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Securitisation 2024

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UK: Law & Practice

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Slaughter and May

UK

Law and Practice

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Slaughter and May

Contents

Slaughter and May has a securitisation and structured finance team that advises on public and private securitisations of every major asset class, and advises both originators and arrangers. It has a core team of 33 securitisation-focused lawyers in its London office, and the broader multi-specialist financing team is also brought in on matters as needed. The firm works with the best local law firms on cross-border matters. Clients include specialist lenders setting up their first funding transactions, the most prolific ABS issuers in Europe, as well as the largest global banks, which come to Slaughter and May for their highest value, most structured transactions. The team regularly works on STS securitisations in the UK and EU, and also on deals marketed to US and other global investors.

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1. Specific Financial Asset Types

1.1 Common Financial Assets

Common asset classes securitised in the UK include:

- residential and commercial mortgages;
- credit cards;
- personal loans and auto loans;
- commercial/trade receivables; and
- corporate loan portfolios.

Other less common asset classes that have been securitised in the UK include:

- lease and rental receivables;
- IP royalty receivables;
- insurance premiums;
- healthcare receivables;
- ticket receivables;
- receivables from public utilities;
- mobile handset loan receivables; and
- student loan receivables.

1.2 Structures Relating to Financial Assets

The transactional structures used in securitisations are designed to isolate financial assets, to transfer risk and to create securities that can be sold to investors.

- Residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) often use a special purpose entity (SPE) to hold the mortgage loans, which are then used to back the issued securities. The cash flows from the mortgage payments (interest and principal) are passed through to investors in prescribed amounts after administrative costs and fees are covered.
- Asset-backed securities (ABS) involving consumer debt are similar to RMBS and CMBS, and also use an SPE structure. Credit card receivables, auto loans and personal loans are transferred to the SPE, which then issues notes to investors.
- Collateralised loan obligations (CLOs) involve pooling commercial loans and are organised by a manager who selects and actively manages the corporate debt. They differ from other structures as they are managed over their life, with the potential for trading and substitution within the portfolio. The CLO issues tranches of debt with varying seniority and risk profiles to investors.
- Trade receivables securitisations typically operate by the sale of customer invoices by an ordinary operating corporate to a structure set up by a financing bank. Structures are typically designed such that the corporate is not considered to be the originator of a securitisation (thereby avoiding the corporate becoming subject to securitisation-specific regulatory requirements).

Securitisation structures are typically constructed to be bankruptcy-remote, meaning the SPE's assets remain beyond the reach of the originator's creditors in the event of bankruptcy. In addition, credit enhancement techniques are used to achieve desired credit ratings and to attract investors.

In a standard securitisation, it is common for the originator to continue to administer the receivables on the SPV's behalf under a servicing agreement in return for a servicing fee. The originator will typically maintain the original contact with the underlying debtors. To mitigate the risk of non-performance by the originator of the servicing and collection role, back-up servicers may also be appointed during the lifetime of the transaction, such that an alternative and suitably experienced and creditworthy entity is in a position to take over the servicing of the receivables in the event of a default by the originator/servicer.

Payments are made according to a priority order of payments specified in the transaction documents (often referred to as the cash flow waterfall or priority of payments).

Any money left over after all such payments have been made is extracted from the SPV and either retained by the holders of the most subordinated tranche of securities or passed back to the originator using various profit extraction techniques. These profit extraction techniques may include:

- the originator taking fees for administering the receivables contracts and collecting the receivables, arranging or managing the portfolio of receivables and/or acting as a swap counterparty;
- the SPV paying the originator deferred consideration on the receivables purchased;
- the SPV making loan payments to the originator in respect of any subordinated loans granted by the originator; and
- the originator holding equity securities/the most subordinated tranche of securities in the SPV.

1.3 Applicable Laws and Regulations

Securitisation transactions are governed by a complex framework of laws and regulations that encompass corporate law, contract law, insolvency law, regulatory requirements and, where applicable, specific securitisation regulations. Historically, an important piece of legislation was Regulation (EU) 2017/2402 (the EU Securitisation Regulation), which was onshored post-Brexit. However, the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) have released new draft rules that will replace the EU Securitisation Regulation. These rules will regulate not only authorised firms that are involved in securitisation, but also entities that are not authorised but act as the original lender, originator or securitisation special purpose entity (SSPE) of a securitisation.

Since the end of the Brexit transition period, the retained EU Securitisation Regulation has continued to apply in Britain, with some modifications (the UK Securitisation Regulation). The UK Securitisation Regulation sets out the following:

- standards for simple, transparent and standardised (STS) securitisations;
- risk retention rules where originators are required to maintain a material economic interest in the risk of the assets; and
- disclosure and reporting requirements to ensure investors have sufficient information.

When brought into force, the new FCA and PRA rules are expected to largely replicate the UK Securitisation Regulation, albeit with some technical improvements. It is likely, however, that further changes will be made over time (and, indeed, the new rules have been constructed in a manner that facilitates future changes).

In addition, there are current FCA and PRA rules that include regulations on the capital treatment for banks and investment firms, and the Financial Services and Markets Act 2000 (FSMA) provides the overarching framework for financial regulation.

For securitisations involving residential mortgages, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 requires specific authorisations for mortgage lending and administration.

Consumer credit laws will also apply in securitisations involving consumer loans, governing the conduct of the servicer. In particular, a wide-ranging consumer duty applies in the UK, which includes a requirement for consumer lenders to provide good customer outcomes. Investor due diligence will typically involve assessing the extent to which the originator and servicer have complied with applicable consumer legislation when originating and servicing loans, the risk being that non-compliance could reduce the amounts recoverable and ultimately reduce the amounts available to pay and repay investors.

Lastly, international standards like Basel III (implemented in the UK) impact the securitisation market by setting out risk-based capital requirements for banking institutions that may hold securitised assets.

1.4 Special-Purpose Entity (SPE) Jurisdiction

SPEs can be incorporated in a variety of jurisdictions, depending on the goals of the securitisation, the originator's location, tax considerations, regulatory concerns and investor preferences.

United Kingdom (England and Wales)

SPEs incorporated in the UK are frequently seen. The UK has a clear legal framework, including for corporate establishment and tax. Using an SPE established in the UK is often the simplest choice where a securitisation relates to UK assets.

European Union

Where a transaction involves assets relating to a jurisdiction in the EU, or where the securitisation transaction is intended to constitute a "simple, transparent and standardised" securitisation for the purposes of the EU Securitisation Regulation, an SPE is typically established in the EU, with the following jurisdictions being the most popular:

- Luxembourg is a particularly favoured jurisdiction due to its flexibility in corporate structuring, and its favourable tax regime; and
- Ireland is frequently chosen for its favourable tax treaties and English-speaking environment.

Other Jurisdictions

SPEs are occasionally established in Jersey, Guernsey or the Cayman Islands, albeit less frequently (although these jurisdictions remain popular as listing venues).

1.5 Material Forms of Credit Enhancement

Four primary forms of credit enhancement are commonly used to improve the creditworthiness of the debt issued.

- Over-collateralisation involves holding a larger pool of assets than the securities issued, which provides a buffer against asset defaults.
- Subordination uses a tiered structure where junior tranches absorb losses before senior tranches, thereby protecting senior investors. It is common for the junior tranches to be held by the originator (or affiliates) to both retain risk and provide confidence to investors.
- Reserve accounts, such as cash reserves or liquidity facilities, are set up to cover potential shortfalls in the cash flow from the asset pool.
- Although this is less common after the financial crisis, guarantees and similar external credit enhancement can be provided by a highly rated entity, offering additional assur-

ance of payment to investors in case the underlying assets fail to generate expected cash flows.

2. Roles and Responsibilities of the Parties

2.1 Issuers

The issuer typically takes the form of a bankruptcy-remote SPE, which is a legally distinct entity created solely to carry out the securitisation transaction. The role of the issuer is typically to acquire or hold an economic interest in the pool of assets to be securitised and issue the securitised debt to investors. The issuer's key obligations are to make payments of principal and interest as required by the transaction documents, to the extent that cash – derived from collections on the receivables – is available for it to do so.

2.2 Sponsors

Securitisation transactions sometimes, but not always, have a "sponsor". This is a financial institution that establishes the transaction and plays a role in its ongoing operation. The sponsor is often involved in structuring the transaction and selecting the portfolio of assets, and may handle or oversee the servicing of the assets post-securitisation. Sponsors can also provide credit enhancement or liquidity facilities to the transaction, or retain risk in the transaction.

An entity that acts as sponsor is subject to regulatory requirements under the UK Securitisation Regulation (or the EU Securitisation Regulation, as applicable).

2.3 Originators/Sellers

An originator is the entity that originally creates or originates the assets being securitised, or that has purchased such assets before they are securitised. In a typical securitisation transaction, the originator sells or transfers a portfolio of financial assets, such as loans, credit card receivables or mortgages, to an SPE. The originator is sometimes a financial institution such as a bank, but non-bank originators are a growing feature of the securitisation market. An originator will typically have an ongoing interest in the securitisation. Often, this is by way of an entitlement to the cash generated by the sold receivables to the extent it is not needed to pay third-party investors.

An entity that acts as sponsor is subject to regulatory requirements under the UK Securitisation Regulation (or the EU Securitisation Regulation, as applicable).

2.4 Underwriters and Placement Agents

Underwriters – often investment banks – serve to facilitate the issuing and distribution of the securitised instruments to investors. Their role encompasses structuring the transaction, pricing the securities, ensuring compliance with relevant legal and regulatory frameworks relating to the marketing of securities and often providing a commitment to purchase any unsold securities. Public securitisations, where the securities are to be widely distributed, will typically have multiple banks that act as underwriters.

In private placements or direct issuances where the securities are sold to a smaller number of sophisticated investors, underwriters are less frequently seen. In such cases, a bank may be appointed to market the deal but not provide an underwriting commitment. A bank fulfilling this function could be described as a placement agent (although that description/title is not frequently used in a securitisation context).

2.5 Servicers

The servicer is responsible for managing the day-to-day operations of the securitised assets, such as collecting payments from borrowers, handling customer enquiries, managing delinquencies and undertaking enforcement and repossession procedures, if necessary.

Servicers thus play a critical role in maintaining the performance and cash flow stability of the securitised asset pool and will generally receive a fee for their role that is sufficient to attract a replacement servicer if the original servicer ceases to be able to perform its role.

The entity that acts as servicer is often the same entity or part of the same group as the originator, but transaction documents typically contemplate that the servicer may be replaced in the future (for example, if the original servicer ceases to be able to perform its role). Specialist servicers are frequently appointed at the outset of transactions to act as a back-up servicer, the intention being that such an entity would be able to quickly assume the role of servicer, if necessary.

2.6 Investors

Investors provide the capital necessary for funding the purchase of assets by buying the securities issued by the SPE. They are typically institutions such as banks, pension funds, insurance companies and asset managers, seeking to deploy capital and earn a yield. Investors will perform due diligence to assess the risk profiles, credit quality and potential returns of the securitisation. Their investment decisions are guided by their own analysis of the underlying assets, the structure of the deal, the protections afforded by credit enhancements and the ratings provided by credit rating agencies.

2.7 Bond/Note Trustees

A note trustee is typically appointed on behalf of the investors in the securitisation. The note trustee will typically be party to the key transaction documents and give the investors, indirectly, the benefit of the representations, warranties and undertakings of the other parties to such documentation.

In practice, the note trustee will typically play an active role in two circumstances:

- during the ordinary life of the deal, when it is proposed that transaction documents are to be modified, in which case the trustee will either exercise discretion to allow the amendment to be made or oversee the process of approaching noteholders for consent; and
- in the case of a default, whereupon the note trustee may be directed by noteholders to declare a default and accelerate obligations under the notes.

In Europe, trustees will typically otherwise play a passive role and not, for example, seek to monitor compliance.

Trustees are usually trust corporations or financial institutions with dedicated trustee departments. While trustees are common in securitisation structures, some transactions might utilise alternative mechanisms like an owner trust or a fiscal agent arrangement, which provides a different level of oversight and control over the adherence to the structure's terms but may offer less comprehensive protection for noteholders than a traditional trustee.

2.8 Security Trustees/Agents

A security trustee (or, less frequently, a security agent) is appointed to hold and manage the security interests on behalf of the secured parties (most notably, the investors). Typically the same firm as the note trustee, the security trustee takes, directly, the benefit of the security and holds it on behalf of the secured parties. Its responsibilities include managing the security according to the terms of the security documentation, handling enforcement proceedings in the event of default (as directed by noteholders) and distributing proceeds from any enforcement. Although focused on security, the role of the security trustee overlaps with that of a note trustee, and both the note trustee and the security trustee will have a role to play where consents are required (for example, in relation to amendments) or in the case of a default.

3. Documentation

3.1 Bankruptcy-Remote Transfer of Financial Assets

Customary documentation effecting bankruptcy-remote transfers to an SPE typically comprises a receivables purchase agreement and a declaration of trust over amounts standing to the credit of collection accounts. Key terms include:

- the assets to be transferred to the issuer by the originator;
- the purchase price;
- conditions precedents for the transaction to occur;
- conditions for perfection of the transfer, such as notifications or registrations (where necessary);
- comprehensive seller warranties on the quality and status of the assets; and
- covenants restricting the seller's actions to protect the asset pool's integrity.

The declaration of trust over the collection accounts is intended to avoid collections forming part of the originator's (or servicer's) insolvent estate, and is typically formally notified to and acknowledged by the collection account bank, so as to reduce the risk that such bank may set off amounts standing to the credit of such accounts against other liabilities of the originator or servicer.

3.2 Principal Warranties

The originator, servicer, SSPE and, to a more limited extent, other transaction parties will each give warranties relating to certain fundamental matters, such as their capacity, power, authority and solvency.

In addition, the originator will give asset warranties. Most fundamentally, the originator will confirm that the assets are free from encumbrances and that it has the right and ability to sell them. It will also represent that the sold assets comply with a set of carefully drafted eligibility criteria. If the asset warranties are breached, the originator will typically be required to repurchase the affected assets or make a compensatory payment equal to the face value of the relevant assets.

3.3 Principal Perfection Provisions

In a securitisation where there is a transfer by assignment, the transfer documentation will normally provide for perfection on (and only on) specified perfection events. Perfection turns the equitable assignment of receivables into a legal assignment, and is important in ensuring the priority of claims and the ability of the securitisation structure to enforce rights under the receivables in circumstances in which the servicer/originator is not able to do so.

Perfection will typically entail the notification of underlying borrowers and, in certain cases, the registration of the securitisation's interest in related assets (for example, at the Land Registry).

3.4 Principal Covenants

Key covenants include:

- covenants of the issuer to make payments of principal and interest to noteholders in the amount and times required;
- covenants of the originator to maintain records of the ownership of the securitisation of receivables and not to do anything that could impair the title of the securitisation to such receivables;
- covenants of the servicer to service the receivables in accordance with any applicable legal requirements and the applicable servicing standards; and
- covenants of any cash manager (or, in the absence of such, the issuer) to apply cash strictly in accordance with prescribed cash waterfalls.

Covenants are enforceable by the trustee on behalf of noteholders. Of the above, failure to pay by the issuer will be an event of default under the notes. Breach of fundamental covenants by the originator may result in a perfection event. Breach by a servicer or cash manager of its duties is likely to entitle the trustee to terminate the appointment and appoint a replacement servicer or cash manager.

3.5 Principal Servicing Provisions

Key obligations of the servicer include:

- the servicing of receivables in a manner that is consistent with and no less favourable than receivables which the servicer and originator have not securitised (and that is compatible with the prescribed servicing standards);
- compliance with laws, including those regarding consumer protection and data protection;
- maintaining the necessary regulatory permissions;
- enforcing the obligations of the underlying obligors;
- the preservation of records; and
- maintaining segregated collection accounts, taking steps to ensure that underlying obligors make payment into such accounts and transferring amounts from such accounts to the securitisation.

Breaches of servicing obligations can trigger the replacement of the servicer.

3.6 Principal Defaults

Key events of default include:

- non-payment by the issuer when due;
- breach by the issuer of other obligations under the transaction documents;
- misrepresentation; and
- insolvency.

The occurrence of an event of default, subject to grace periods, would typically entitle noteholders to direct the trustee to accelerate payment obligations under the notes and to direct the security trustee to enforce security.

3.7 Principal Indemnities

Indemnities are carefully negotiated and vary from deal to deal. In some deals, indemnities are given by the originator in respect of losses caused by the sale of ineligible assets.

3.8 Bonds/Notes/Securities

The notes are typically constituted by a deed of covenant, with terms and conditions set out in a trust deed.

The terms and conditions set out the issuer's payment obligations, interest provisions, maturity dates and redemption rights, and can sometimes also set out other provisions, such as covenants, representations and warranties, events of default, cash flow waterfalls and provisions regarding ranking and security (although these provisions can equally be found in other related documentation). Either the conditions or the trust deed will set out provisions governing voting and decision making by noteholders. In the case of a public securitisation, the terms and conditions are typically set out in full in the prospectus.

3.9 Derivatives

Derivatives are often, but not always, used in order to hedge interest rate basis risk and currency risk; where present, they are usually entered into by the SPE.

Commonly encountered derivatives include rate swaps, caps or floors. These derivatives are employed to hedge various risks:

- interest rate swaps mitigate the risk of fluctuating interest rates affecting cash flows;
- currency swaps are used when the securitised assets and the notes issued are in different currencies, thus protecting against foreign exchange risk; and
- caps or floors limit the exposure to interest rate volatility by setting maximum or minimum rates.

Aside from the hedging of risk, currency swaps enable the issuance of notes in a currency other than that of the underlying assets, thereby allowing securitisations to issue notes targeted at investors in different jurisdictions.

3.10 Offering Memoranda

A prospectus is typically required when securities are offered to the public or admitted to trading on a regulated market. A prospectus will set out detailed information on the offer and the issuer in a manner that is consistent with the applicable legal requirements (in the UK, Prospectus Regulation (EU) 2017/1129 as retained and amended by UK law post-Brexit). For private placements or transactions not involving public offerings or regulated markets, the issuer will instead publish a transaction summary, with less extensive/detailed content.

4. Laws and Regulations Specifically Relating to Securitisation

4.1 Specific Disclosure Laws or Regulations

In addition to the disclosure requirements relating to the offer of securities to the public (see **3.10 Offering Memoranda**), there are also specific disclosure regulations under Article 7 of the UK Securitisation Regulation. The originator, SPE and any sponsor are jointly responsible for providing the required information, although one of them must be designated as the entity that fulfils the requirements in practice. Information required to be made available includes loan level performance data (on the basis of prescribed templates), as well as the transaction documents and investor reports. In the case of a public securitisation (determined by reference to whether or not there is a prospectus), information must be made available by way of an authorised securitisation repository.

4.2 General Disclosure Laws or Regulations

See **4.1 Specific Disclosure Laws or Regulations**.

4.3 Credit Risk Retention

The UK Securitisation Regulation mandates credit-risk retention to ensure that originators or sponsors have "skin in the game", requiring a minimum retention of 5% of the credit risk of the securitised exposures. This can be done by way of (one of) a number of permitted methods, including by retention of a vertical slice of exposures, a first loss tranche and the maintaining of exposure to a random selection of assets that would otherwise be securitised. The regulation is overseen by the FCA and (in the case of banks) the PRA, which enforce compliance through supervision, auditing and sanctions. Penalties for non-compliance can include fines and other regulatory penalties. It is essential that the risk is retained for the life of the transaction. Hedging or transferring of the retained exposure is not permitted.

4.4 Periodic Reporting

The UK Securitisation Regulation sets out periodic reporting requirements, as described in **4.1 Specific Disclosure Laws or Regulations**. Originators, sponsors and issuers are required to provide regular reports on the performance and underlying exposures of the securitised assets. These reports include data on the credit quality and cash flows of the assets, which must be made available to investors, potential investors and the relevant authorities. The reports are typically required on a quarterly basis, but the frequency can vary depending on the asset type and the transaction's structure. Non-compliance with these reporting obligations can lead to enforcement action by regulatory authorities, including fines or other penalties.

The reports described above must be made available on standardised, prescribed templates. The reporting requirements and these templates are currently subject to review by regulators and are likely to change in the medium term.

UK Market Abuse Regulation (MAR) reporting obligations can also apply in relation to inside information.

4.5 Activities of Rating Agencies

The activities of credit rating agencies (CRAs) are regulated, with the key regulation being the Credit Rating Agencies Regulation (CRA Regulation), which is retained EU law, with CRAs supervised by the FCA. The FCA ensures CRAs adhere to standards of integrity, transparency and analytical rigour by requiring they are registered, disclose and manage conflicts of interest and apply appropriate rating methodologies. The enforcement of rules can lead to sanctions, fines or the suspension of the CRA's registration.

4.6 Treatment of Securitisation in Financial Entities

In the UK, capital and liquidity rules apply for banks, insurers and regulated financial entities, and are broadly aligned with international standards. For banks, such holdings are governed by the Capital Requirements Regulation (CRR), which incorporates Basel III and dictates the risk weighting applied to securitisation positions to determine regulatory capital requirements. Under Solvency II, insurers (and reinsurers) must also hold capital against securitisation investments, on a similar basis. However, the Edinburgh Reforms are intended to bring in changes to, among other things, the Solvency II regulations. All these institutions must also adhere to liquidity requirements, ensuring sufficient high-quality liquid assets to cover short-term liabilities. These rules aim to mitigate systemic risk and ensure financial stability. Non-compliance with capital and liquidity requirements can result in penalties, increased capital charges or other regulatory actions.

4.7 Use of Derivatives
Derivatives used in securitisations are regulated under the European Market Infrastructure Regulation (EMIR), which is EU law onshored post-Brexit (UK EMIR). These regulations mandate risk mitigation techniques for non-centrally cleared derivatives and the reporting of all derivative contracts to trade repositories. The FCA is the primary enforcer of these rules, with the Bank of England also playing a role. In practice, securitisation SPEs are treated as non-financial counterparties; this means that derivatives regulation applicable to securitisations is much lighter than, for example, that applicable in transactions between banks or other financial counterparties.

4.8 Investor Protection
The UK Securitisation Regulation and FSMA protect investors, along with UK MAR, the CRR and Solvency II. The regulations aim to encourage due diligence and monitoring, whilst also avoiding insider trading, market manipulation and instability. The FCA and PRA enforce these rules, focusing on transparency, risk retention and due diligence. Breaches can result in sanctions, fines and restrictions being imposed on the relevant entities.

4.9 Banks Securitising Financial Assets
Please see **4.8 Investor Protection**.

4.10 SPEs or Other Entities
SPEs established in the UK are registered as companies under the Companies Act 2006 with limited liability. Where it is proposed that securities are issued to the public, the SPE is registered as a public company. Limited liability companies are often preferred as the form of entity used as SPEs in UK securitisations for several reasons.

- Limited liability – shareholders of a limited company have limited liability, which means that they are only responsible for the debts of the company up to the amount of unpaid share capital (if any).
- Separate legal personality – a limited company is a separate legal entity from its owners and from any other person/entity, and can enter into binding contractual arrangements in its own name. This allows for the assets and liabilities associated with the securitisation to be segregated from the originator, enhancing bankruptcy remoteness.
- Ring-fencing of assets – as a separate entity, a limited company's assets are inherently ring-fenced from the assets/broader business of the originator and servicer. This assists in the structure being bankruptcy-remote.

To enhance the above, it is usual for an SPE's shares to be held on trust, with the trust being in favour of a purpose rather than any individual beneficiaries. The lack of any individuals/entities that can be said to beneficially own or control the SPE enhances its bankruptcy-remoteness and separation from the originator's group.

4.11 Activities Avoided by SPEs or Other Securitisation Entities
It is important for an SPE to avoid engaging in activities that would classify it as conducting a "regulated activity" under FSMA, such as deposit-taking, providing investment advice or undertaking insurance business. This is to maintain the SPE's status as a bankruptcy-remote entity and to circumvent the need for authorisation by the FCA or the PRA. The activities performed by the SPE are determined by its directors, but

these are strictly outlined in the transaction documents to ensure compliance with regulations.

Similarly, servicing activities facing customers are typically regulated and require regulatory permission. It is therefore a servicer – with the appropriate permissions – that performs this role, rather than the SPE.

If an SPE performs regulated activities, it could face enforcement actions, including fines or sanctions, and may be required to cease activities or obtain the appropriate authorisations, which could impact the securitisation structure. In practice, this is a fairly minimal risk, unlikely to arise with proper drafting of the transaction documents and transaction structuring.

4.12 Participation of Government-Sponsored Entities

The UK government has an established history of participating in the securitisation market, albeit to a much more limited extent than US agencies. Examples include the securitisation by UK Asset Resolution of receivables acquired from rescued banks in the financial crisis, and the use by the British Business Bank of securitisation funding tools to fund SME lenders via its ENABLE programme.

4.13 Entities Investing in Securitisation

A wide variety of investors invest in securitisations, including banks, pension funds and their asset managers, insurance companies and – primarily in respect of mezzanine tranches – private credit funds.

Investors are required to conduct due diligence on securitisations before they invest, with prescribed rules for this set out in Article 5 of the UK Securitisation Regulation. This includes a requirement to ensure that securitisations themselves comply with a number of provisions of the UK Securitisation Regulation (to the extent applicable), such as reporting requirements. The extent to which this restricts UK investors from investing in third country securitisations has been subject to some debate, and is subject to review and potential reform by the FCA and PRA.

4.14 Other Principal Laws and Regulations

UK GDPR (the onshored version of the EU's General Data Protection Regulation) and the Data Protection Act 2018 govern the handling of personal data, which must be considered carefully in every transaction; it is a fundamental principle of securitisations that the securitisation structure can outlast the business of the servicer, but for this to occur, a large volume of personal data relating to underlying customers must be made available to a replacement servicer. It is important to ensure that arrangements in this regard are lawful and operate on an appropriate basis. For so long as the original servicer remains responsible for servicing the assets, the transfer, holding and processing of personal data by the SPE and any investors is minimised.

5. Synthetic Securitisation

5.1 Synthetic Securitisation Regulation and Structure

Synthetic securitisations are common in the UK and, whilst this was a relatively quiet market in the immediate aftermath of the financial crisis, it has grown significantly in recent years. Synthetic securitisation is a form of structured finance where credit risks are transferred to investors using credit derivatives or guarantees rather than through the transfer of actual assets. The focus is on the transfer of risk rather than the transfer of the underlying assets themselves, as found in traditional securitisations. Synthetic securitisations, like true sale securitisations, operate by virtue of general principles of English contract and property law, although the UK Securitisation Regulation does apply.

In terms of structure, a synthetic securitisation typically involves the following elements.

- CDS or credit-linked notes (CLN) – the originator (usually a bank) enters into a credit default swap with an SPE or directly with investors. Alternatively, an SPE may issue credit-linked notes to investors, where the payments on the notes depend on the performance of the reference assets.
- Reference portfolio – this comprises the assets whose risks are being transferred. The originator still holds the actual assets, and only the credit risk is shifted to the investors.
- Tranching – like traditional securitisations, synthetic transactions are structured with different levels of risk, creating tranches that allow for varying degrees of protection for investors and different levels of return.

6. Structurally Embedded Laws of General Application

6.1 Insolvency Laws

The purpose of a securitisation is to give the investor exposure to the credit risk of underlying obligors, not the originator. Structural protections and contractual provisions are designed not only to insulate the SPE's assets from creditors of the originator in the event of insolvency, but also to ensure that investors are exposed only to the obligors. In particular, steps are taken to reduce the possibility of an insolvency practitioner, in the insolvency of the originator, successfully unwinding the transfer of assets to the SPE (for example, by alleging that the sale amounted to a preference or a transaction at an undervalue). This is primarily achieved by ensuring that the transfer of assets is by way of a sale (and that it cannot readily be recharacterised as security) that occurs (other than in the case of NPL securitisations) at the face value of the receivables. In addition, confirmations of the solvency of the originator at the time of sale, by way of directors' certificates, are almost always sought.

6.2 SPEs

The key consideration for an SPE is ensuring that it is bankruptcy-remote and separate from the corporate group of the originator. This is typically ensured by incorporating an SPE that has no prior history and no contractual relationships other than as part of the securitisation, and that is part of an orphan structure (rather than the corporate group of the originator). The directors of an SPE are typically provided by a corporate services provider that is appointed as part of the securitisation and are not employees of the originator.

English courts do not recognise a doctrine of substantive consolidation.

6.3 Transfer of Financial Assets

The transfer of receivables by way of equitable assignment (see **3.3 Principal Perfection Provisions**) results in the SPE acquiring an equitable interest in such receivables and a right to the benefit of collections relating to such receivables.

In the ordinary course, the transfer of receivables will not be notified to the underlying customers – instead, the originator will maintain its customer relationships and the servicer will collect amounts in the name of the originator.

The servicer will typically hold any collections received on trust for the securitisation structure before paying such amounts to the securitisation. Such a trust is intended to put such amounts beyond the reach of the servicer or originator's other creditors. It is important to ensure that trust funds are not comingled with funds not held on trust, and to ensure that any collection account bank is notified that amounts held in the relevant account are held on trust.

Under certain circumstances, such as the insolvency of the originator, it is usual that the equitable assignment of receivables will be perfected into a legal assignment by notifying the underlying obligors of the sale of receivables – see **3.3 Principal Perfection Provisions** for the description of perfection.

It is common for legal analysis to be undertaken to confirm that the transfer of receivables operates by way of a sale and is not readily recharacterisable as security. It is customary for counsel for the banks/investors to deliver a formal, reasoned legal opinion to this effect. Counsel will typically look to ensure that:

- receivables are transferred in exchange for a price that is calculated by reference to the face value of the receivables;
- the SPE has a right to both interest and principal receipts relating to the receivables; and
- the originator has only limited rights to repurchase receivables from the SPE.

6.4 Construction of Bankruptcy-Remote Transactions

It is also possible to use a trust instead of a "true sale" of assets. In this less common structure, the originator would declare a trust over its rights under the assets, with the SPE as the beneficiary. Whilst this achieves bankruptcy-remoteness, it is uncommon in practice.

In addition, it is inherent in a synthetic securitisation that investors' liability is tied to the performance of the portfolio of reference assets, rather than the originator.

6.5 Bankruptcy-Remote SPE

Securitisation documents will always include specific provisions to protect the SPE from insolvency. One key measure is the "limited recourse" provision, which ensures that the investors can only claim against the secured assets of the SPE, and not beyond that for any shortfall.

Another safeguard is the "non-petition" clause, where the investors agree not to petition for the insolvency of the SPE. This prevents the investors from forcing the SPE into insolvency proceedings, thereby allowing the securitisation structure to remain intact and cash flows to be distributed by way of the prescribed cash flow waterfalls, even in circumstances in which payments to noteholders are delayed or not made in full due to a shortfall in cash generated by the securitised assets.

In addition, the SPE is typically structured so as not to form part of the corporate group of the originator, and the transfer of assets to the SPE is structured as a sale.

7. Tax Laws and Issues

7.1 Transfer Taxes

Generally, there are no taxes payable by the SPE on the transfer to it of the financial assets from the originator. There may be potential stamp taxes on the transfer of certain interests in real estate or equity-like securities to the SPE, but this is usually not an issue for securitisations.

7.2 Taxes on Profit

Provided that the SPE satisfies the conditions imposed by the Taxation of Securitisation Companies Regulations 2006, the SPE will be chargeable to corporation tax only on the retained profit after it has paid its expenses in accordance with the transaction waterfall. Practitioners will therefore generally structure the SPE so that it benefits from this tax regime by ensuring that:

- the SPE falls within certain categories of company as defined by the regulations;
- payments (other than the retained profit and any amounts reasonably required to cover losses or expenses and support creditworthiness) flow through to investors within 18 months of the end of the accounting period;
- the SPE is not party to any transactions for which UK tax avoidance was one of the main purposes; and
- the SPE is generally not involved in business activities other than those that are incidental to its role as an SPE in the securitisation.

7.3 Withholding Taxes

Withholding Taxes and Cross-Border Payments Received by SPE

The financial assets securitised in UK SPEs are typically UK financial assets, so UK withholding taxes are not usually an issue. Where cross-border payments are received by a UK resident SPE, withholding taxes may be relevant, depending on the jurisdiction, but treaty or other reliefs may be available to minimise these taxes.

Withholding Taxes and Cross-Border Payments Made by SPE

The SPE is subject to UK withholding tax at the basic rate of income tax (20%) on interest paid on the securitisation notes it issues, unless an exemption applies. A commonly used exemption is the “quoted Eurobond” exemption, where the notes are listed on a “recognised stock exchange” such as the London Stock Exchange or admitted to trading on a “multilateral trading facility” operated by a “regulated recognised stock exchange”, being a recognised stock exchange that is regulated in the UK, EEA or Gibraltar. The “qualifying private placement” exemption may also be available if the SPE issues notes to investors resident in jurisdictions that are party to a double tax treaty with the UK that includes a “non-discrimination” article. In some securitisations with a more limited number of counterparties, a normal claim for treaty relief may also be possible.

7.4 Other Taxes

UK VAT on servicing fees incurred by the SPE may be relevant, depending on the nature of the services. Where possible, the servicer will usually look to provide the services in a way that falls within a VAT exemption (such as the exemptions for financing transactions). Where this is not possible, the VAT incurred is likely to be an additional cost of the securitisation.

7.5 Obtaining Legal Opinions

The tax lawyers acting for the SPE/arrangers are commonly required to give a tax opinion addressed to the SPE, the trustee acting for the noteholders, and the arrangers. The material conclusions will generally be that:

- the SPE should be chargeable to corporation tax only on the retained profit;
- there should be no requirement to withhold UK income tax from payments of interest on the securitised assets and the securities issued by the SPE; and

- no VAT or stamp duty should be chargeable on the acquisition of the securitised assets by the SPE, nor on the issue or transfer of notes by the SPE.

The tax opinion(s) will make a number of factual assumptions based on the transaction documentation.

8. Accounting Rules and Issues

8.1 Legal Issues with Securitisation Accounting Rules

Originators will typically obtain accounting advice to ensure the desired accounting treatment of the securitisation is achieved. The accounting treatment that is desired and is achievable varies from transaction to transaction, but key considerations include:

- whether the assets sold should be derecognised from the originator's balance sheet; and
- whether the SPE should be consolidated as part of the originator's group accounts.

As to derecognition, a key consideration is typically whether the originator has sufficiently relinquished control over the sold assets. This requires particular care in the case of whole loan/forward flow funding transactions (which, although not strictly securitisations, provide analogous asset backed funding), where accountants will often require that the purchaser is able to trigger perfection of legal title to the receivables, sell the receivables on and appoint an alternative servicer. Care is required to assess the impact of the exercise of any such rights on, for example, any originators' entitlement to deferred consideration.

8.2 Dealing with Legal Issues

Legal opinions as to a "true sale", the SPE's independence and bankruptcy-remote status and the legal enforceability of transaction documents are the principal interaction between lawyers and these accounting issues. Accountants are likely to use such opinions when drawing conclusions and advising the originator, but it is uncommon for lawyers to directly opine on the accounting treatment of a given transaction.

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