EUROPEAN CENTRAL BANK

EUROSYSTEM

GUIDANCE NOTE ON THE DEFINITIONS OF 'FINANCIAL VEHICLE CORPORATION' AND 'SECURITISATION' UNDER REGULATION ECB/2008/30

Regulation ECB/2008/30 of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions[1] (the 'Regulation') establishes a set of statistical reporting requirements for financial vehicle corporations (FVCs). Article 1 sets out the definitions of FVC and securitisation.

The purpose of this statistical guidance note is to assist national central banks, market participants and statistical reporting agents with the practical application of the definitions by providing advice on the implementation of their different elements. By providing information on these definitions, there are gains to be made in terms of a consistent classification of this statistical sector across the euro area, which is essential for producing harmonised FVC statistics. This guidance note is not intended to provide an exhaustive interpretation of the different elements of the definitions set out in the Regulation or of how such interpretation is to be applied in the light of the facts and circumstances of each individual case. It reflects current knowledge about FVC activities; however, it does not preclude the possibility of modified interpretations of the definitions depending on future developments within the FVC sector regarding activities or structures. This guidance note provides statistical support and background information. It will be supplemented with additional statistical advice that will eventually be published in a comprehensive manual on FVC statistics, similar to other statistical manuals published in various statistical domains.

1 PRINCIPAL ACTIVITY AND INSULATION FROM THE ORIGINATOR'S BANKRUPTCY

Article 1(1)(a) of the Regulation requires that, in order to qualify as an FVC, the principal activity of an undertaking must meet the following criterion: 'it intends to carry out, or carries out, one or more securitisation transactions and is insulated from the risk of bankruptcy or any other default of the originator'.

Securitisation, as defined in Article 1(2), must be the principal activity of the entity[2]. For example, an entity whose principal activity is loan origination but which incidentally engages in loan purchases would not qualify as an FVC, even if the loan purchases were to lead to the subsequent issuance of asset-backed securities by that entity.

The determination of the principal activity is to be done on an *ex ante* basis, i.e. based on the documentation that establishes the relevant entity and/or the entity's investment guidelines. For instance, if it can be established from its documentation that activity relating to the entity's own-originated loan portfolio may be reasonably expected to exceed any other activity, or the own-originated portfolio is expected to exceed more than 50% of total assets, when it has fully taken up business, the entity would not be considered to qualify as an FVC.

Additionally, in its principal activity, the entity must be insulated from the possible bankruptcy of the originator. This means that the assets which are the object of securitisation are effectively segregated from the bankruptcy estate of the originator in the event of its bankruptcy, or that a similar arrangement protects the entity's rights over the assets from being affected by any claims against the originator. Complete protection from any of the consequences of an originator's bankruptcy in connection with any

1 OJ L 15, 20.1.2009, p. 1.
2 Paragraph 3.10 of the European System of National and Regional Accounts 1995 (ESA 95) defines principal activity as the 'activity whose value added exceeds that of any other activity carried out within the same unit'.

other role that the originator may have in the securitisation (e.g. servicer, hedge counterparty, etc.) is not required. These constitute ancillary tasks that could also be provided by a third party distinct from the originator. Thus, the entity's potential exposure to disruptions in these activities would not constitute a failure to be insulated from the bankruptcy of the originator.

2 ISSUANCE ACTIVITY FALLING WITHIN THE FVC DEFINITION

With the aim of reflecting the wide diversity of possible financing arrangements supporting a securitisation, the definition of the issuance activity of an FVC in Article 1(1) of the Regulation includes the following: 'it issues, or intends to issue, securities, securitisation fund units, other debt instruments and/or financial derivatives'. In addition, selling to the public and issuance through private placement are included within the scope of the definition.

Consequently, in order to comply with the FVC definition, an entity must either issue certain financial instruments listed in Article 1(1)(b) and/or legally or economically own assets underlying the issue of securities or other instruments, possibly as part of a securitisation transaction which uses a number of FVCs in its structure[3].

The following examples may be used to help determine the type of instruments that could be issued and are relevant for the purpose of the FVC definition contained in Article 1(1)(b) of the Regulation:

- instruments admitted to trading in a regulated market;
- instruments that are eligible assets for Eurosystem refinancing operations, within the meaning of Guideline ECB/2011/14[4];
- instruments rated by an external credit assessment institution or whose issuer is rated;
- instruments with identification numbers assigned by a national or international numbering agency;
- instruments concluded as bilateral loans, which are distributed by way of private placement to several distinct creditors (usually, where the instruments are distributed to five or more distinct creditors this would fall within the definition), either with the same or with different ranking of seniority;
- instruments with characteristics similar to those of mutual funds units, in particular units issued which grant ownership rights over the entity;
- instruments, more than half of which are issued to banks that treat them as securitisation exposures for the purposes of determining regulatory capital;
- instruments, more than half of which are issued to a credit institution or subsidiaries thereof, and the accounts of the entity is consolidated in the credit institution's group accounts.

As a rule, the issuance of any one of these types of instrument can be deemed sufficient to satisfy the issuance activity criterion under Article 1(1)(b) of the Regulation.

3 INDIRECT ISSUANCE IN MULTI-VEHICLE SECURITISATION STRUCTURES

Multi-vehicle structures are often used in the context of asset-backed commercial paper (ABCP) programmes, and 'master trust' structures. Multi-vehicle structures may also be used whenever it is advantageous to have the securities issued by an entity subject to the law

3 See the following section on multi-vehicle securitisation structures.

4 Guideline ECB/2011/14 of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem (OJ L 331, 14.12.2011, p. 1).

of a different jurisdiction than that of the FVC holding the securitised assets.

In determining whether an entity within a multi-vehicle structure qualifies as an FVC, the structure as a whole needs to be considered. As a general rule, where the structure as a whole would qualify as an FVC if its individual component entities were to be consolidated, then each individual entity within the structure qualifies as an FVC. As a result, all individual entities within the structure that reside in the euro area would be subject to the Regulation[5].

An entity forming part of a securitisation structure involving multiple vehicles may qualify as an FVC even if it does not directly issue the instruments referred to in Article 1(1)(b). For instance, in a structure where entity B issues securities and passes the proceeds as a bilateral loan to entity A that purchases and holds the assets, both entities A and B qualify as FVCs. Another entity between A and B (entity C) that receives funding from B and lends to A on its own or together with other creditors is also an FVC as it forms an integral part of the securitisation structure, together with A and B[6].

4 TRANSFER OF ASSETS AND/OR CREDIT RISK TO AN ENTITY SEPARATE FROM THE ORIGINATOR

4.1 SECURITISATION OF LOANS

To qualify as an FVC, the entity's principal activity must be that of carrying out securitisation transactions. The Regulation contains a definition of securitisation transaction in Article 1(2). Article 1(2) provides that such a transaction means a transfer of assets and/or of the credit risk associated with assets to the investors in the financial instruments issued by an entity separate from the originator. The most typical form of securitisation is the purchase of loans from a credit institution or another financial intermediary. However, for the purposes of the Regulation, it is irrelevant whether an entity purchases the loans directly from the original lender or from a third party (e.g. where a managed collateralised loan obligation vehicle purchases loans from the secondary market). In both cases the purchase constitutes a loan transfer to an entity that is not the originator.

On the other hand, where an entity primarily acts as a 'first' lender, originating new loans, the conditions of Article 1(2) are not met, since no asset (and hence no credit risk) is transferred to or purchased by the entity. Therefore, the following entities would, as a rule, not be considered as being engaged in a securitisation transaction, within the meaning of the Regulation:

- an entity that issues notes to investors and uses the proceeds to grant new loans on its own account, as opposed to purchasing them from another lender (this does not apply to vehicles lending to other vehicles within a multi-vehicle structure: see Section 3);
- a financing vehicle that raises funds in the capital markets in order to on-lend the proceeds to its sponsor;
- an entity that grants new loans to non-FVC customers and issues limited recourse notes to investors, i.e. notes

5 By way of example, consider a multi-seller ABCP programme sponsored by a euro area monetary financial institution (MFI). The programme consists of two commercial paper (CP) issuing conduits, one resident in the US and the other resident in the euro area. The proceeds of the CP issuance are used to finance purchases of receivables sold by three different customers of the bank (A, B and C) into the programme. Three dedicated vehicles (one per seller) hold the receivables sold into the programme. The receivables-holding vehicles are resident in the country of residence of the seller. A and B are euro area residents, C is resident in the UK. All of the vehicles/conduits involved would qualify as an FVC, but only the CP-issuing conduit in the euro area and the vehicles holding the receivables sold by A and B are subject to the Regulation due to the vehicle's residency.

6 This situation occurs not only because any other interpretation would lead to a circumvention of the reporting obligations but also because the criterion 'intends to carry out/carries out securitisation' is interpreted to include the activity of being part of, i.e. an interposed vehicle in, a multi-vehicle securitisation (where assets and/or credit risk is transferred to an entity that is separate from the originator) and because the activity of such an interposed vehicle is treated by its nature as issuing a debt instrument and/or owning assets underlying the issue of securities.

that are solely payable from collections from specific ring-fenced parts of its loan portfolio rather than from its general assets, but such entity does not transfer the ring-fenced loans to a separate entity.

4.2 TRANSFER OF CREDIT RISK

Article 1(2)(a) of the Regulation explains how the transfer of credit risk may be achieved. In principle, this will apply to most securitisations of loans, debt securities or re-securitisations of asset-backed securities. The transfer of credit risk may be achieved by transferring the assets subject to that risk (traditional securitisation) or by means of instruments that provide insurance against credit losses, without an actual transfer of assets taking place (synthetic securitisation).

In the case of economic transfer of the relevant assets, the actual transfer of legal title over them is not required[7]. For instance, a sub-participation arrangement will also constitute a transfer of the asset, as will any arrangement whereby the rights to the cash flows generated by the asset are transferred but strict legal ownership remains with the originator[8].

In the case of synthetic securitisation, credit derivatives, guarantees or any equivalent mechanism are used to achieve the transfer of credit risk without requiring an actual transfer of ownership of the assets. For instance, an MFI may enter into a credit default swap contract with an FVC whereby the MFI buys protection against a default within a portfolio of loans or bonds it owns. The FVC issues securities to investors whose proceeds are used to collateralise the FVC's potential obligations towards the MFI. The securities issued effectively bear the credit risk of the MFI's portfolio, usually because a reduction of their principal is triggered as a result of the occurrence of certain credit events in the insured portfolio. The Regulation does not require that any of the parties involved in a synthetic securitisation had, prior to the transaction, an actual exposure to any of the assets, entities or credit indices referenced by the credit derivatives involved. That is, the transfer of the credit risk to the investors in the securities issued by an entity that holds credit derivatives that are associated with a 'notional' portfolio of assets (as opposed to a 'real' portfolio actually owned by any of the parties involved) will still qualify as a transfer of credit risk to the investors in the securitisation, within the meaning of Article 1(2).

Finally, in both traditional and synthetic securitisation, the instruments issued to investors must not represent payment obligations of the originator (Article 1(2)(b)). For instance, in certain cases the issuance of covered bonds requires that these are transferred to an entity separate from the covered bond issuer, due to specific legislation and/or to ensure bankruptcy remoteness of the cover assets. However, principal and interest due on the covered bonds must still be paid by the issuer, irrespective of the collections made on the cover pool. Therefore, even though assets have been transferred to an entity, the transaction will not qualify as a securitisation because the covered bonds are direct, unconditional obligations of the 'originator' (the issuer and original lender in the claims used as cover assets).

4.3 ENTITIES THAT OFFER SYNTHETIC EXPOSURE TO NON-CREDIT RELATED ASSETS

Some entities may meet the issuance activity requirements under Article 1(1)(b) of the Regulation, but be set up primarily to create or otherwise offer synthetic exposure for its investors to an asset class outside the

7 While an FVC may be exposed to the economic risks associated with securitised assets through both traditional and synthetic structures, 'economic' transfer, as used here, means direct participation in an asset, as opposed to an exposure created through a derivative instrument or equivalent mechanism. A situation in which an FVC acquires such rights without acquiring legal title, which may typically remain with a trust company or the sponsoring MFI, will therefore differ from the legal form.

8 The originator may wish to retain the legal ownership of the asset while transferring the right to its cash flows for a variety of legal, regulatory and operational reasons, especially when it continues to service the asset.

credit universe, with the result that there is no transfer of credit risk. These entities may purchase assets of high credit standing, such as highly-rated government bonds, or place deposits with highly-rated credit institutions as a way to collateralise their obligations under the derivatives contracts or similar techniques used to create such an exposure. Even though a transfer of assets to the entity may have occurred (e.g. a purchase of government securities), such a transfer is only accessory to the principal activity of the entity which is the creation or transmission of the non-credit related synthetic exposure. Consequently, such an entity does not fulfil the requirement that its principal activity is securitisation within the meaning of Article 1(1) of the Regulation. An example would be an entity whose principal activity is the creation of synthetic exposure for its investors to equities, commodities or indices thereof, by means of derivatives or similar techniques.

4.4 SECURITISATION OF ASSETS OTHER THAN LOANS

An FVC may purchase financial assets other than loans as the basis for a securitisation, such as debt securities, shares or other equity. Secondary market purchases of such assets are considered to meet the requirements of Article 1(2) since 'originator' is understood in broad terms as 'transferor', as stated in Article 1(3).

Primary market purchases may appear less of a clear-cut case when the assets involved represent debt obligations, since the entity may in this case be seen as acting in a similar way to a loan originator lending to the primary market issuer. However, most primary market purchases are distinct from a loan origination in the sense that they involve the adhesion by the purchaser to a set of pre-determined terms that are identical or essentially similar to those on offer to other investors. In the light of this, the following should be generally considered as examples of investments that may constitute the basis for a securitisation:

- subscription of securities in a primary market offering;
- participation in a loan syndication, unless the vehicle has underwriting responsibilities[9];
- purchase of investment fund units in an open-end fund;
- purchase of an equity interest in an entity that is raising new or additional capital.

5 INDEPENDENCE FROM ACCOUNTING TREATMENT WHEN APPLYING THE FVC DEFINITION

The statistical treatment of securitisation transactions may not always be the same as their accounting treatment. Under some accounting standards, certain agreements designed for the economic transfer of an asset in a securitisation may not qualify as an asset transfer for accounting purposes[10]. This may impact the way in which the originator accounts for the securitised assets (e.g. a qualifying transfer of the asset is a pre-condition for derecognition by the originator) and potentially also the accounting treatment by the FVC, e.g. the FVC may not be permitted to recognise an asset that the originator has not derecognised.

In addition, even if the agreement qualifies as an asset transfer for accounting purposes, this does not ensure that the originator is permitted to derecognise the transferred assets, since further conditions regarding the degree of risk transferred by the operation may be required[11]. Failure to derecognise a securitised

9 Participation in loan syndications by a securitisation vehicle is to be reported nonetheless under securitised loans in the FVC reporting scheme. The point being made here is that participation as a mere investor does not constitute acting as a 'first' lender that originates new loans, and as a consequence, a vehicle doing this as its principal activity can still qualify as an FVC.

10 See, for instance, International Accounting Standard 39 (IAS 39), paragraph 19.

11 See, for instance IAS 39, paragraph 20.

asset leads to an accounting treatment in which the securitisation is seen as a collateralised borrowing by the originator from the vehicle.

Potential reporters should not rely on the accounting treatment applied to the transaction by the originator or by the vehicle to determine whether a transaction is a securitisation for the purposes of the Regulation. For instance, consider a transaction where a pool of mortgages is transferred by a bank to a vehicle by means of a sub-participation agreement. Assume that this specific agreement fails to qualify as an asset transfer for accounting purposes (e.g. because the agreement does not fulfil the IAS 39 requirement of remittance of cash flows by the originator without material delay). The entity may need to account for the transaction as a loan to the bank secured by the mortgage pool. However, it cannot be argued that for statistical reporting purposes under the Regulation the entity is considered an 'originator' or 'first' lender to the bank, as opposed to a purchaser of a mortgage pool, on the grounds that this view is consistent with the accounting treatment. The transaction would still qualify as a securitisation for the purposes of the Regulation since loans have been transferred by sub-participation to an entity that is separate from the originating bank. Hence the vehicle should show the loans with reference to the ultimate borrowers (and not to the bank) in its statistical balance sheet.

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ISBN 978-92-899-0824-5 (online)