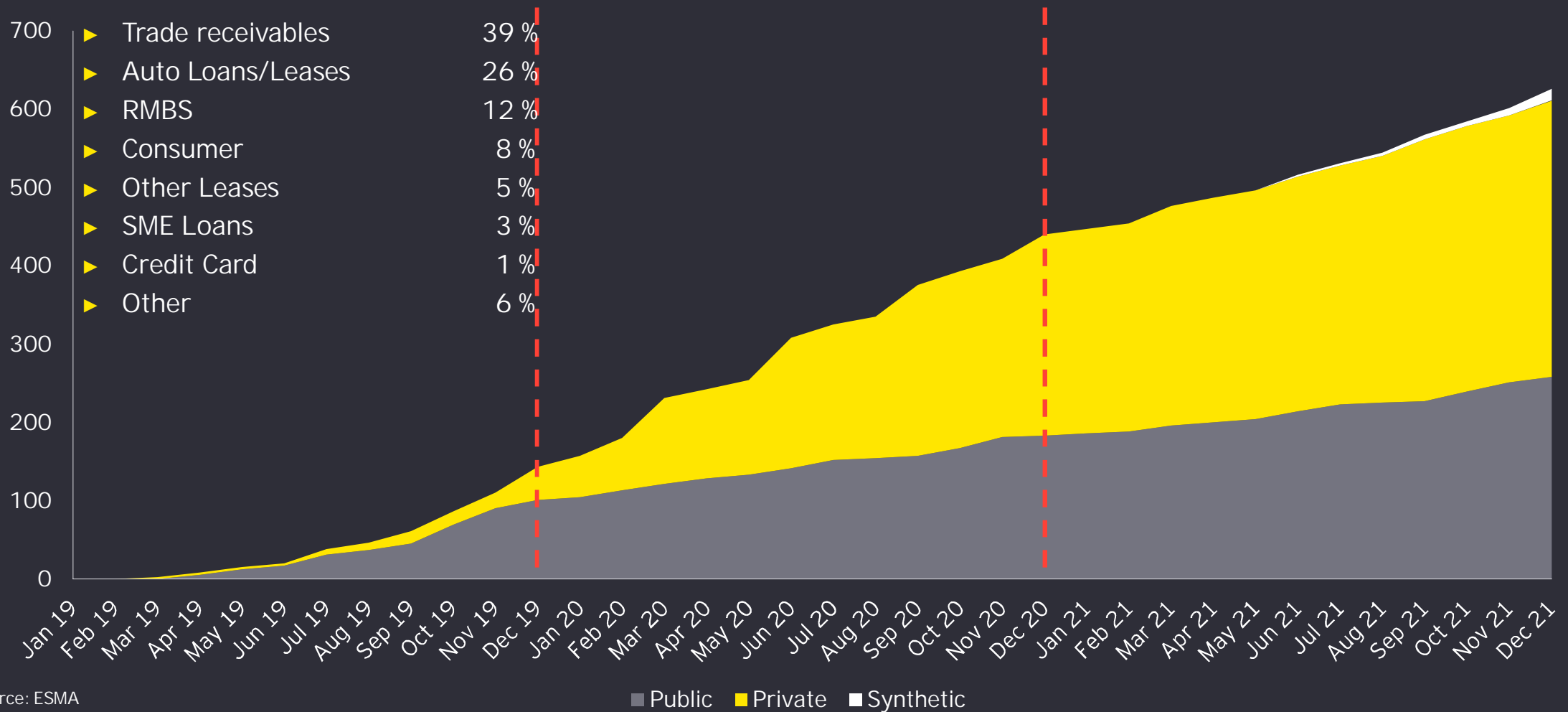
Luxembourg Securitization Market Review

The power of an established legal framework



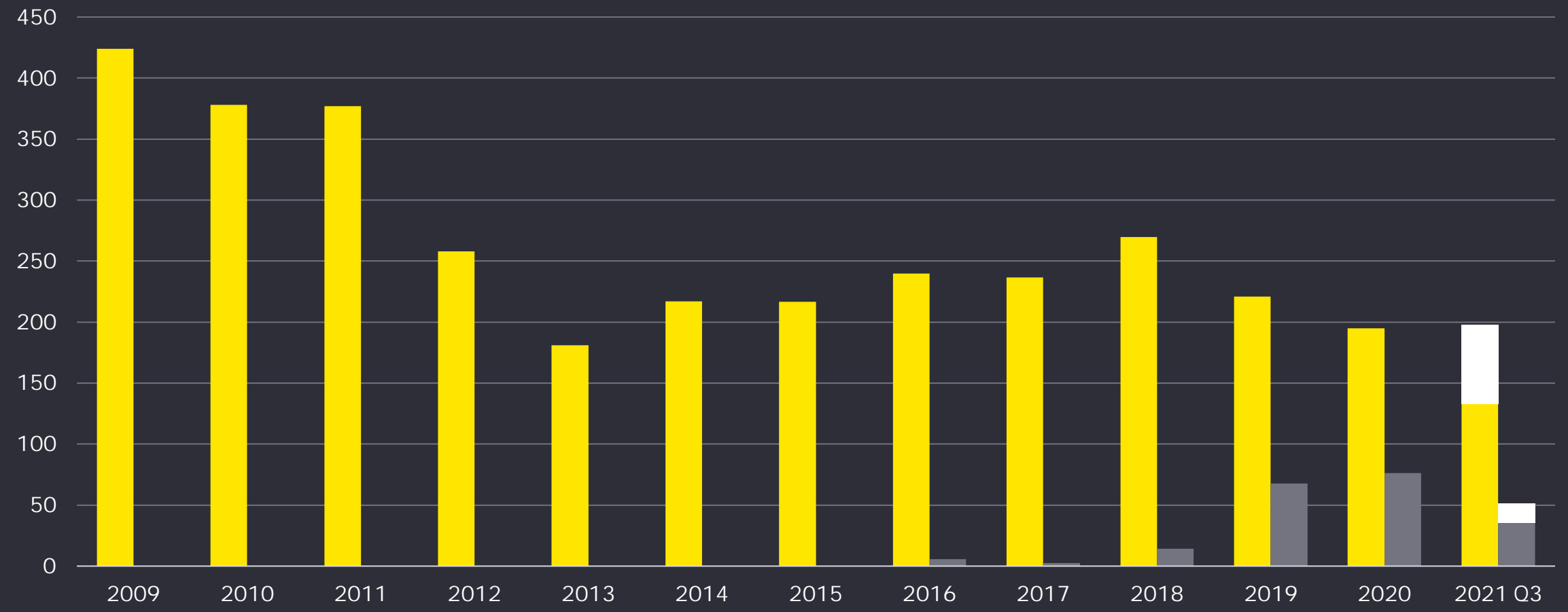
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STS Notifications – Gross Count Public, Private and Synthetic (Q4 2021)



06

European Issuance Volumes in EUR billion (Q3 2021)



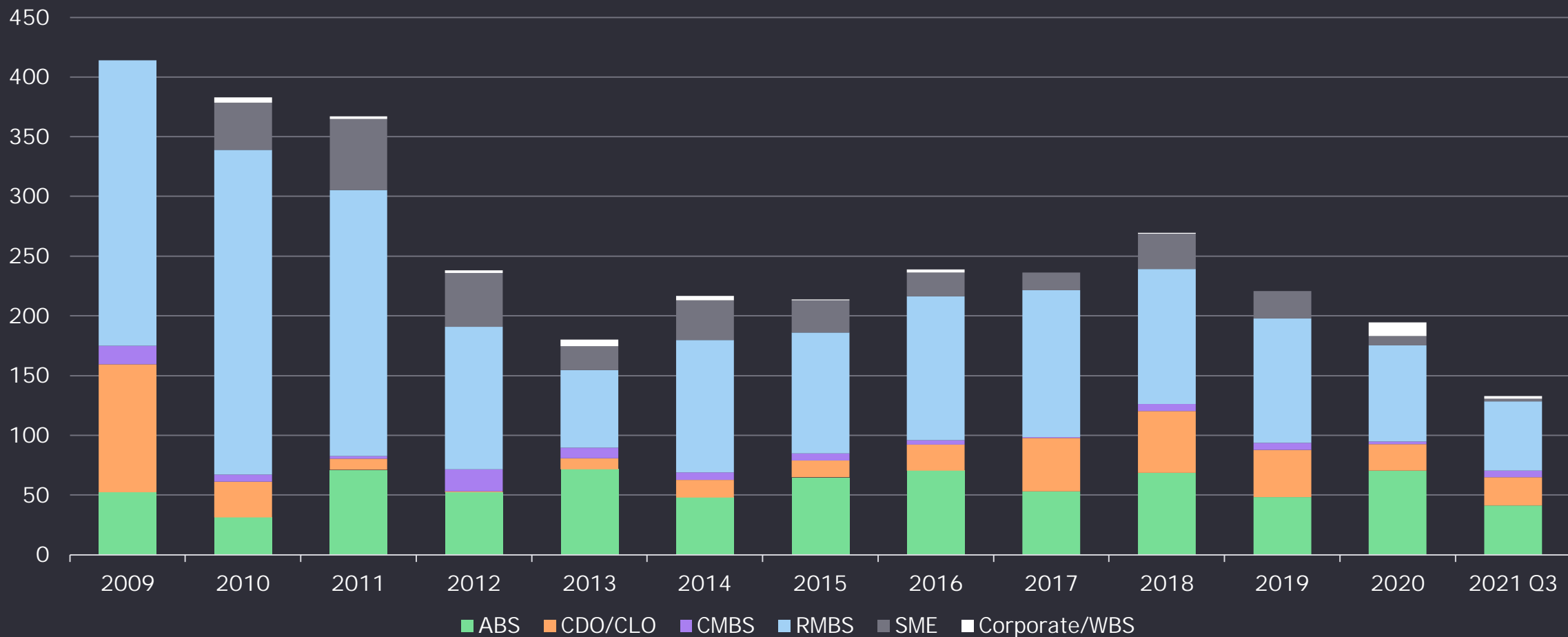
Source: AFME, EY

■ Issuance ■ Thereof: STS Issuance ■ Q4 2021 estimated



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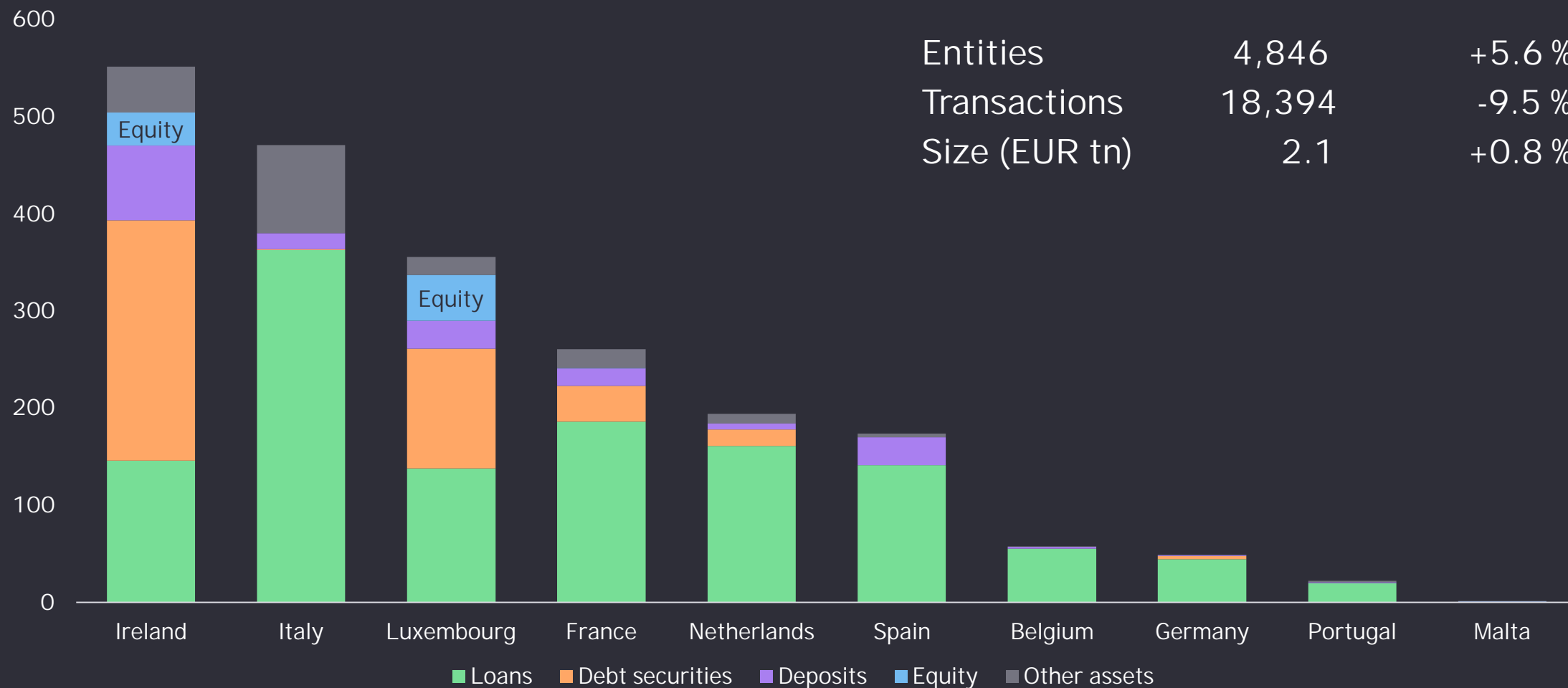
European Issuance Volumes in EUR billion (Q3 2021) - Collateral Class



Source: AFME

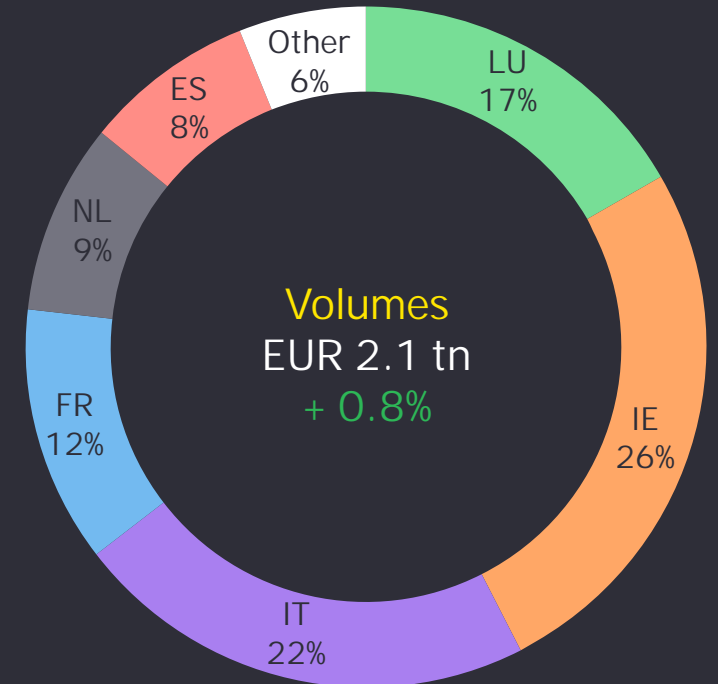
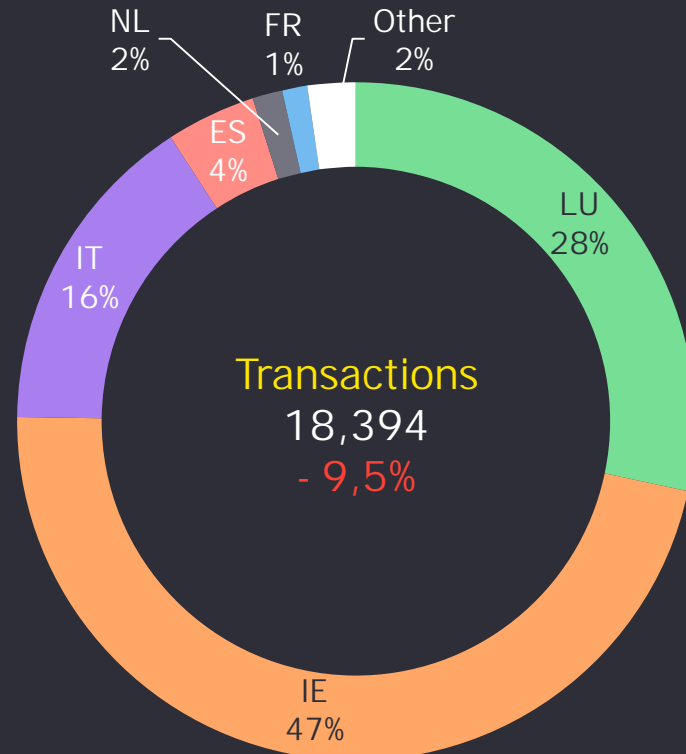
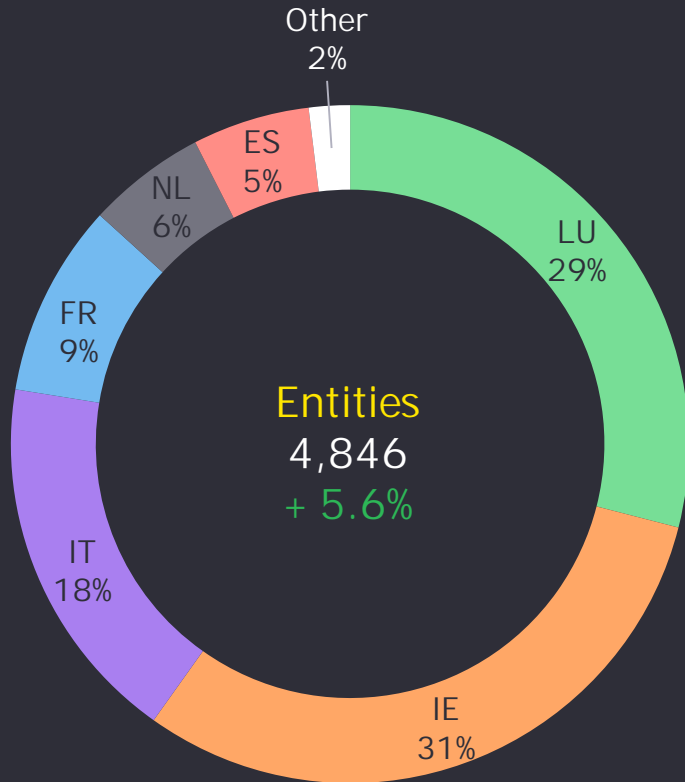
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ECB Euro Area by Country and Asset Class – in EUR tn (Q4 2021)



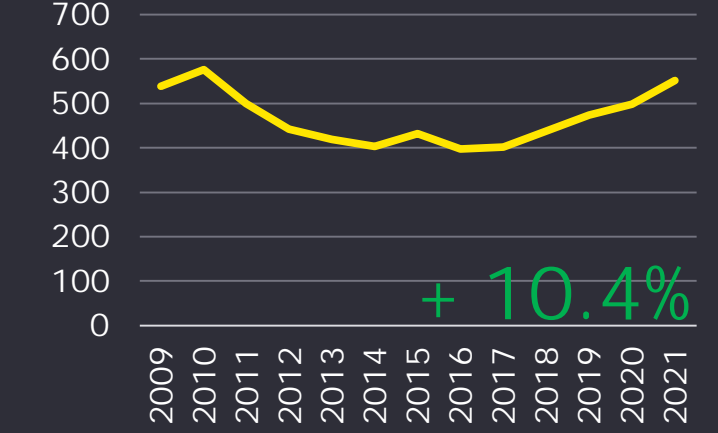
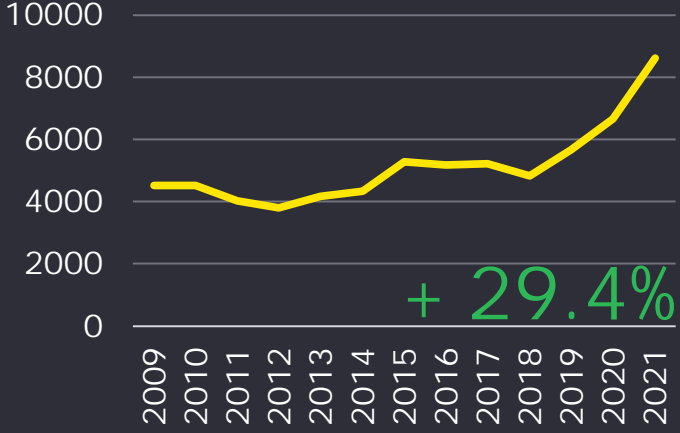
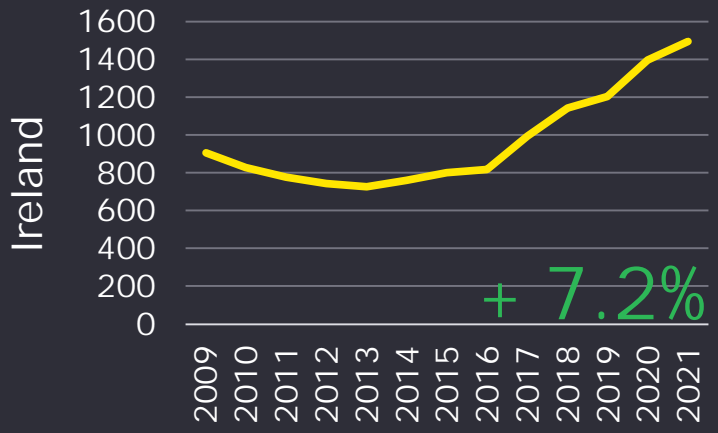
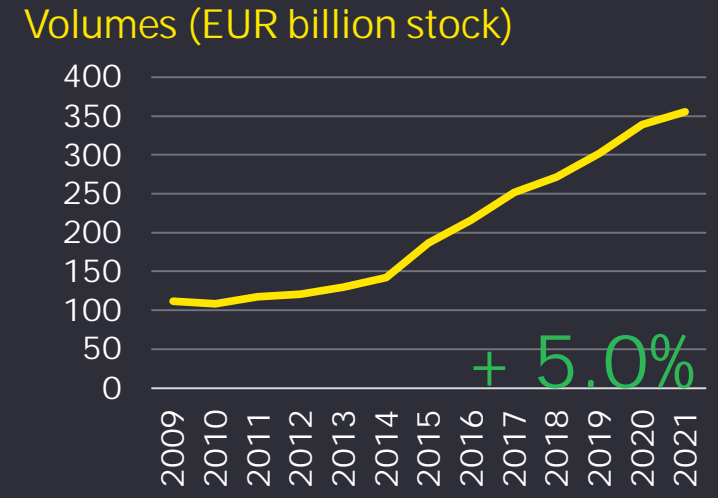
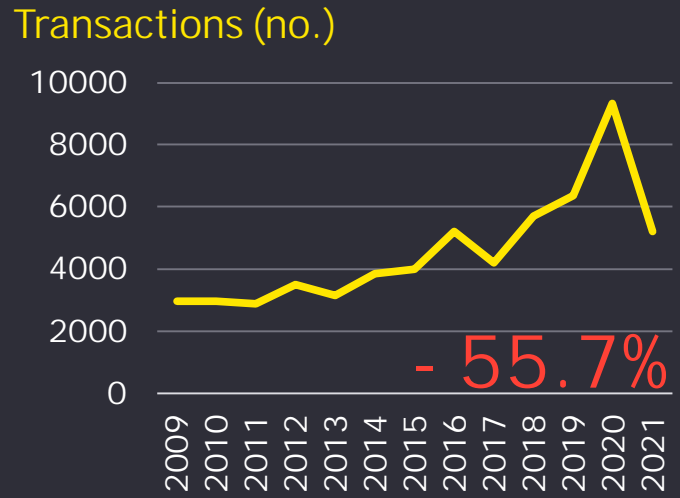
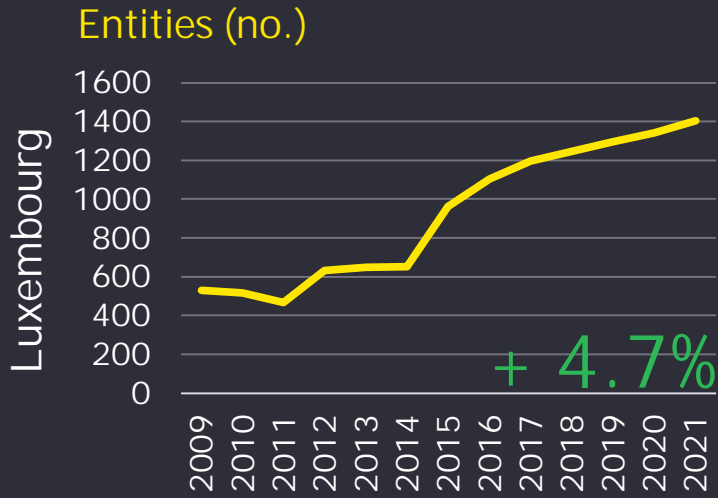
Source: ECB FVC statistics

ECB Euro Area Securitization Market Shares (Q4 2021)



Source: ECB FVC statistics

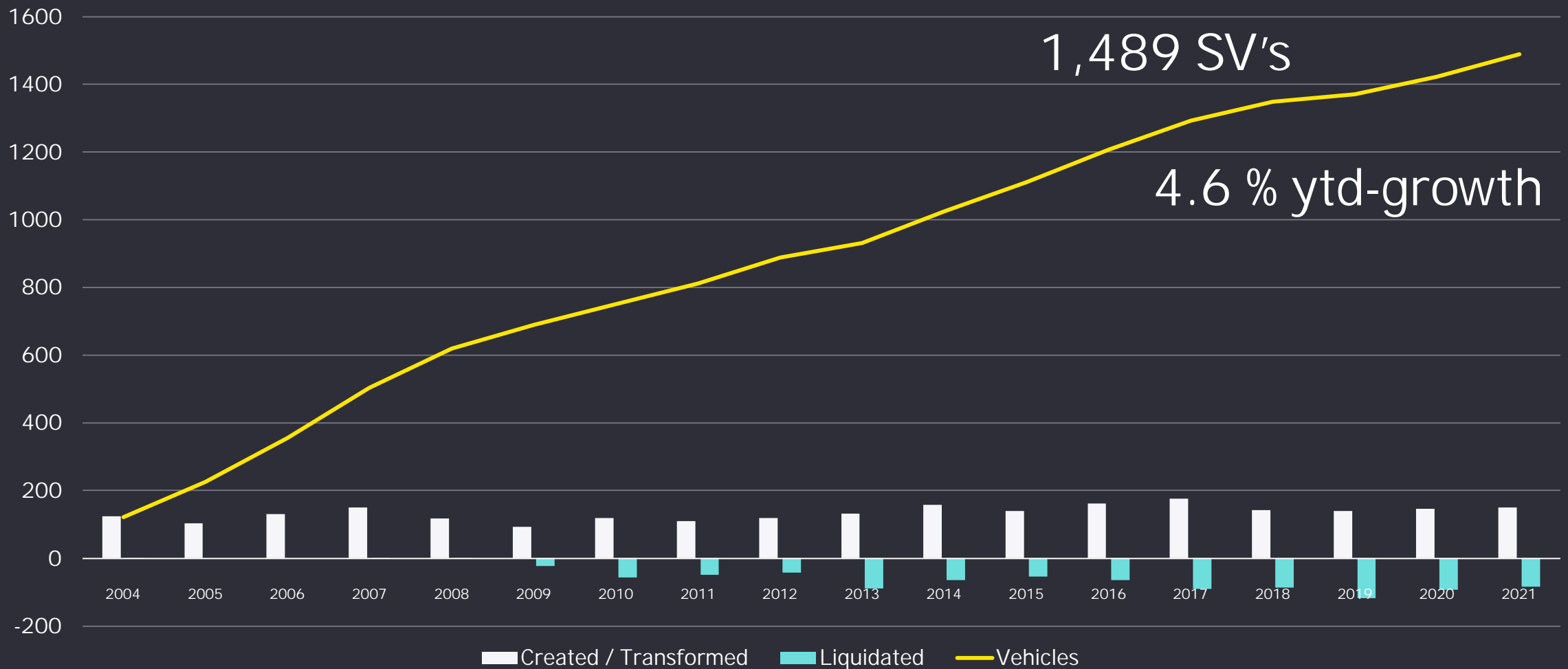
ECB Luxembourg & Ireland Movements year-to-date (Q4 2021)



Source: ECB FVC statistics



EY Research – Luxembourg Movements in Securitization Vehicles



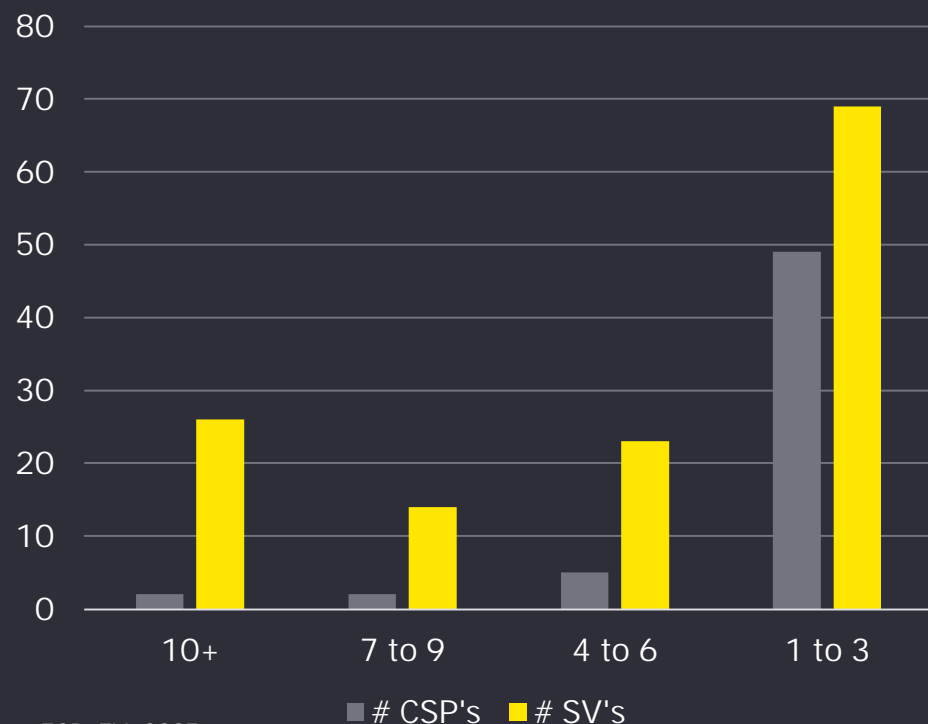
Source: ECB, EY, www.lbr.lu



EY Research – Luxembourg Creation and Liquidation Analysis 2021

Creations

- 132 Companies and 18 Funds
- Widespread CSP market



Sources: ECB, EY, CSSF

Creations (continued)

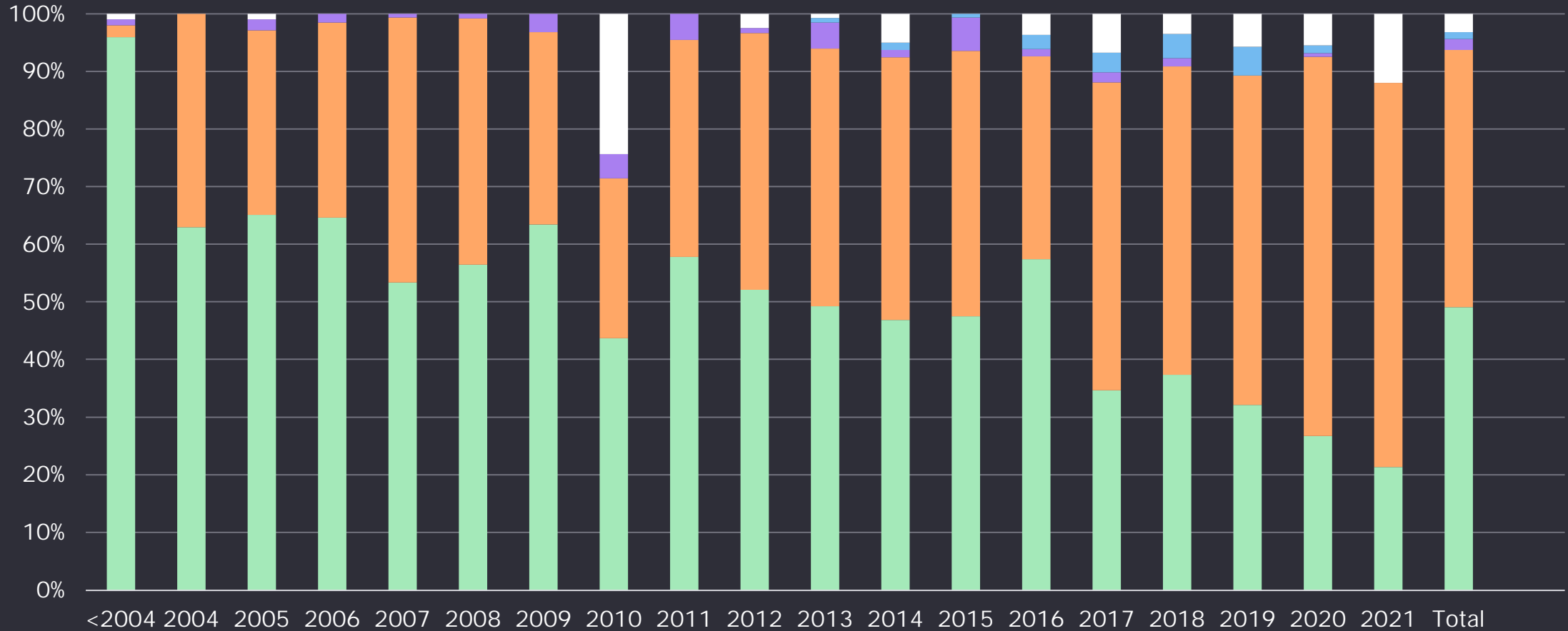
- Widespread Asset Classes: trend in sustainable projects, receivables, non-performing loans, digital assets

Liquidations

- 2021 average life 8.8 years (1.7 years above total average)
- Includes two SV's created in 2020
- SV activity ranges from receivables securitization to equity investments; no clear effect of ATAD I interest limitation rules identifiable



EY Research – Luxembourg Development of legal forms used

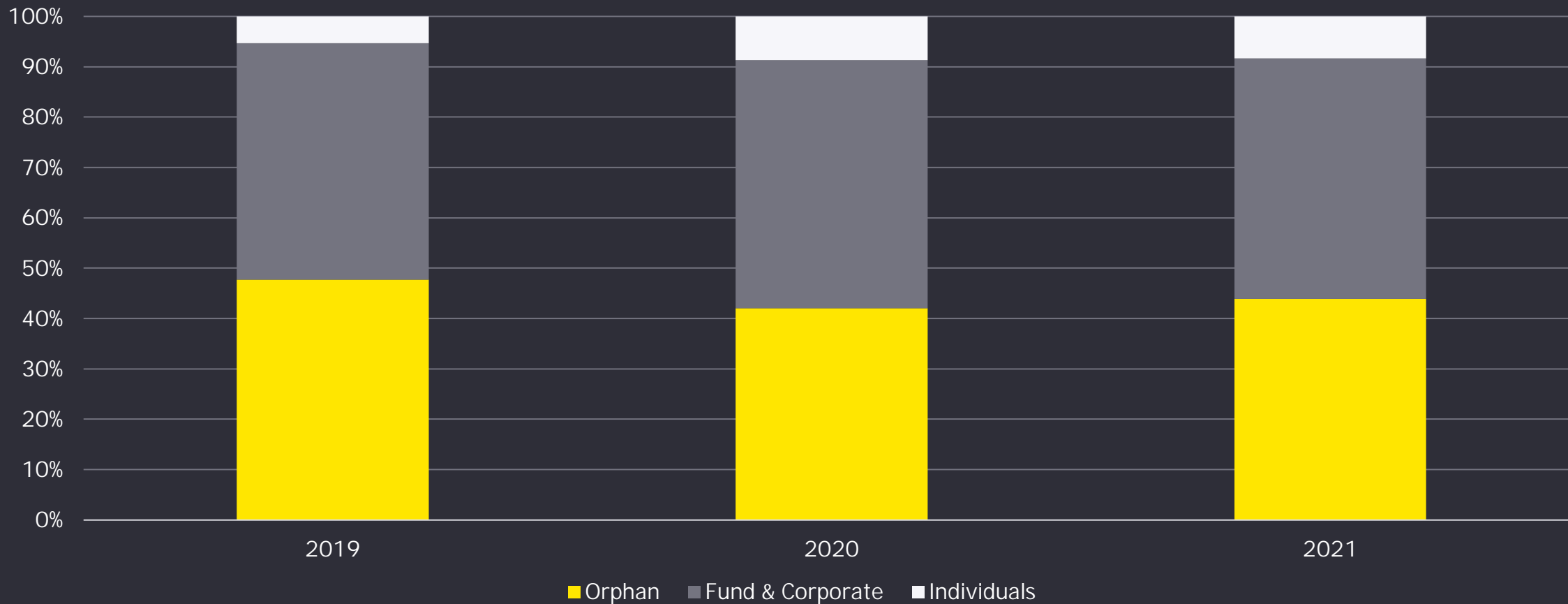


Source: ECB, EY, www.lbr.lu

■ SA ■ SARL ■ SCA ■ SCOSA ■ Fund



EY Research – Luxembourg Shareholder oversight



Source: ECB, EY, www.lbr.lu

ESG Decarbonization – net zero impact



Vanessa Müller
Partner,
ESG Leader



Papa Saliou Diop
Associate Partner
Assurance, Banking & Capital Markets
Securitization Leader

Final remarks



Papa Saliou Diop
Associate Partner
Assurance, Banking & Capital Markets
Securitization Leader

08 Contacts



Papa Saliou Diop

Associate Partner, Assurance, Banking & Capital Markets
Securitization Leader
Papasaliou.Diop@lu.ey.com
+352 691 830 884



Christophe Vandendorpe

Partner, Strategy and Transaction Leader
Christophe.Vandendorpe@lu.ey.com
+352 691 919 394



Vanessa Müller

Partner, ESG Leader
Vanessa.Muller@lu.ey.com
+352 621 364 234



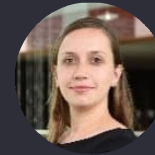
Oliver Cloess

Associate Partner, Assurance, Banking & Capital Markets
Securitization & Structured Finance
Oliver.Cloess@lu.ey.com
+352 621 995 696



Anja Taferner

Executive Director, International Tax and Transaction Services
Anja.Taferner@lu.ey.com
+352 621 343 517



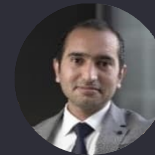
Léna Le Gal

Associate Partner, Non-Financial Reporting Assurance
Lena.Le-Gal@lu.ey.com
+352 661 764 171



Noor Muazeem Aly Sahabun

Senior Manager, Assurance, Banking & Capital Markets, Securitization
Noor-Muazeem-Aly.Sahabun@lu.ey.com
+352 621 838 910



Sheroff Shafi Shaikh

Senior Manager, Assurance, Banking & Capital Markets, Securitization
Sheroff-Shafi.Shaikh@lu.ey.com
+352 621 838 932

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