

MIND THE GAP

Exotic or misconstruction?

Securitisation funds

How a problem can arise from best intentions.

Foreword

By 2004, the securitisation fund was already included as one of the possible structuring options in the Luxembourg Securitisation Act.

The extremely low number of securitisation funds launched by the late 2010s, however, made it clear that the market had no real “use” for this hybrid construct. Even the financial crisis of 2008, which meant a significant loss of reputation for securitisations and simultaneously heaved traditional fund vehicles to the forefront, could not do much to change this.

It was only when the Anti-Tax-Avoidance Directive (“ATAD”) caused Luxembourg securitisation companies to fear that the interest barrier would be applied to securitisation transactions, effectively exposing investors to double taxation, that the securitisation fund became an “insider tip”. Proceed as usual, but no ATAD interest barrier – that was the simple motto.

Ever since, the securitisation fund has established itself. Although the proportion of securitisation funds in Luxembourg is still at the lower end at approximately 6%, hardly any securitisation event goes by without the “securitisation fund” being touted as an intriguing instrument.

And that’s not wrong at all: the securitisation fund certainly has its appeal. And unlike almost all other fund types in Luxembourg, the Securitisation Act does not impose any requirements regarding risk diversification. Even the *Taxe d’abonnement*, conventional in Luxembourg, does not apply.

The securitisation fund therefore has a justified niche in the capital market.

However, if it is used to launch securitisations that do not fall under the EU regulation but are designed similarly to typical structured products (certificates, index/basket linked notes, etc.), investors and initiators should be aware of the increased legal uncertainty surrounding this vehicle.



The basic(s) of the Luxembourg securitisation fund...

Article 5. The articles of incorporation of a securitisation company may authorise the "management body"⁵ to create one or more compartments each compartment corresponding to a distinct part of its assets and liabilities.

Section 2 – Securitisation funds and their management companies

Sub-section 1 – Securitisation funds

Article 6. (1) Securitisation funds consist of one or several co-ownerships or one or several fiduciary estates. The management regulations of the fund shall expressly specify whether the fund is subject to the co-ownership rules or to the trust and fiduciary rules.

(2) Securitisation funds do not have legal personality. They are managed by a management company.

(3) Securitisation funds which consist of one or more fiduciary estates are subject to the legislation on the trust and on fiduciary contracts.

(4) The provisions of the civil code relating to co-ownership in undivided shares (*indivision*) do not apply to securitisation funds.

Article 7. (1) The rights of investors in the fund, whether such investors act as joint owners or settlers (*fiduciants*), are represented by "financial instruments issued"⁶ in accordance with the management regulations.

(2) The ownership of registered securities is evidenced by an entry in the register held for such purposes by the management company. The transfer of such registered securities is effected by a declaration of transfer recorded in the register, dated and signed by the transferor and the transferee or evidenced as set out in the management regulations. The transfer of bearer securities is effected by mere delivery.

(...)⁷

Article 8. If provided for in the management regulations, a securitisation fund may consist of several compartments each compartment corresponding to a distinct co-ownership or fiduciary estate.

Article 9. Debt instruments may be issued on behalf of the securitisation fund or one of its compartments.

Article 10. (1) The management regulations of a securitisation fund shall contain at least the following provisions:

- an indication whether the fund is set up in the form of a co-ownership or fiduciary estate,
- the name, object and duration, limited or unlimited, of the securitisation fund,
- the name of the management company,
- the specific administration and management rules which apply to it,
- the possibility for the securitisation fund to consist of several compartments,
- the circumstances in which the fund or one of its compartments will be in, or may be put into, liquidation,
- the respective rights and obligations of the management company and, as the case may be, of the investors,
- the rules governing the assumption of risks, and/or the issuance of "financial instruments"⁸,
- the procedures for amending the management regulations.

(2) Securitisation funds, consisting of several compartments, may determine by separate management regulations the characteristics of and the rules applicable to each compartment.

⁵ Law of 25 February 2022
⁶ Law of 25 February 2022
⁷ Law of 25 February 2022
⁸ Law of 25 February 2022

(3) The management regulations as well as subsequent amendments thereto must be lodged with the *Registre de commerce et des sociétés* and its publication in the *Recueil électronique des sociétés et associations* shall be made through a notice of the filing of this document in accordance with the provisions of⁹ "Chapter Va of Title I of the Law of 19 December 2002 on the trade and companies register and the accounting practices and annual accounts of undertakings, as amended."¹⁰

(4) The provisions of such regulations are deemed accepted by the investors in the securitisation fund by the mere acquisition of "financial instruments issued"¹¹ by the fund.

Article 11. Without prejudice to Article 62, investors in a securitisation fund are only liable for the debts of the securitisation fund up to the assets of the fund and in proportion to their participation.

Article 12. The securitisation fund shall be liable only for the obligations expressly imposed upon it by its management regulations or which it has contracted in conformity with the latter. It shall not be liable for the debts of the management company or of the investors.

Article 13. "(1) The liquidation of a securitisation fund must be lodged with the *Registre de commerce et des sociétés* and published "by the management company in the *Recueil électronique des sociétés et associations* in accordance with the provisions of Chapter Va of Title I of the Law of 19 December 2002 on the trade and companies register and the accounting practices and annual accounts of undertakings, as amended,"¹² and in at least two newspapers with adequate circulation, one of which must be a Luxembourg newspaper, by the management company within a period of 15 days."¹³

(2) Once the liquidation has commenced, the issuance of "financial instruments"¹⁴ is prohibited under penalty of avoidance, except for the sake of the liquidation.

(3) Without prejudice to the preceding paragraph, the commencement of the liquidation is effective against third parties only as from the day of its publication in the "Recueil électronique des sociétés et associations"¹⁵ except if the securitisation fund can establish that such third parties had prior knowledge thereof. Third parties may however rely upon the liquidation prior to its publication.

Sub-section 2 – Management companies

Article 14. The management company is a commercial company whose object is to manage securitisation funds and, as the case may be, to act as fiduciary of funds consisting of one or more fiduciary properties.

Article 15. (1) The management company shall draw up the management regulations for the securitisation fund.

(2) Without prejudice to the powers conferred upon a fiduciary-representative, the management company acts on behalf of the securitisation fund and its investors vis-à-vis third parties. It acts on their behalf in all judicial proceedings, whether as plaintiff or defendant, without having to disclose the identity of the investors, the sole indication that the management company is acting in such capacity being sufficient. As long as they are represented, the investors cannot individually bring actions, which fall within the authority of the management company.

Article 16. The management company must perform its duties in an independent manner and in the sole interest of the securitisation fund and the investors. It may not use the assets of the securitisation fund for its own needs and it is liable towards the investors and third parties for the proper performance of its duties.

Article 17. The creditors of the management company or of the investors have no rights of recourse against the assets of the securitisation fund.

Article 18. The duties of the management company in respect of the securitisation fund shall cease:

- in the event of resignation or removal of the management company, provided that it is replaced by another management company, authorised, as the case may be, in accordance with the provisions of this law;
- if the management company has been declared bankrupt, has entered into a composition with creditors (*concordat*), has obtained a suspension of payment (*sursis de paiement*), has been put under court controlled management (*gestion contrôlée*), or has been the subject of a similar proceedings or has been put into liquidation,
- if, in the case of an authorised securitisation undertaking, the *Commission de Surveillance du Secteur Financier* withdraws the management company's authorisation;
- in all other circumstances set out in the management regulations.

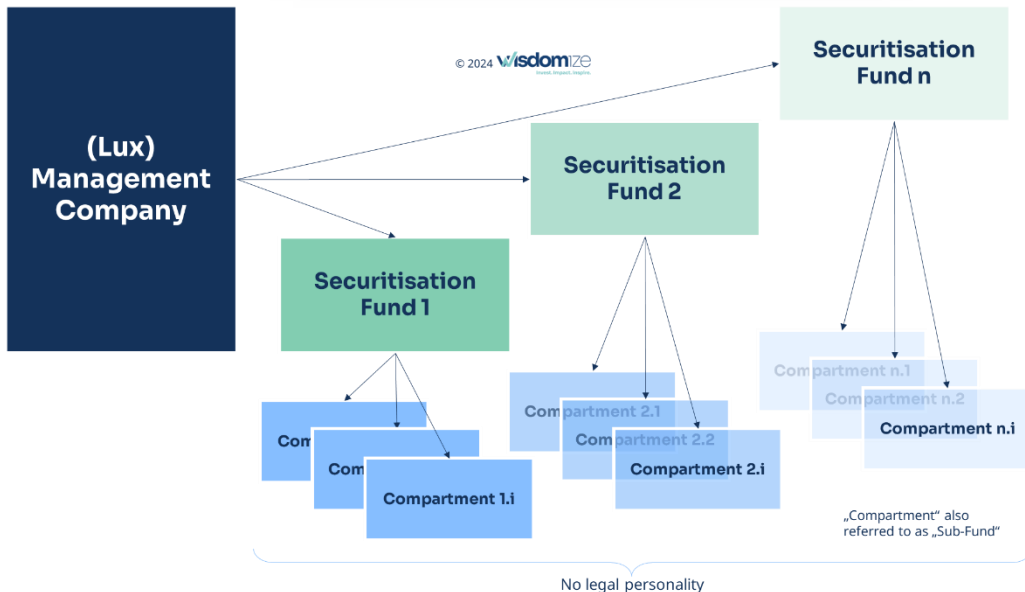
Chapter 2 – Authorised securitisation undertakings

Section 1 – Obligation and conditions for an authorisation

Article 19. Securitisation undertakings which issue on a continuous basis "financial instruments offered to the public"¹⁶ ("authorised securitisation undertakings") must be authorised by the

The Luxembourg Securitisation Act describes the structure of the securitisation fund, whereby the term *trust assets* can also be used instead of *special assets*:

→ We will explain the red markings below, so please keep them in mind



Catalyst: ATAD

The ATAD is based on an EU directive from 2016 (EU 2016/1164 = ATAD 1). An amended directive was published in 2017 (EU 2017/952), which was to be implemented by the member states from 2020 (ATAD 2). The EU's main aim was to prevent aggressive tax arrangements aimed at exploiting different taxation systems and tax rates within the member states.

Especially problematic for securitisations are the regulations on the interest barrier: Most securitisation transactions use debt securities that are issued to investors. These in turn pay taxed "interest" to the investors (even though they may be designed to completely reinvest all distributions).

However, if this interest can no longer be offset against the income of the securitisation vehicle due to the application of the interest barrier, the difference is taxable at the level of the securitisation vehicle. This means that the investor must also pay tax on the inflow of interest, increasing their tax burden.

The EU directive was transposed into national law in Luxembourg on 18 December 2018. Up until the last session of parliament the securitisation industry had reason to hope that the transposition would only have a minor impact on the industry. However, things turned out differently.

From the viewpoint of securitisations, it is particularly important to pay attention to the provisions of article 168bis of the "Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu".

Article 168bis contains two exceptions that appear to be applicable to securitisations:

- UCITS funds and AIFs are exempt.
- Securitisations that fall under the EU regulation are also exempt.

After it quickly became clear to the industry that many of the Luxembourg securitisations do not fall under the EU regulation and would therefore not be directly exempt from the application of the interest barrier, the focus shifted to the concept of funds, as specific exemptions are also provided for them within the directive.

Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu Art. 168bis, L.16

ART. 168BIS.
L.17.12.1982.2.1 - L.17.12.2017.1.17.12.21.319

(1) Au sens du présent article, on entend par :

- 1) contributeur un organisme visé par l'article 159 ou un établissement stable indigène d'un organisme visé par l'article 160, alinéa 1^{er};
- 2) coûts d'emprunt: les charges d'intérêts sur toutes les formes de dette, les autres coûts économiquement équivalents à des intérêts et les charges supportées dans le cadre de financements, notamment, mais pas exclusivement,
 - les rémunérations dues sur des prêts participatifs,
 - les intérêts imputés sur des instruments, tels que des obligations convertibles et des obligations sans coupon,
 - les montants déboursés au titre de mécanismes de financement alternatif, du type finance islamique,
 - les intérêts dus au titre de contrats de crédit-bail,
 - les intérêts capitalisés inclus dans la valeur de l'actif correspondant inscrit au bilan, ou l'amortissement des intérêts capitalisés,
 - les montants mesurés par référence à un rendement financier en vertu des règles d'établissement des prix de transfert, le cas échéant,
 - les intérêts notés sur des instruments dérivés ou de contrats de couverture portant sur les emprunts d'un organisme,
 - certains gains et pertes de change sur emprunts et instruments liés à des financements,
 - les frais de dossier et frais similaires liés à l'emprunt de fonds;
- 3) surcoûts d'emprunt: le montant du dépassement des coûts d'emprunt déductibles supportés par un contributeur par rapport aux revenus énoncés imposables et autres revenus imposables économiquement équivalents réalisés par ce contributeur;
- 4) IFRD/DA: le total des revenus nets majorés des surcoûts d'emprunt visés au numéro 3, des amortissements calculés après les articles 23 à 4 et des déductions pour dépréciation qui ont été opérées. Sont exclus du calcul de l'IFR/DA, les revenus exonérés d'impôts et les dépenses d'exploitation qui sont en connexion économique avec ces mêmes revenus exonérés;
- 5) projet d'infrastructures publiques à long terme: un projet reconnu d'intérêt public visant à fournir, à améliorer, à exploiter ou à conserver un actif de grande envergure;
- 6) entité autonome: un contributeur qui ne fait pas partie d'un groupe consolidé à des fins de comptabilité financière et qui n'a pas d'emprunt associé au sens de l'article 164ter, alinéa 2 ou pas d'établissement stable situé dans un État autre que le Luxembourg;
- 7) entreprises financières,
 - a) un établissement de crédit, une entreprise d'investissement au sens de l'article 4, paragraphe 1^{er}, point 1), de la directive 2004/39/CE du Parlement européen et du Conseil du 21 avril 2004 concernant les marchés d'instruments financiers, modifiant les directives 93/11/CEE et 93/22/CEE du Conseil et la directive 2002/12/CE du Parlement européen et du Conseil et abrogeant la directive 93/22/CEE du Conseil, un gestionnaire

Tout contributeur en vigueur au 01/01/2023

Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu Art. 168bis, L.16

de fonds d'investissement alternatifs au sens de l'article 4, paragraphe 1^{er}, point 3), de la directive 2011/61/UE du Parlement européen et du Conseil du 8 juin 2011 sur les gestionnaires de fonds d'investissement alternatifs et modifiant les directives 2003/41/CE et 2009/65/CE ainsi que les règlements (CE) no 3309/2002 et (UE) no 1095/2010 ou une société de gestion d'OPCVM (organisme de placement collectif en valeurs mobilières) au sens de l'article 2, paragraphe 1^{er}, point 3), de la directive 2009/65/CE du Parlement européen et du Conseil du 13 juillet 2009 portant coordination des dispositions législatives, réglementaires et administratives concernant certains organismes de placement collectif en valeurs mobilières (OPCVM);

- b) une entreprise d'assurance au sens de l'article 13, point 1), de la directive 2009/138/CE du Parlement européen et du Conseil du 23 novembre 2009 sur l'accès aux activités de l'assurance et de la réassurance et leur exercice (solvabilité II);
- c) une entreprise de réassurance au sens de l'article 13, point 4), de la directive 2009/138/CE précitée;
- d) une institution de retraite professionnelle relevant du champ d'application de la directive 2004/84/CE du Parlement européen et du Conseil du 3 juin 2004 concernant les activités et la surveillance des institutions de retraite professionnelle, sauf si un État membre a choisi de ne pas appliquer ladite directive en tout ou partie à cette institution conformément à l'article 5 de cette directive, ou le délégué d'une institution de retraite professionnelle visé à l'article 13, paragraphe 1^{er}, de ladite directive;
- e) les institutions de retraite gérées des régimes de retraite qui sont considérées comme des régimes de sécurité sociale relevant du règlement (CE) no 883/2004 du Parlement européen et du Conseil du 29 avril 2004 portant sur la coordination des systèmes de sécurité sociale et du règlement (CE) no 887/2009 du Parlement européen et du Conseil du 16 septembre 2009 fixant les modalités d'application du règlement (CE) no 883/2004 portant sur la coordination des systèmes de sécurité sociale, ainsi que toute entité juridique créée aux fins d'investissements de tels régimes;
- f) un fonds d'investissement alternatif, d'après le FIA, y compris par un gestionnaire de fonds d'investissement alternatifs au sens de l'article 4, paragraphe 1^{er}, point 3), de la directive 2011/61/UE du Parlement européen et du Conseil du 8 juin 2011 sur les gestionnaires de fonds d'investissement alternatifs et modifiant les directives 2003/41/CE et 2009/65/CE ainsi que les règlements (CE) no 3309/2002 et (UE) no 1095/2010, ou un FIA autorisé en vertu de la directive du 13 juin 2004 relative à la Société d'investissement en capital à risque (SICAR);
- g) les OPCVM au sens de l'article 1^{er}, paragraphe 2, de la directive 2009/65/CE du Parlement européen et du Conseil du 13 juillet 2009 portant coordination des dispositions législatives, réglementaires et administratives concernant certains organismes de placement collectif en valeurs mobilières (OPCVM);
- h) les contreparties centrales au sens de l'article 2, point 1), du règlement (UE) no 648/2012 du Parlement européen et du Conseil du 4 juillet 2012 sur les produits dérivés de gré à gré, les contreparties centrales et les référentiels centraux;
- i) les dépositaires centraux de titres au sens de l'article 2, paragraphe 1^{er}, point 1), du règlement (UE) no 909/2014 du Parlement européen et du Conseil du 23 juillet 2014 concernant l'amélioration du règlement de titres dans l'Union européenne et les

Tout contributeur en vigueur au 01/01/2023

Undertakings for Collective Investments in Transferable Securities (UCITS)

The Luxembourg interest barrier regulation states that UCITS within the meaning of EU Directive 2009/65/EC of 13 July 2009 are deemed to be financial institutions that are generally exempt from the application of the interest barrier.

The specific provision mentioned states:

„Management company“ means a company, the regular business of which is the management of UCITS in the form of common funds or of investment companies (collective portfolio management of UCITS);

In this respect, the provision in itself also describes the activities of the aforementioned management company of a securitisation fund. So far, so good.

However, the term "UCITS" is used in this provision, which in our opinion implies that the definition of UCITS in this directive must be included in the analysis. From our perspective as a securitisation fund, the biggest problem lies in Article 1 (2) a):

„For the purposes of this Directive, and subject to Article 3, UCITS means an undertaking,

a) with the sole object of collective investment in transferable securities or in other liquid financial assets referred to in Article 50(1) of capital raised from the public and which operate on the principle of risk-spreading; and...“

In principle, the definition of a securitisation fund in the Luxembourg Securitisation Act does not contradict the definition of a UCITS within the meaning of the above directive. Only this would mean that securitised securities would have to or could be reassessed for regulatory and tax purposes in most EU countries, as they would then be considered "investment assets".

In our opinion, the provider would be required to establish a risk management system that meets the requirements of a UCITS management company and the respective UCITS would have to be authorised in accordance with Article 5 of EU Directive 2009/65/EC. Furthermore, the directive calls for diversification, which must be maintained (virtually) at all times. As these stipulations are generally not (or cannot be) maintained for securitisations and diversification would entail a considerable constraint for securitisation transactions, this alternative for securitisation funds has not yet been implemented according to our research.

Additionally, it should be mentioned that paragraph (4) of Article 1 contains another problem for a large part of securitisation transactions customary in Luxembourg:

„Investment companies, the assets of which are invested through the intermediary of subsidiary companies, mainly other than in transferable securities, shall not be subject to this Directive.“

Many securitisation transactions are based on loans, derivatives, or other assets, and these do not (usually) qualify as securities.

Alternative Investment Funds (AIF)

The Luxembourg interest barrier regulation also states that AIFMs within the meaning of EU Directive 2011/61/EUR of 8 June 2011 are classified as financial institutions that are exempt from the application of the interest barrier.

Here it is stated:

- a) *„AIF“ means collective investment undertakings, including investment compartments thereof, which:
 - i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
 - ii) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC.*
- b) *„AIFMs“ means legal persons whose regular business is managing one or more AIFs.*

The result is almost the same as for the UCITS described above: what seems possible in principle is ruled out for most providers of securitisations, according to our understanding.

Contrary to UCITS, however, there are individual cases in Luxembourg that have chosen the option of the "AIF".

The regulatory requirements for management companies are somewhat less onerous than for UCITS. However, as we will explain below, qualifying a securitisation fund as an AIF is the only way to avoid double taxation under the ATAD. One must (be able to) accept the fact that the securities then generally qualify as "investment assets".

Neither UCITS nor AIF

Since both exceptions to the Luxembourg interest barrier describe two very specific types of funds (UCITS and AIF) and the securitisation fund is neither expressly included nor excluded from application, one could assume that there is a loophole in the law and argue that the securitisation fund should be treated in analogy with the described UCITS and AIF.

However, the use of analogy in the application of the law is dependent on two prerequisites: (i) an **unintended** loophole in the law and (ii) comparable interests. This means that the interests that are to be realised through the application of analogy are comparable to those in the statutory case.

Whether this is (i) an unintentional loophole is most likely questionable because the inclusion of the securitisation fund established by the Luxembourg Securitisation Act would have required a special treatment of Luxembourg within the EU. As application of an analogy is legally prohibited in the event of an intended loophole, we do not need to consider this option any further.

But even if one assumes that the omission of the Luxembourg securitisation fund from the definition of a **"financial institution"** was unintentional - an analogous consideration would have to take (ii) comparable interests into account.

Both variants mentioned in Art. 168bis are categorised as investment funds sharing the following characteristics:

1. capital from a number of investors,
2. for the account of/in favour of the investors, and
3. risk diversification/pre-defined investment strategy.

Accordingly, in the event of an analogous application of the law to the securitisation fund, it would also have to be assumed that the securitisation fund is an **investment fund** in order to imply a situation of comparable interests.

To understand why the assumption of an investment fund is a problem, we need to take a closer look at the question of what an investment fund is and what the differences are to a traditional security.

Investment funds vs. securities

As is so often the case, the distinction is important for several reasons:

- a) In many jurisdictions, investment funds are subject to a taxation system that differs from traditional securities and/or even different tax rates. Whether this leads to a lower or higher tax burden for investors can be disregarded at this point. Even the question regarding which system applies leads to a risk in relation to the tax compliance of the securitisation vehicle and the investor. And the idea of securitisation is, after all, not to generate (new) risks.
- b) Under *regulatory law*, several levels must be taken into account. Not only the level of the investor, but also the level of the distributor and that of the securitisation vehicle must be considered.

Investor Level:

In the case of **retail investors** (usually private investors), it is a necessity to be able to understand the opportunities and threats (risks) of the assets ("underlyings") invested at the level of the investment fund. This also implies that the description of risks before an investment is made must be based on the description of the underlying assets and not - as is usual with securities - on the characteristics of the security and the risks of the issuer.

The impact on institutional investors is even more drastic: **in most cases**, they are subject to a range of rules and regulations that restrict risk-taking with regards to investments. In some cases, these are fixed quotas or capital backing requirements to demonstrate risk-bearing capacity (e.g. Solvency II or CRR). Whether it is an investment fund or a bond therefore has a significant impact on the ability of institutional investors to acquire said investment funds or securities.

Distribution Level:

Different requirements are also attached to the distribution of an investment fund or a security ensuring that the respective distributor can prove the suitability of the product for the investor groups it addresses:

The sale of investment funds is generally subject to lower requirements than the sale of securities, as the legislator has already provided a high level of investor protection due to the higher standards of regulation at product level.

In many jurisdictions, however, securities may only be sold by authorised financial service providers. This ensures that securities with lower regulatory requirements are only offered to suitable investors.

It becomes problematic for distributors if they sell the products under the wrong regime.

If investors were subsequently harmed, their lawyers would primarily turn to the distributor who marketed the products with incorrect product documentation and risk disclosures. Even if it were to be concluded that the level of risk ultimately was identical, miscounselling regularly represents the highest liability risk for distributors.

As a result, the distributor would seek to indemnify itself and assert liability claims against the securitisation vehicle and its management.

Several parties would also have to be taken into account at the level of the securitisation vehicle:

To simplify matters, we will now limit ourselves to the vehicle itself (in this specific case, the management company) and the directors.

Management Company Level:

For the management company, classification as an investment fund means that the company must describe the corresponding processes and (as far as possible) obtain authorisation. Anyone who operates an investment fund without a corresponding permit is acting **without the appropriate authorisation**. In most cases, this would mean that the company would be prohibited from doing business, subject to high fines and, if in doubt, face insolvency.

Management Level:

The management of a company that sells such products without authorisation may even be subject to criminal sanctions.

The level of punishment would be based on the culpability of the sanctioned party. As we assume that none of the relevant persons would intentionally violate a possible authorisation obligation, it would have to be examined whether it was a case of simple or gross negligence.

You can't have the cake and eat it!

As part of our analysis, we found corresponding passages in the documentation of almost all providers of securitisation funds, which on one hand deny that they are investment funds within the meaning of the AIFMD, but on the other claim to be exempt from the application of the interest barrier under the ATAD as securitisation funds. However, as already explained, this is not the intention!

Case 1:

Anyone who has acted on the mistaken assumption that the interest barrier should be disregarded, since a securitisation fund should be seen as analogous to a UCITS or an AIF, is, in our opinion, confronted with the problem of having submitted an incorrect tax return. Whether the incorrect declaration also has an impact on the tax burden must of course be considered on a case-by-case basis.

Case 2:

Let's examine what happens when one walks the thin path of using the analogous application of the law and goes as far as recognising that securitisation funds constitute investment funds. According to our derivation, on one hand, the person faces the problem that an analogous application of the law is not actually applicable, or at least that there is a high degree of uncertainty as to whether this would have any prospect of success in the event of a legal dispute.

At the same time, a way would have to be found not to be classified as an AIF to circumvent the problem (in most cases) of lack of authorisation.

In Case 2, the securitisation fund cannot rely on the very sweeping statement of the CSSF in its FAQs on securitisations from 2013 that securitisation vehicles solely issuing debt instruments should not be classified as AIFs because this securitisation fund would not be considered an investment fund.

The ECB definitions of securitisations, also mentioned in the same FAQs, could also come into question:

In the Luxembourg AIF Law (Law of 12 July 2013 on alternative investment fund managers), "*securitisation special purpose entities*" are excluded from application and defined as follows:

"securitisation special purpose entities": entities whose sole purpose is to carry on a securitisation or securitisations within the meaning of point 2 of Article 1 of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions and other activities which are appropriate to accomplish that purpose.

The CSSF explains in its FAQs from 2013:

"Securitisation special purpose entities" are defined as entities whose sole purpose is to carry on a securitisation or securitisations within the meaning of Article 1(2) of Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30) and other activities which are appropriate to accomplish that purpose (the "ECB Regulation").

According to the ECB Regulation, "securitisation" means "a transaction or scheme whereby an asset or pool of assets is transferred to an entity that is separate from the originator and is created for or serves the purpose of the securitisation and/or the credit risk of an asset or pool of assets, or part thereof, is transferred to the investors in the securities, securitisation fund units, other debt instruments and/or financial derivatives issued by an entity that is separate from the originator and is created for or serves the purpose of the securitisation, and:

- a) in case of transfer of credit risk, the transfer is achieved by:
 - the economic transfer of the assets being securitised to an entity separate from the originator created for or serving the purpose of the securitisation. This is accomplished by the transfer of ownership of the securitised assets from the originator or through sub-participation, or
 - the use of credit derivatives, guarantees or any similar mechanism;
- and
- b) where such securities, securitisation fund units, debt instruments and/or financial derivatives are issued, they do not represent the originator's payment obligations;"

According to the clarifications provided by the European Central Bank in its "Guidance note on the definitions of 'financial vehicle corporation' and 'securitisation' under Regulation ECB/2008/30", point 4.1, page 3, a securitisation vehicle issuing "collateralised loan obligations" would indeed meet the definition of the ECB Regulation, so that these vehicles do not qualify as AIFs.

On the other hand, according to the same Guidance note (points 4.1 and 4.3, pages 3 and 4), securitisation undertakings whose core business is the securitisation of loans which they grant themselves (securitisation undertakings acting as "first lender")⁶ do not meet the definition of the ECB Regulation and thus cannot benefit from the exclusion. The same applies to securitisation undertakings that issue structured products that primarily offer a synthetic exposure to assets other than loans (non credit-related assets) and where the credit risk transfer is only ancillary.

⁶ Regarding this point, the CSSF refers to question 7 of these Frequently Asked Questions and notably draws the attention on the ongoing discussions at international level on shadow banking.

Unfortunately, this published opinion of the CSSF in conjunction with the Luxembourg AIF Law again results in a slightly different definition of securitisations:

The ECB's "Guidance Notes" cited by the CSSF expressly include (in contrast to the definition published not long ago in 2017 in accordance with EU Regulation 2017/2402) securitisations that, for example, acquire fund units or equity instruments as assets to be securitised.

Interestingly, the securitisation fund can therefore constitute an investment fund, but at the same time be classified neither as a UCITS nor as an AIF.

For this scenario, the problem is reduced to the legally inadmissible analogy of the application of the law in terms of the interest barrier.

BUT:

Based on our current research, we could not find any securitisation funds in Luxembourg that has used this constellation: all analysed cases either claim AIF status or deny classification as investment funds.

The theoretically still possible constellation (case 3): neither AIF, nor investment fund, nor ATAD solution, could not be found in our research in Luxembourg so far.

Negation of the status as an investment fund

In our opinion, anyone who has chosen this route is in deeper trouble than they might realise.

There is a considerable risk that the providers of securitisation funds would be accused of using the securitisation fund only because (in the opinion of the providers) the interest barrier of the ATAD is not applicable to them and thus a tax could be avoided that would have been incurred if it had been declared as a normal securitisation company. The aforementioned revival in the launch of securitisation funds following the implementation of the ATAD in Luxembourg also suggests a corresponding motivation.

Especially as these providers do exactly what the ATAD is in fact trying to prevent:

The securitisation funds we analysed almost exclusively all issued debt instruments (securities).

While traditional investment funds (UCITS) and AIFs generally give rise to transparent taxation at investor level (investors are taxed as if they had a direct interest in the assets), securities issued by securitisation funds regularly lead to different taxation at investor level. In Germany, for example, income from securities is subject to flat-rate withholding tax, while income from investment funds is subject to the German Investment Tax Act (InvStG).

Here, too, there is no general answer as to which regulation triggers a lower tax burden - but in any case, the question arises as to whether the investors' tax returns are based on the correct framework.

The argument that the fund units required to set up the fund, whose performance depends on the NAV of the securitisation fund, are transparent for tax purposes does not help either. Typically, the capital invested through the fund units only makes up a marginal proportion of the balance sheet.

General Anti-Abuse Rule (GAAR)

With the implementation of the ATAD in Luxembourg, the "abusiveness" of arrangements was also defined more strictly.

In their analyses, the tax authorities are increasingly focusing on the question of "non-tax reasons" for the use of securitisation funds versus securitisation companies.

Some providers may now retreat to the fact that their legally binding documents somewhere presumably contain risk warnings about tax risks arising from the application of the ATAD, thereby transferring the financial risk of taxation to the investors. Investors in the products, though, retain the risk.

Worst-Case from the viewpoint of investors

If, contrary to the opinion of the management company, the securitisation fund was to be classified as an investment fund after all, investors' worst-case scenario would unfold: no exemption from the application of the interest barrier and classification as an investment fund.

In order to analyse the latter, the interpretive letter published by the German Federal Financial Supervisory Authority (BaFin) on the concept of investment assets from 2013 is a good place to start.

As already elaborated elsewhere, BaFin's interpretation is that an investment fund always exists if the following criteria are met:

„An investment fund within the meaning of section 1 (1) sentence 1 KAGB is any undertaking for collective investment that collects capital from a number of investors in order to invest it in accordance with a defined investment strategy for the benefit of these investors and that is not an operating company outside the financial sector.“

Now note the passages marked in red in the Securitisation Act on page 3 of this document:

Question 1:

Is a securitisation fund an undertaking?

Answer: yes, without doubt.

Question 2:

...for collective investment?

Answer: That depends. If investors can demand unconditional repayment of their invested capital, BaFin will deny this. However, this in turn would have a direct impact on the question of whether it is a securitisation within the meaning of the ECB definition, especially as we were unable to find any existing securitisation funds that securitised the unconditional repayment of the capital invested during our research for this paper. For the vast majority of securitisation funds = **yes**.

Question 3:

...for the benefit of a number of investors?

Answer: De facto all of the securitisation funds analysed are aimed at a number of investors. Whether it is possible to have the fund units and the securities held by the same investor and still have established a securitisation fund is disputed in Luxembourg. However, the prevailing opinion is that at least TWO investors are necessary for the establishment of a fund or at least it must be provided that there can be several investors. In terms of BaFin's interpretation, the question would therefore be answered quite clearly in the affirmative.

Question 4:

...in accordance with a defined investment strategy?

This question can also be clearly answered by the wording of the Securitisation Act in Article 10 (1). BaFin describes that, in its view, an investment strategy already exists if (quote):

„According to the explanatory memorandum to Section 1 (1) KAGB, the existence of a defined investment strategy requires that the criteria according to which the collected capital is to be invested are precisely defined in writing to an extent that goes beyond that of a general business strategy (hereinafter "corporate strategy").“

Since Article 10 of the Luxembourg Securitisation Act expressly requires that "specific management arrangements" and "arrangements for the assumption of risks" must be in place, an investment strategy within the meaning of BaFin's interpretative letter exists. **Answer: Yes.**

Question 5:

For the benefit of the investors?

Answer: Yes, for whom else? As the securitisation fund has no legal personality, the investment can only be made for the benefit of the investors invested in the securitisation fund. This is also clearly stated in Article 16 of the Luxembourg Securitisation Act.

Question 6:

Not an operating company outside the financial sector?

Answer: Here, too, the wording of the Luxembourg Securitisation Law is clear: for the „sole interest of... the investors“. **So yes**, a securitisation fund is not a company outside the financial sector.

As a result, all securitisation funds analysed by us would have to be classified as investment assets in accordance with the interpretive letter published by BaFin.

Securitisation funds that are not offered in Germany could argue that different interpretations apply in other countries. As BaFin **only uses national law** to interpret the definition of an "investment strategy", it is not to be expected that the application in other jurisdictions within the EU will differ significantly.

If you, as an investor, would like a detailed analysis for your country based on the above discussion, we would be pleased to invite you to send us a corresponding enquiry.

Conclusion

The securitisation fund is, despite its increasing popularity, an exotic. For many investors, however, "exotic" is not the attribute they are looking for in connection with their security. The hybrid structure of the securitisation fund harbours risks, which we have examined in detail in this elaboration based on the information available to us.

The fact that, according to our analysis, corresponding securities issues of securitisation funds are currently on the books as bonds, participation certificates, or asset-backed securities and not as investment funds, especially by institutional investors, poses a considerable risk of (active) investment limit violations and quota overruns, in the case the products were to be examined more closely by the supervisory authority or authorities.

At the same time, the securitisation fund also offers hybrid opportunities (addressing different types of investors and asset classes in parallel), particularly in conjunction with a corresponding AIF licence.

Nevertheless, for reasons mentioned above, you will not find a securitisation fund in our portfolio.

The classic securitisation company, the AIF and (now) the ELTIF 2.0 appear to us to be much more suitable vehicles.

Sources:

In the "Knowledge" section of our website, we provide a collection of the laws/foundations and circulars on which this report is based ("Collection: Mind the Gap").



Unfortunately, this has to be.

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