Lithuanian Banking Association

www.lba.lt

SECURITISATION **GUIDELINES**

2024

DISCLAIMER

These guidelines have been prepared in accordance with the legal acts of the European Union and the Republic of Lithuania, best international and European market practices, and in consultation and coordination with the Bank of Lithuania.

The information we provide in these guidelines does not, and is not intended to, constitute legal advice; instead, all information, materials, and other content available are for general informational purposes only. Information provided herein may not constitute the most up-to-date legal or other information.

We recommend contacting a lawyer to obtain advice with respect to any particular legal without first seeking legal advice. Only a legal professional can provide assurances that the information contained herein – and your interpretation of it – is applicable or appropriate to your particular situation. Use of these guidelines does not create an attorney-client relationship between you and TGS Baltic, KPMG Baltics, UAB (hereinafter referred to as KPMG) or the authors and contributors of these guidelines.

It should be noted that, when applying the information in this Guidelines to a real-life securitisation, the actual individual facts and circumstances are vital to determining the accounting treatment. Therefore, it will generally not be possible to directly deduce the appropriate accounting treatment for the securitisation from the examples and other information in this Guidelines without further consideration. Time should be spent well in advance of executing the transaction in understanding the accounting consequences and given the subjective nature of some of securitisation assessments, it is important to involve the auditors, lawyers and/or other advisors of the Bank at an early stage to ensure that they do not hold any differing opinions.

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CHAPTER 1

GENERAL OVERVIEW

1.1. Purpose

These Securitisation Guidelines provide a general overview of the nature of securitisation and its types, focusing on traditional securitisation from investors' and originators' perspectives. In addition, the purpose of these Securitisation Guidelines is giving a roadmap of applicable core requirements over investors and originators with reference to applicable EU regulation, including applicable requirements applicable under Lithuanian law.

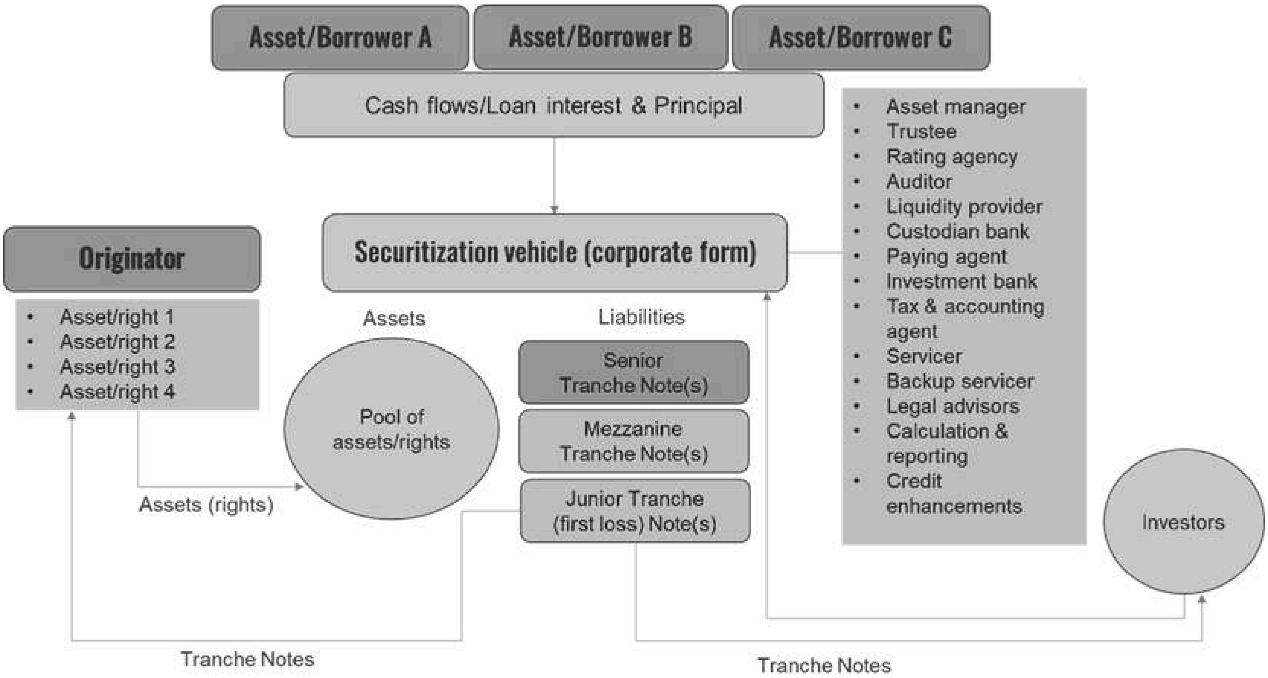
1.2. Introduction

From a capital market perspective, securitization can provide additional investment opportunities to institutional investors with differing asset diversification, risk and returns, and duration profiles. The repackaging of non-liquid assets or loans into new financial instruments enables conversion from illiquid to liquid securities. Investors can, therefore, gain exposure to different asset classes such as real estate, shipping, consumer finance, aviation, or vehicle leases without directly financing individual assets and violating investment policies or restrictions.

The main legal act that describes securitisation is the Securitisation Regulation, which covers two main areas. Firstly, it sets out provisions in relation to all securitisations within the scope of the regulation, consolidating and adding to the rules that previously applied to particular types of regulated entities. These provisions include requirements for securitisation of special purpose entities, due diligence, risk retention and transparency obligations, credit-granting standards, and a ban on resecuritisation, together with the relevant definitions. Secondly, the regulation sets out the criteria and other rules for simple, transparent, and standardized securitisations. The Securitisation Regulation is also supplemented by other legal acts that describe the applicable requirements in more detail.

The securitization process begins when an originator designs a marketable financial instrument by merging or pooling various financial assets, such as multiple mortgages, into one group. The Originator then sells this group of repackaged assets to the SPV, SPV issued notes and investors invest and takes the risk of pool of asset under SPV. Securitization offers opportunities for investors and frees up capital for originators, both of which promote liquidity in the marketplace.

The overview of true sale securitisation:



1.3. Regulation

The Securitisation Regulation has replaced the main securitisation provisions in sectoral legislation which were applicable to banks (CRR), insurers (Solvency II Directive) and fund managers (the AIFMD regime and, collectively, the Old EU Securitisation Framework) and provided a harmonised regime, which took effect on 1 January 2019. This new regime is applicable to all institutional investors (which now includes UCITS and pension funds) and originator/sponsor-type entities (whether or not regulated). In addition, the Securitisation Regulation has introduced the concept of the STS securitisation, and STS securitisations have received better regulatory treatment than other securitisations. The Securitisation Regulation will apply in respect of a) securities relating to securitisation transactions issued on or after 1 January 2019, and b) securitisation transactions issued prior to 1 January 2019 where new securities are issued on or after 1 January 2019. Securities issued in respect of securitisation transactions before 1 January 2019 can use the STS designation provided (a) that ESMA is notified of such an election and (b) the criteria set out in the Securitisation Regulation are met.

Until the new Level 2 measures are in place, existing provisions on risk retention and disclosure requirements will continue to apply.

EU regulation

Art.	Theme	Adopted by	Type	Subject	Law
6(7)	Risk retention	EBA	RTS	Risk retention details including modalities (Art 6(3)), measurement (Art 6(1)), no hedging/selling (Art 6(1)), consolidated basis (Art 6(4)), conditions for exemption based on index (correlation trading) (Art 6(6))	Draft Securitisation Regulation RTS
7(3)	Transparency requirements	ESMA	RTS	Information to be provided under Art 7(1) (a) and (e) (on underlying exposures and in periodic investor reports)	Securitisation Securitisation Disclosure RTS
7(4)	Transparency requirements	ESMA	ITS	Format of reports - standardised templates	Securitisation Disclosure ITS
8(5)	Ban on resecuritisation	ESMA	RTS	(Permitted) supplement to list of legitimate purposes for permitted resecuritisation (Art 8(3))	The technical standards mentioned in Article 8(5) have not yet entered into force.
17(2)	Availability of data held in repository	ESMA	RTS	Information to be provided under Art 7(1); templates; operational standards for collection, aggregation, comparison of data; information to which ESAs and the European Systemic Risk Board will have access; conditions of direct and immediate access	Securitisation Disclosure RTS

EU regulation

Art.	Theme	Adopted by	Type	Subject	Law
17(3)	Information to repository	ESMA	ITS	Standardised templates for information to be provided to repository.	Securitisation Disclosure ITS
19(2)	STS securitisation	EBA	Guidelines	Guidelines on harmonisation and application of STS requirements in Arts 20-22	Guidelines on the STS criteria for ABCP and non-ABCP securitisation
20(14)	Requirements re. simplicity	EBA	RTS	Which underlying exposures deemed homogeneous (Art 20(8))	RTS on homogeneity of the underlying exposures in securitisation
23(3)	STS ABCP securitisation	EBA	Guidelines	Harmonised interpretation and application of STS requirements in Arts 24-26	Guidelines on the STS criteria for ABCP and non-ABCP securitisation
24(21)	STS transaction level requirements	EBA	RTS	Which underlying exposures deemed homogeneous (Art 24(15))	RTS on homogeneity of the underlying exposures in securitisation

EU regulation

Art.	Theme	Adopted by	Type	Subject	Law
27(6)	STS notification requirements	ESMA	RTS	Information for originator/sponsor notification (Art 27(1))	RTS on STS Notifications and RTS on STS Notifications for on-balance-sheet synthetic securitisations
27(7)	STS notification requirements	ESMA	ITS	Templates for originator/sponsor notification (Art 27(6))	ITS on templates for the provision of information in accordance with the STS notification requirements
28(4)	Third party verifying STS compliance	ESMA	RTS	Information to be provided in application for authorisation (Art 28(1))	RTS adopted February 2019 and published in Official Journal.
36(8)	Cooperation between competent authorities and ESAs	ESMA	RTS	Cooperation obligation and information exchange (Art 36(1)); notification obligations (Art 36(4), (5))	RTS on the cooperation, exchange of information and notification obligations between competent authorities and ESMA, the EBA and EIOPA

For additional information see:

- ESAs' Opinion on Securitisation Regulation.
- Joint Committee Q&As relating to the Securitisation Regulation.
- ESMA Q&As on the Securitisation Regulation.
- EBRD Introduction of a Covered Bond and Securitisation Framework.

LITHUANIAN REGULATION

The Law on Securitisation and Covered Bonds.

Provisions of this Law describes the relations of traditional securitization, considering the peculiarities of the Lithuanian legal system:

- The rights to claim the assets must be transferred to the SPV whose ownership of the underlying assets is absolute and valid without any exceptions or conditions, and the transferred assets cannot be diverted to the claims of unsecured creditors, which is particularly relevant in the event of the seller's insolvency.
- The procedure for the assignment of rights of claim and the assignment of collateral and for informing debtors is being simplified.
- Assets must be pledged for the benefit of investors (and special creditors).
- A trustee's institute is established, whose task is to represent the interests of investors.
- The formation, management, activities, reorganization, supervision, and liquidation of the SPV (restricted activities, simple organizational structure) are regulated.

Accounting regulation

These Guidelines is intended to enhance the understanding of the reader of the basic principles of IFRSs 9 and 10. Therefore, the Guidelines does not contain an exhaustive description of all relevant aspects of IFRSs 9 or 10 that might be applicable in a particular securitisation.

These Guidelines contains information that is based on the current version of IFRSs 9 and 10 as per 31 December 2023. Any changes made to the standards, interpretations issued by the IASB or other relevant authoritative bodies, and/or changes in accepted practices for interpretating and applying the standards will to be taken into consideration by the users of the information in this Guidelines.

An aspect of a securitisation that is not covered by this guidelines is the classification and measurement of investments made by a Bank in the securities issued by the SPV, when cash flows from these instruments are linked to the performance of the underlying assets held by the SPV.

CHAPTER 2

SECURITISATION

2.1.Definition of Securitisation

Following Article 2(1) of the Securitisation Regulation which defines securitisation as a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is “tranched”, having all of the following characteristics:

(i)payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures, and
(ii)the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme, and
(iii) the transaction or scheme does not create exposures which possess all of the characteristics listed in Article 147(8) of CRR.

Following this, generally, securitisation involves transactions that enable a lender or a creditor – typically a credit institution or a corporation – to refinance a set of loans, exposures, or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables, by transforming them into tradable securities (but not necessarily). The lender pools and repackages a portfolio of its loans and organises them into different risk categories for different investors, thus giving investors access to investments in loans and other exposures to which they normally would not have direct access. Returns to investors are generated from the cash flows of the underlying loans. Nevertheless, there are numerous possible variations of the securitisation, not necessarily just the traditional securitisation which entails the true sale principle.

In addition, tranching refers to contractually established segments of the credit risk associated with an exposure or a pool of exposures, each containing different risks of credit loss (Article 2(6) of the Securitisation Regulation).

The Securitisation Regulation restricts sales of securitisation positions to MiFID II retail clients unless a MiFID II-compliant suitability test has been carried out by the seller on the client, and a number of other conditions have been met.

Subject to limited exceptions, the Securitisation Regulation prohibits re-securitisation as the creation of securitisations which include securitisation positions in their pool of underlying exposures (Article 8(1) of the Securitisation Regulation). Nonetheless, this prohibition does not affect securitisations where the securities are issued prior to 1 January 2019. While the resecuritisations are generally prohibited by the Securitisation Regulation, the competent authorities may authorise these transactions on a case-by-case basis (Article 8(2) of the Securitisation Regulation).

2.2. Types of the Securitisation

Traditional Securitisation

Pursuant to the Article 2(9) of the Securitisation Regulation, a traditional securitisation means a securitisation involving the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to an SPV or through sub-participation by an SPV, where the securities issued do not represent payment obligations of the originator. So in traditional securitisation there must be a) a transfer of ownership of the securitised exposures from the originator, and b) the securities issued do not represent payment obligations of the originator. Usually traditional securitisations are so called "true sale" securitisations.

STS Securitisation

Originators, sponsors and SSPEs may use the designation STS or simple, transparent and standardised, or a designation that refers directly or indirectly to those terms for their securitisation, only where:

(i)it meets all of the criteria set out in Chapter 4 of the Securitisation Regulation;
(i)ESMA has been notified; and
(ii)ESMA has added the securitisation to an official list of STS securitisation that it will maintain on website.

A securitisation cannot be designated as an STS securitisation unless the originator, sponsor and SSPE are established in the EU.

The eligibility criteria that an ABCP securitisation and a term securitisation must meet are broadly similar, however the criteria for ABCPs have been adapted to reflect the specificities of short-term securitisation, and distinguish between transaction, sponsor and programme-level criteria. The criteria for both types of securitisation focus more on the structure of the transaction, than on the quality of the underlying assets, and many of the criteria are quite vague.

Advantages of STS label

Notwithstanding the STS label, the investors will still have due diligence obligations. Nonetheless, the investors may derive comfort from the knowledge that the structure of the securitisation has rigorously examined to attain the STS label. Exposures to STS securitisations may also receive favourable regulatory capital treatment under the CRR if certain conditions are met.

Verification of compliance with STS eligibility criteria

Pursuant to Article 27(2) of Securitisation Regulation, an originator, sponsor or SSPE can avail of the services of an authorised third-party verification agent to check whether the securitisation transaction meets the STS eligibility criteria. However, the use of such service does not affect the liability of the originator, sponsor or SSPE i.e. the originator, sponsor and SSPE remain responsible for ensuring compliance with the STS eligibility criteria when making the notification to ESMA. Equally, the use of such a service does not relieve institutional investors of their due diligence obligations.

When carrying out due diligence prior to holding a securitisation position, institutional investors are, where the securitisation in question is an STS securitisation, required to assess compliance with the eligibility criteria set out in Chapter 4 of the Securitisation Regulation. They are allowed to "rely to an appropriate extent on the STS notification…and on the information disclosed by the originator, sponsor and SSPE …without solely or mechanistically relying on that notification or information" (Article 5(3)(c) of Securitisation Regulation). Thus, it is essential that investors make their own assessment under Article 5 of Securitisation Regulation, take responsibility for their investment decisions and do not mechanistically rely on such third parties. The involvement of a third party should not in any way shift away from originators, sponsors and institutional investors the ultimate legal responsibility for notifying and treating a securitisation transaction as STS (Recital 34 of the Securitisation Regulation).

Notification to ESMA

Pursuant to Article 27(1) of Securitisation Regulation, in the case of term securitisations, the originators and sponsors must jointly notify ESMA. For ABCP securitisations, only the sponsor must notify. The notification to ESMA must set out how the relevant STS eligibility criteria have been met. Originators and sponsors must also notify their competent authorities and agree between themselves who should be designated as the key point of contact. The originator and sponsor must also notify ESMA and their competent authorities when a securitisation designated as an 'STS securitisation' no longer meets the criteria for such a designation (Article 27(4) of Securitisation Regulation).
The STS notification to ESMA is also one of the items that must be disclosed by the originator, sponsor and SSPE as part of the detailed information they must disclose to holders of securitisation positions, competent authorities and (upon request) potential investors. Equally, if the securitisation no longer meets the eligibility criteria, that is a matter that must be disclosed by the originator, sponsor and SSPE without delay.

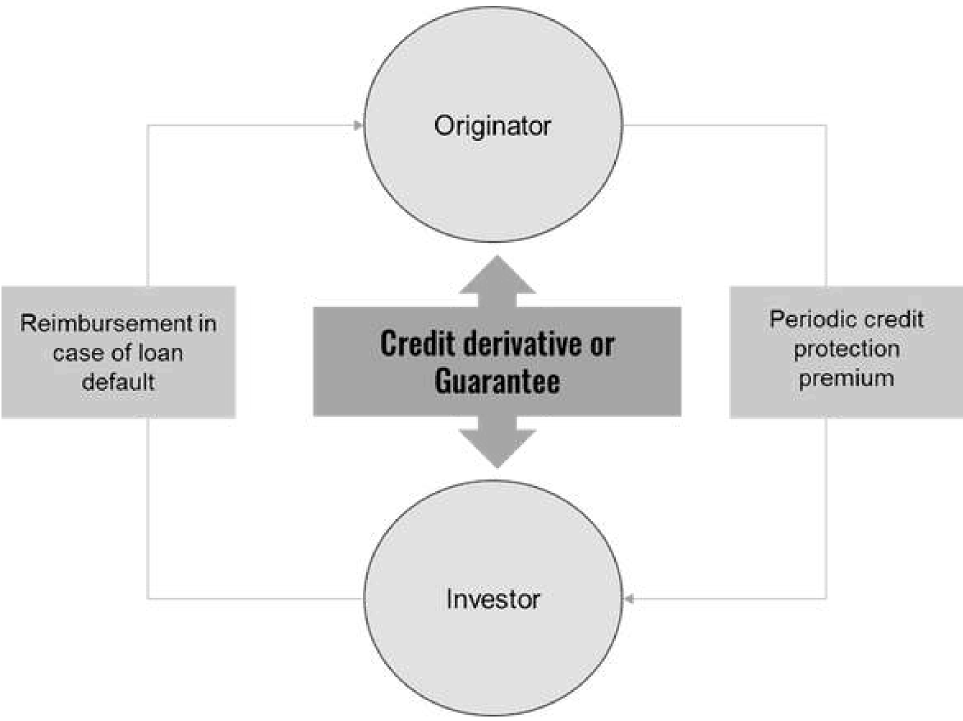
For more detailed information see:
- Guidelines on the STS criteria for ABCP and non-ABCP securitisation.

Synthetic securitisation

Pursuant to Article 2(10) of the Securitisation Regulation synthetic securitisation means a securitisation where the transfer of risk is achieved using guarantees or credit derivatives, and the exposures being securitised remain exposures of the originator. Thus, under synthetic securitisation transaction the assets are not sold but the whole or part of the risk of holding the assets is still effectively transferred using guarantees or derivative instruments. Guarantees are usually between the originator and one or more investors. Furthermore, there are two main ways of structuring a synthetic securitisation by using derivative instruments: i) using an SPV, which enters into a credit default swap (CDS) with the originator and then issues notes which transfer the risk under the CDS to capital markets investors, and ii) using one or more bi-lateral CDS between the originator and one or more investors. In general, under synthetic securitisation the originator retains ownership of the securitised assets, and these assets remain on the originator's balance sheet, but the transaction effectively provides credit protection to the originator on the assets and the originator may obtain a more favourable regulatory capital treatment.

The originator willing to obtain a more favourable regulatory capital treatment, has to qualify the transaction as synthetic securitisation pursuant to the Article 2(10) of the Securitisation Regulation and come to the conclusion that the guaranteed agreement may be qualified as being in compliance with the requirements under Article 245 of CRR. In general, a guarantee as unfunded credit protection could be a background for the originator obtain a more favourable regulatory capital treatment, if (among others) guarantee provider complies with eligibility criteria (Article 201 of CRR), the guarantee itself complies with eligibility criteria (Articles 203 and 201 – 217 of CRR), securitisation documentation does not contain terms or conditions listed in Article 245(4)(c) of CRR, and credit protection is enforceable in all relevant jurisdictions (Article 245(4)(d) of CRR) (including opinion from a qualified legal counsel confirming that (Article 245(4)(g) of CRR)).

Please find below the overview of synthetic securitisation:



Source: Deutsche Bank Research.

2.3. No “Cherry picking” in selection of assets to be securitised

Pursuant to article 6(2) of the Securitisation Regulations the originator will not be permitted to select assets to be transferred to a SPV (ie to be securitised) with the aim of rendering losses on such assets measured over the life of the transaction (or a maximum of 4 years where the life of the transaction is longer than 4 years), higher than the losses over the same period on “comparable assets” held on the balance sheet of the originator. This is intended to prevent originators from taking advantage of the fact that they could hold more information in respect of the assets than investors. The recitals to the Securitisation Regulation note that this is intended to catch an intentional (rather than a negligent) transfer of assets with a higher credit risk profile.

The recitals also provide that the assets being securitised can have a higher-than-average credit risk profile compared with the average credit risk profile of comparable assets that remain on the balance sheet of the originator, as long as the higher credit risk profile of the assets is “clearly communicated” to the investors or potential investors (Recital 11 of the Securitisation Regulation).

2.4. Securitisation transactions’ parties

2.4.1. Originator

Originator is usually an owner and “generator” of the assets to be securitised. Pursuant to the Article 2(2) of the Securitisation Regulation an originator means an entity which:

(i)itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or

(ii)purchases a third party’s exposures on its own account and then securitises them.

There is no requirement (direct or indirect) on any non-EU originator, sponsor, original lender or SPV to comply with the Securitisation Regulation if: a) each of the originator, sponsor, original lender or SPV is established and located outside the EU; and b) no EU institutional investor invests in the exposures created by that securitisation.

Nonetheless, the Securitisation Regulation requires EU institutional investors to confirm as part of their regulatory due diligence that any securitisation transaction in which they invest complies with relevant requirements. As a result, the Securitisation Regulation may apply indirectly to non-EU entities to the extent securitisation positions are offered to EU institutional investors. So voluntary compliance by originators, sponsors, original lenders plan to sell securitisation exposures to EU institutional investors, these non-EU entities would be indirectly required to comply with the Securitisation Regulation, because EU institutional investors are subject to due diligence requirements under Article 5 of the Securitisation Regulation (see more Chapter 3.2 Disclosure requirements over originator, sponsor and SPV of the Guidelines). Accordingly, non-EU originators, sponsors, original lenders and SPV need to consider the impact of the Securitisation Regulation when deciding whether to market to EU institutional investors.

2.4.2. Original lender

Article 2(20) states that the “original lender” means an entity which, itself or through related entities, directly or indirectly, concluded the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised.

Original lenders or originators use securitisation:

(i)to transfer to investors (and thus 'eliminate') the risk that loans will not be serviced in a timely manner; and more broadly, partly reduce the problem of asset-liability mismatch;

(ii)to decrease their interest costs, by de-linking the rating of the securitised products from their own rating;

(iii)to diversify funding sources, since securitisation extends the investor pool available to an entity.

2.4.3. Institutional investor

Article 1(2) of the Securitisation Regulation states that the Securitisation Regulation applies to institutional investors. The term "institutional investor" is defined in Article 2(12) of the Securitisation Regulation:

(i)an insurance undertaking as defined in point (1) of Article 13 of the Solvency II Directive;

(ii)a reinsurance undertaking as defined in point (4) of Article 13 of the Solvency II Directive;

(iii)an institution for occupational retirement provision falling within the scope of the IORPs (1) in accordance with Article 2 thereof, unless a Member States has chosen not to apply that IORPs in whole or in parts to that institution in accordance with Article 5 of the IORPs; or an investment manager or an authorised entity appointed by an institution for occupational retirement provision pursuant to Article 32 of the IORPs;

(iv) an alternative investment fund manager (AIFM) as defined in point (b) of Article 4(1) of the AIFMD that manages and/or markets alternative investment funds in the Union;

(v)an undertaking for the collective investment in transferable securities management company, as defined in point (b) of Article 2(1) of the UCITS;

(vi) an internally managed UCITS, which is an investment company authorised in accordance with the UCITS and which has not designated a management company authorised under that Directive for its management;

(vii) a credit institution as defined in point (1) of Article 4(1) of CRR for the purposes of that CRR or an investment firm as defined in point (2) of Article 4(1) of CRR.

In general, the definition of institutional investor under the Securitisation Regulation covers: a) EU-regulated banks (including investment firms), b) EU-regulated insurers (including reinsurers), c) alternative investment fund managers (AIFMs) either established in the EU or with a full EU passport, d) EU pension funds (and the investment managers who manage their assets); e) UCITS funds (whether self-directed or UCITS management companies); and f) non-EU AIFMs that manage and/or market alternative investment funds in the EU (even when they are only marketing into the EU on a private placement basis using so-called "Article 42 registrations").

2.4.4. Special Purpose Vehicle (SPV)

Legal form and status of SPV. The legal form of the SPV varies by jurisdiction and Article 2(2) of the Securitisation Regulation does not limit this variety. The Law on Securitisation and Covered Bonds does not limit the legal form of SPV which could be established in Lithuania or to which the assets could transferred (Article 2(12) of the Law on Securitisation and Covered Bonds). In addition, it should be noted that SPV which falls under the definition pursuant to the Article 2(2) of the Securitisation Regulation it should not be considered a financial sector entity, as its sole purpose is to isolate the obligations of the SPV from those of the originator. According to Article 4(2) of the Law on Securitisation and Covered Bonds, SPV is not subject to any additional authorisation, permissions or licensing.

Place of establishment. Pursuant to Article 4 of the Securitisation Regulation SPV shall be established in EU country or any other third country unless this third country: (a) is listed as a high-risk and non-cooperative jurisdiction by the FATF; (b) has not signed an agreement with a Member State to ensure that that third country fully complies with the standards provided for in Article 26 of the OECD Model Tax Convention on Income and on Capital or in the OECD Model Agreement on the Exchange of Information on Tax Matters, and ensures an effective exchange of information on tax matters, including any multilateral tax agreements. In addition, the Law on Securitisation and Covered Bonds does not foresee any additional limitations over the place of establishment of the SPV.

Restrictions on SPV activities. The concept of an SPV is key to securitisation. An SPV is a legal entity created by a firm (known as the sponsor or originator) by transferring assets to the SPV, to carry out some specific purpose or circumscribed activity, or a series of such transactions. SPVs have no purpose other than the transaction(s) for which they were created, and they can make no substantive decisions; the rules governing them are set down in advance and carefully circumscribe their activities. Under Article 2(2) of the Securitisation Regulation, SPV means a corporation, trust or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SPV from those of the originator. Therefore, with the aim to ensure that the SPV will not enter into insolvency proceedings itself, its activities are restricted to the acquisition and funding of the assets (and absolutely necessary ancillary activities such as asset servicing and hedging). As a result, SPV may not create security interests over its assets or transfer its assets for any purposes, except to secure the obligations SPV has assumed under securitisation transaction or in favour of its investors (Article 14 of the Law on Securitisation and Covered Bonds). In addition, SPV may not sale, transfer or otherwise assign its assets except in accordance with the provisions laid dawn in the Law on Securitisation and Covered Bonds SPV‘s Articles of Association (Article 13 of the Law on Securitisation and Covered Bonds).

True sale. In a true sale securitisation, the originator sells a pool of its assets (often, receivables generated in the ordinary course of its business) to an SPV. It is imperative that once the sale and transfer of the assets to the SPV has been effected, it cannot be challenged, voided or otherwise reversed in an insolvency of the originator or otherwise. This concept is referred to as true sale. Otherwise, if the transaction is not structured properly, the transaction could be construed as a security assignment rather than a "true sale" transaction. Whether a transaction constitutes a true sale under the applicable law (notably, whether it will be recognized as such by the competent court in the originator's insolvency) must be established through a legal analysis of the transaction.

Under the Securitisation Regulation only STS securitisations have to ensure that underlying exposures shall be acquired by the SPV by means of a true sale or assignment or transfer with the same legal effect in a manner that is enforceable against the seller or any other third party. The transfer of the title to the SSPE shall not be subject to severe clawback provisions in the event of the seller's insolvency (Article 20 of the Securitisation Regulation). Nonetheless, the Law on Securitisation and Covered Bonds implements the principle that under Lithuanian law all assets acquired by SPV under securitisation transaction would be executed under true sale principle (Article 7 of the Law on Securitisation and Covered Bonds).

It is important to note, that mere compliance with the formalities is not sufficient to satisfy a thorough legal analysis that a sale has been completed, and additional features of the transaction must also be considered in this context. As far as "true sale" securitisations are concerned, the transfer of the assets is typically ascertained on the basis of certain criteria that demonstrate that the assets have indeed been isolated from the originator's balance sheet. Therefore, the provision of a true sale legal opinion by relevant legal counsel is typically expected in a securitisation transaction.

Bankruptcy remoteness. An essential feature of an SPV is that it be bankruptcy remote. This means that should the shareholder of the SPV enter a bankruptcy procedure, the shareholder's creditors cannot seize the assets of the SPV. It also means that the SPV itself can never become legally bankrupt. The most straightforward way to achieve this would be for the SPV to waive its right to file a voluntary bankruptcy petition, but this legally could be unenforceable. The only way to completely eliminate the risk of either voluntary or involuntary bankruptcy is to create the SPV in a legal form which activities can be restricted. For instance, under Article 2(2) of the Securitisation Regulations the SPV activities are limited to carrying out one or more securitisations. In addition, under Article 14 of the Law on Securitisation and Covered Bonds the SPV may not create security interests over its assets or transfer its assets for any purposes, except to secure the obligations it has assumed under securitisation in favour of investors or other creditors in securitisation transaction. As a result, bankruptcy remoteness feature derives from relevant national law regulation and transaction documentation. Whether a transaction constitutes a bankruptcy remoteness principle under the applicable law, must be established through a legal analysis of the transaction. Therefore, as a common practice there is to have a legal opinion regarding bankruptcy remoteness in securitisation transactions.

2.4.5. Services providers (auditors, liquidity providers, etc.),

The following service providers could be involved in the securitisation transaction:

- ***Servicer** — services the assets to be securitised (frequently the Originator retains this role). Where receivables are securitised, the Servicer will collect, administer and, if necessary, enforce the receivables.*

- ***Back-up Servicer** — will service the assets in the event the Servicer is unable to service them, or in the event the Purchaser exercises its right to remove the Servicer (for instance, as a result of the insolvency of the Servicer).*

- ***Liquidity Facility Provider** — provides a liquidity facility in relation to certain tranches of the asset-backed securities. Typically, a liquidity facility is provided in conduit transactions where the Purchaser issues revolving short-term commercial paper to fund the purchase of the assets. The Purchaser may draw upon the liquidity facility if it is unable to refinance maturing commercial paper because of a market disruption. The liquidity facility thus secures commercial paper investors against a default in such a case. Liquidity facilities are also sometimes required in standalone securitisations.*

- ***Lead Manager** — arranger and structurer of the transaction (in the context of conduit transactions, also referred to as Programme Administrator). The Lead Manager is often the primary distributor of the asset-backed securities in a particular transaction. Individual distributors are also referred to as Managers.*

- ***Rating Agencies** —rate the asset-backed securities. The three key rating agencies in securitisation are Standard & Poor's, Moody's and Fitch.*

- ***Hedge Providers** — hedge any currency or interest rate exposures the SPV may have.*

- ***Cash Administrator** — provides banking and cash administration services to the SPV.*

- ***Security Trustee** — acts as a trustee for the secured creditors of the SPV (notably, holds the SPV's assets granted to it as security for the SPV's obligations, on behalf of the Investors).*

- ***Note Trustee** — acts on behalf of the holders of the asset-backed securities.*

- ***Auditors** — if necessary, they audit the asset pool as may be required under the documentation of the relevant transaction.*

CHAPTER 3

TRADITIONAL SECURITISATION AND ORIGINATORS

3.1. Risk Retention

Under Article 6 of the Securitisation Regulations, one of the originator, sponsor or original lender is required retain a net economic interest of at least 5% in the securitisation. This is known as the 'direct' risk retention obligation as it places the onus on the originator, sponsor or original lender to retain. Nonetheless, even if none of the originator, sponsor or original lender is established in the EU, and so none of them is subject to the EU (as applicable) direct retention obligation, one of them will still need to comply with equivalent requirements in order for EU institutional investors to be able to invest in the securitisation. This is known as the 'indirect' risk retention obligation as it places an onus on the investing institutions to ensure that the originator, sponsor or original lender retains at least 5% of the net economic interest of any securitisation in which it invests.

Article 6 of the Securitisation Regulation sets out risk retention requirements that apply to all securitisations which fall under the scope of Securitisation Regulation. The purpose of the requirement to retain a material net economic interest is to align the interests between two sets of parties in a securitisation: the sell-side parties that transfer the credit risk of the securitised exposures, and the investors that assume or purchase the credit risk. The retention requirement is essential to ensuring that the sell-side parties retain an on-going stake in the securitisation's performance ("skin in the game") and, thus, to preventing the reoccurrence of the "originate to distribute" model.

Overview of the regulation over risk retention in the EU. A 5% risk retention requirement was first introduced in the EU by way of the Capital Requirements Directive II to new securitisations issued on or after 1 January 2011. These provisions were superseded by an equivalent requirement in the CRR and similar to those in the CRR, in the Solvency II Directive regime in relation to insurers and in the AIFMD regime in relation to certain alternative fund managers.

The CRR Risk Retention RTS supplements and provides further detail in respect of the risk retention requirement in the CRR by way of regulatory technical standards including providing further detail on the modes of risk retention, the fulfilment of the retention requirement through a synthetic or contingent form (eg a total return swap (TRS)), and on multiple originators, original lenders, or sponsors.

The European Commission, following review of the various requirements applicable to EU securitisations, published the Securitisation Regulation on 28 December 2017 and an accompanying Regulation amending the CRR (the CRR Amendment Regulation). These regulations entered into force on 17 January 2018, superseding the CRR, Solvency II Directive and AIFMD risk retention requirements, largely combining requirements applicable to EU investors and creating new requirements in respect of originators, sponsors or original lenders of EU securitisations, and applicable to securitisations, the securities of which are issued (or where no securities are issued, the securitisation positions of which are created) on or after the application date of 1 January 2019.

Article 6(7) of the Securitisation Regulation requires the EBA to develop draft regulatory technical standards to specify in greater detail the risk retention requirement including the modalities of retaining risk, the measurement of the level of retention, the prohibition of hedging or selling the retained interest and the conditions for retention on a consolidated basis. On 1 April 2022, Draft Securitisation Regulation RTS was published by the EBA. However, the Draft Securitisation Regulation RTS have not yet been adopted by the European Commission. The transitional provisions of the Securitisation Regulation provide that until the Draft Securitisation Regulation RTS apply, originators, sponsors or the original lender shall apply Chapters I, II and III and Article 22 of the CRR Risk Retention RTS to securitisations the securities of which are issued on or after 1 January 2019.

For more detailed information see:
(i)Article 6 of the Securitisation Regulation;

(ii)The CRR Risk Retention RTS;

(iii)Draft Securitisation Regulation RTS[1];

3.1.1. Main requirement of the Risk Retention

In general, the originator, the sponsor or the original lender shall keep a material net economic interest in the securitization of at least 5% on an ongoing basis for as long as the investor interests or other non-retained securitisation exposures remain outstanding (5% of nominal value of tranches sold to investors (for vertical slice option) or 5% of nominal value of securitised exposures (for other retention options)).

In order to ensure the ongoing retention of the material net economic interest, retainers should ensure that there is no embedded mechanism in the securitisation structure by which the retained material net economic interest measured at origination would necessarily decline faster than the interest transferred. Similarly, the retained material net economic interest should not be prioritised in terms of cash flows to preferentially benefit from being repaid or amortised such that it would fall below 5% of the ongoing nominal value of the tranches sold or transferred to investors or the exposures securitised, or the 5% net value in the case of non-performing exposures of traditional NPE securitisations. Moreover, the credit enhancement provided to the investor assuming exposure to a securitisation position should not decline disproportionately to the rate of repayment on the underlying exposures. This should not prevent the retainer from being remunerated on a priority basis for services rendered to the securitisation's special purpose entity, provided that the remuneration's amount is set on an arm's length basis and the structure of such remuneration does not undermine the retention requirement.

*[1] **Draft Securitisation Regulation RTS** specify in greater detail the risk retention requirements and, in particular:*
i) requirements on the modalities of retaining risk,
ii) the measurement of the level of retention,
iii) the prohibition of hedging or selling the retained interest,
iv) the conditions for retention on a consolidated basis,
v) the conditions for exempting transactions based on a clear, transparent and accessible index,
vi) the modalities of retaining risk in case of traditional securitisations of non-performing exposures, and
vii) the impact of fees paid to the retainer on the effective material net economic interest.

3.1.2. Retainers of a material net economic interest

Under the Securitisation Regulations, the retention must be held by the originator, sponsor, or original lender. Where the originator, sponsor or original lender have not agreed between them who will retain the material net economic interest, the originator has to retain. There can be no multiple applications of the retention requirements for any given securitisation. The material net economic interest cannot be split amongst different types of retainers, and it cannot be subject to any credit risk mitigation or hedging (Article 6(1) of the Securitisation Regulation) but hedges of the net economic interest are permitted where they do not hedge the retainer against the credit risk of either the retained securitisation positions or the retained exposures (Article 12 of the Draft Securitisation Regulation RTS). In the case of traditional NPE securitisations, the requirement of risk retention also could be fulfilled by the "servicer" who can demonstrate that it has expertise in servicing exposures of a similar nature to those securitised and that it has well-documented and adequate policies, procedures and risk-management controls in place relating to the servicing of exposures and who can fulfil expertise requirement following Article 18 of the Draft Securitisation Regulation RTS.

Pursuant to Article 2(3) of the Securitisation Regulation, an "**originator**" is an entity which:

(i)itself (or through related entities), directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor (or potential debtor) giving rise to the exposure being securitised, or

(ii)purchases a third party's exposures for its own account and then securitises them.

In addition, an entity shall not be considered to be an originator where it has been established or operates for the "sole" purpose of securitising exposures (paragraph 2 of Article 6(1) of the Securitisation Regulations). This is to avoid the possibility of an "originator" being created for risk retention purposes that meets the legal definition but is not an entity of real substance. The meaning of "sole purpose" has been clarified in the Draft Securitisation Regulation RTS (Article 2(7) of the Draft Securitisation Regulation RTS) which provides that, in assessing whether an entity has been established or operates, for the "sole purpose" of securitising exposures, appropriate consideration shall be given to two principles, which both should be met:

(i)the entity has a business strategy and the capacity to meet payment obligations from sources other than the exposures being securitised or retained interests, consistent with a broader business enterprise, and

(ii)the responsible decision makers have the required experience to enable the entity to pursue the established business strategy, as well as an adequate corporate governance arrangement.

Pursuant to Article 2(5) of the Securitisation Regulation, a "**sponsor**" means a credit institution, whether located in the EU or not, as defined in point (1) of Article 4(1) of the CRR, or an investment firm as defined in point (1) of Article 4(1) of the MiFID II other than an originator, that: (a) establishes and manages an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities, or (b) establishes an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities and delegates the day-to-day active portfolio management involved in that securitisation to an entity authorised to perform such activity in accordance with the UCITS, the AIFMD or the MiFID II. The definition of "sponsor" for the purposes of the Securitisation Regulation includes "investment firms" as defined in MiFID II. The MiFID II definition of investment firm is not limited by jurisdiction and so, on a literal interpretation of the Securitisation Regulation, it appears that non-EU entities could also act as sponsors. However, it is not clear that this was the legislators' intention, and this point remains unclear whether a sponsor may be located in any country.

Pursuant to Article 2(20) of the Securitisation Regulation, an "**original lender**" is an entity which (itself or through related entities) directly or indirectly concluded the original agreement which created the obligations (or potential obligations) of the debtor (or potential debtor) giving rise to the exposures being securitised.Pursuant to Article 2(13) of the Securitisation Regulation, a "**servicer**" means an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis.

3.1.3. Forms of Risk Retention

There are a variety of methods by which the originator, sponsor or original lender may retain the risk. According to Article 6(3) of the Securitisation Regulation, calculating the net economic interest can involve one of five different methods:

(**i)Vertical slice:** the retention of at least 5% of the nominal value of each class of notes / tranche, i.e. a vertical slice throughout the tranche structure (Article 6(3)(a) of the Securitisation Regulation, Article 5 of the CRR Risk Retention RTS);
(ii)Originator interest (revolving assets): retention of an interest in revolving assets equal to at least 5 percent of the nominal value of the underlying assets, i.e., of each of the securitized exposures (a pari passu share) (Article 6(3)(b) of the Securitisation Regulation, Article 6 of the CRR Risk Retention RTS);
(iii)On-balance sheet (random selection): retention of an interest in randomly selected assets equal to at least 5 percent of the nominal value of the portfolio, provided selection is made from a pool comprising not less than 100 potentially securitised exposures from which retained and securitised exposures are randomly selected (Article 6(3)(c) of the Securitisation Regulation, Article 7 of the CRR Risk Retention RTS);
(iv)First loss tranche in securitisation: retention of the most subordinated payment obligation in the structure, i.e. a horizontal slice. If the first loss tranche is less than 5% of the securitized exposures, the retained piece shall be complemented by additional tranches of higher risk and longer maturity than the ones sold to investors (Article 6(3)(d) of the Securitisation Regulation, Article 8 of the CRR Risk Retention RTS);
(v)First loss exposure: retention of first loss exposure in each underlying asset, amounting to at least 5% of each exposure (Article 6(3)(e) of the Securitisation Regulation, Article 9 of the CRR Risk Retention RTS).

The net economic interest may not be hedged in any way so as to ensure that the retaining originator, sponsor or original lender shares the losses when the underlying assets are not performing (Article 6(1) of the Securitisation Regulation, Article 12 of the CRR Risk Retention RTS).

Vertical slice: the retention of not less than 5% of the nominal value of each of the tranches sold or transferred to investor

The retention of not less than 5 % of the nominal value of each of the tranches sold or transferred to investors may be complied with through any of the following methods:

(i)the retention of not less than 5 % of the nominal value of each of the securitised exposures, provided that the retained credit risk ranks pari passu with or is subordinated to the credit risk securitised in relation to the same exposures;

(ii)the provision, in the context of an ABCP programme, of a liquidity facility, where the following conditions are met:

a)the liquidity facility covers 100% of the share of the credit risk of the securitised exposures of the relevant securitisation transaction that is being funded by the respective ABCP programme;

b)the liquidity facility covers the credit risk for as long as the retainer has to retain the material net economic interest by means of such liquidity facility for the relevant securitisation transaction;

c)the liquidity facility is provided by the originator, sponsor or original lender in the securitisation transaction;

d)the investors have been given access to appropriate information within the initial disclosure to enable them to verify that points (a)-(c) are complied with.

(iii)the retention of an exposure which exposes its holder to the credit risk of each issued tranche of a securitisation transaction on a pro-rata basis (vertical tranche) of not less than 5 % of the total nominal value of each of the issued tranches.

Originator interest (revolving assets): the retention of the originator's interest in a revolving securitisation or securitisation of revolving exposures

The retention of the originator's interest of not less than 5% of the nominal value of each of the securitised exposures shall only be considered fulfilled, where the retained credit risk of such exposures ranks pari passu with or is subordinated to the credit risk securitised in relation to the same exposures.

On-balance sheet (random selection): the retention of randomly selected exposures equivalent to not less than 5% of the nominal value of the securitised exposures

The pool of at least 100 potentially securitised exposures from which retained and securitised exposures are randomly selected shall be sufficiently diverse to avoid an excessive concentration of the retained interest.

When carrying out the selection of retained exposures, the retainer shall take into account appropriate quantitative and qualitative factors to ensure that the distinction between retained and securitised exposures is random. The retainer of randomly selected exposures shall take into consideration, where appropriate, factors such as vintage, product, geography, origination date, maturity date, loan to value ratio, property type, industry sector, and outstanding loan balance when selecting exposures.

The retainer shall not designate different individual exposures at different points in time, except where this may be necessary to fulfil the retention requirement in relation to a securitisation in which the securitised exposures fluctuate over time, either due to new exposures being added to the securitisation or to changes in the level of the individual securitised exposures.

Where the retainer is the securitisation's servicer, the selection conducted shall not lead to a deterioration in the servicing standards applied by the retainer on the transferred exposures relative to the retained exposures.

First loss tranche in securitisation: the retention of the first loss tranche

The retention of the first loss tranche may be fulfilled by holding either on-balance sheet or off-balance sheet positions and by any of the following methods:

(i)provision of a contingent form of retention or of a liquidity facility in the context of an ABCP programme, provided that each of these methods meets all of the following criteria:

a)it covers at least 5% of the nominal value of the securitised exposures;

b)it constitutes a first loss position in relation to the securitisation;

c)it covers the credit risk for the entire duration of the retention commitment;

d)it is provided by the retainer;

e)the investor have been given access within the initial disclosure to appropriate information to enable them to verify that points (a)-(d) are complied with.

(ii)overcollateralisation[2], if that overcollateralisation operates as a 'first loss' position of not less than 5% of the nominal value of the securitised exposures.

Where the first loss tranche exceeds 5% of the nominal value of the securitised exposures, it shall be possible for the retainer to only retain a pro-rata portion of such first loss tranche, provided that this portion is equivalent to at least 5% of the nominal value of the securitised exposures.

*[2] '**overcollateralisation**' means any form of credit enhancement by virtue of which underlying exposures are posted in value which is higher than the value of the securitisation positions.*

First loss exposure: the retention of a first loss exposure of not less than 5% of every securitised exposure

The retention of a first loss exposure at the level of every securitised exposure shall only be considered to be fulfilled, where the retained credit risk is subordinated to the credit risk securitised in relation to the same exposures. The retention may also be fulfilled by the sale at a discounted value of the underlying exposures by the originator or original lender, where each of the following conditions is satisfied:

(i)the amount of the discount is not less than 5% of the nominal value of each exposure;

(ii)the discounted sale amount must be refundable to the originator or original lender if, and only if, such discounted sale amount is not absorbed by losses related to the credit risk associated to the securitised exposures.

3.1.4. Risk retention exemptions

Pursuant to Article 6(5) and 6(6) of the Securitisation Regulation there are some limited exemptions when risk retention requirement described in Article 6(1) of the Securitisation Regulation shall not apply:

(i)where the securitised exposures are exposures on or exposures fully, unconditionally, and irrevocably guaranteed by (Article 6(5) of the Securitisation Regulation):
- a)central governments or central banks;
- b)regional governments, local authorities and public sector entities[3];
- c)institutions to which a 50 % risk weight or less is assigned under CRR;
- d)national promotional banks or institutions[4];
- e)the multilateral development banks listed in Article 117 of CRR.

(ii)to transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than securitisation positions (Article 6(6) of the Securitisation Regulation).

However, Article 13 of the Draft Securitisation Regulation RTS states that the transactions referred to in Article 6(6) of the Securitisation Regulation and listed above shall include securitisation positions in the correlation trading portfolio which are reference instruments satisfying the criterion in Article 338(1) point (b) of CRR or are eligible for inclusion in the correlation trading portfolio.

3.1.5. Risk Retention in NPE securitisation

The Articles 9 and 18 of the draft Securitisation Regulation RTS specify how to apply the risk retention options on traditional NPE securitisations, with reference to the net value of non-performing exposure. They also set out requirements for a servicer to be considered to have the necessary expertise to act as retainer in traditional NPE securitisations and the criteria that the servicer should meet to be able to demonstrate that they have the required expertise in the servicing of non-performing exposures.

*[3] '**public sector entity**' means a non-commercial administrative body responsible to central governments, regional governments or local authorities, or to authorities that exercise the same responsibilities as regional governments and local authorities, or a non-commercial undertaking that is owned by or set up and sponsored by central governments, regional governments or local authorities, and that has explicit guarantee arrangements, and may include self-administered bodies governed by law that are under public supervision.*
*[4] '**national promotional banks or institutions**' means legal entities carrying out financial activities on a professional basis which are given a mandate by a Member State or a Member State's entity at central, regional or local level, to carry out development or promotional activities.*

3.2. Disclosure requirements over originator, sponsor and SPV

Disclosure of information relating to a securitisation is crucial and necessary for investors and it enables investors in securitisation positions and potential investors to effectively conduct due diligence and understand the risks involved: the credit risks of the underlying exposures, the model risk, the legal risk, the operational risk, the counterparty risk, the servicing risk, the liquidity risk, and the concentration risk. It also allows for the competent authorities to monitor the functioning of securitisation markets.

Article 7 of Securitisation Regulation sets out disclosure requirements that apply to all securitisations, including for public and private securitisations. It requires the manufacturers of a securitisation to make available certain information to investors in securitisation positions, competent authorities and, upon request, to potential investors.

Also, it should be noted that in case there is a public securitisation Prospectus Regulation would be applicable in respect of disclosure requirements as well.

For more detailed information see:
(i)Article 7 of Securitisation Regulation;
(ii)Securitisation Disclosure RTS;
(iii)Securitisation Disclosure ITS;
(iv)XML schemas for required Securitisation Disclosures.

3.2.1.Scope of information to be disclosed

The information that needs to be disclosed includes at least the following information:

(i)Information on the underlying exposures;
(ii)Documentation that is essential to understanding the securitisation transaction;
(iii)An STS notification (where relevant);
(iv) Regular investor reports, including relevant data on the credit quality and performance of underlying exposures, trigger events, cash flow modelling and information about risk retention; and
(v)Inside information which the Originator, Sponsor and SPV are required to make public in accordance with Article 17 of the Market Abuse Regulation on insider dealing and market manipulation.

The information on the underlying exposures and the investor reports shall be complete and consistent. Where the reporting entity identifies factual errors in any information that it has made available to the investors, it shall make available, without undue delay, a corrected report of all information about the securitisation required under Securitisation Disclosure RTS.

3.2.1.1. Information on the underlying exposures

Scope: information which has to be made available for a non-ABSP securitisation is specified in the following annexes of Securitisation Disclosure RTS:

(i)Annex II for loans to private households secured by residential real estate, regardless of the purpose of those loans;

(i)Annex III for loans for the purposes of acquiring commercial real estate or secured by commercial real estate;

(ii)Annex IV for corporate underlying exposures, including underlying exposures to micro, small- and medium-sized enterprises;

(iii)Annex V for automobile underlying exposures, including both loans and leases to legal or natural persons backed by automobiles;

(iv) Annex VI for consumer underlying exposures;

(v)Annex VII for credit card underlying exposures;

(vi) Annex VIII for leasing underlying exposures;

(vii)Annex IX for underlying exposures that do not fall within any of the categories set out in points (a) to (g).

Information which has to be made available for ABCP securitisation is specified in Annex XI of Securitisation Disclosure RTS.

The table below summarises the various templates available and their applicability for each type of securitisation.

Annexes of Securitisation Disclosure ITS		**Securitisation type**	**Reporting sections**
Annex II	Underlying exposures – residential real estate	Non-ABCP	• Underlying exposure • Collateral
Annex III	Underlying exposures – commercial real estate	Non-ABCP	• Underlying exposure • Collateral • Tenant
Annex IV	Underlying exposures – corporate	Non-ABCP	• Underlying exposure • Collateral •
Annex V	Underlying exposures – automobile	Non-ABCP	• Underlying exposure

Annexes of Securitisation Disclosure ITS		Securitisation type	Reporting sections
Annex VI	Underlying exposures – consumer	Non-ABCP	• Underlying exposure
Annex VII	Underlying exposures – credit cards	Non-ABCP	• Underlying exposure
Annex VIII	Underlying exposures – lasing	Non-ABCP	• Underlying exposure
Annex IX	Underlying exposures – esoteric (other underlying exposure type)	Non-ABCP	• Underlying exposure • Collateral
Annex X	Underlying exposures – add-on non-performing exposures	Non-ABCP	• Underlying exposure • Collateral • Historical collections
Annex XI	Underlying exposures	ABCP	• Underlying exposure type

Reference date of the information being reported: the information to be made available shall be on: (a) active underlying exposures as at the data cut-off date; (b) inactive underlying exposures that were active underlying exposures at the immediately-preceding data cut-off date.

Frequency: information on the underlying exposures on a quarterly basis shall be made available simultaneously each quarter at the latest one month after the due date for the payment of interest or, in the case of ABCP transactions, information on the underlying receivables or credit claims monthly, shall be made available simultaneously at the latest one month after the end of the period the report covers.

Information granularity: in non-ABCP securitisation the information will be made available on the following - underlying exposures, collaterals, tenants, historical collections, cashflows, tests/events/triggers (Article 4(1) of Securitisation Disclosure RTS). For ABCP securitisation the information will be made available as listed in Article 4(2) of Securitisation Disclosure RTS.

Information timeliness: Where a securitisation is not an ABCP securitisation, the information on the underlying exposures made available shall not have a data cut-off date later than two calendar months prior to the submission date. Where a securitisation is an ABCP securitisation the information specified in Annex XI of Securitisation Disclosure RTS shall not have a data cut-off date later than two calendar months prior to the submission date.

3.2.1.2. Documentation that is essential to understanding the securitisation transaction

Scope: all underlying documentation (or summary of the documentation concerned) that is essential for the understanding of the securitisation transaction, including but not limited to, where applicable, the following documents have to be provided:

(i)the final offering document or the prospectus together with the closing transaction documents, excluding legal opinions;

(ii)for traditional securitisation the asset sale agreement, assignment, novation or transfer agreement and any relevant declaration of trust;

(iii)the derivatives and guarantee agreements, as well as any relevant documents on collateralisation arrangements where the exposures being securitised remain exposures of the originator;

(iv)the servicing, back-up servicing, administration and cash management agreements;

(v)the trust deed, security deed, agency agreement, account bank agreement, guaranteed investment contract, incorporated terms or master trust framework or master definitions agreement or such legal documentation with equivalent legal value;

(vi)any relevant inter-creditor agreements, derivatives documentation, subordinated loan agreements, start-up loan agreements and liquidity facility agreements.

Also, the underlying documentation shall include a detailed description of the priority of payments of the securitisation. In addition, in case there is a private securitisation, the potential investors has to be provided with a transaction summary or overview of the main features of the securitisation including, where applicable:

(i)details regarding the structure of the deal, including the structure diagrams containing an overview of the transaction, the cash flows and the ownership structure;

(ii)details regarding the exposure characteristics, cash flows, loss waterfall, credit enhancement and liquidity support features;

(iii)details regarding the voting rights of the holders of a securitisation position and their relationship to other secured creditors;

(iv) a list of all triggers and events referred to in the documents provided in accordance with point 3.2.1.2 of the Guidelines above that could have a material impact on the performance of the securitisation position.

In case there is a public securitisation and there was prepared prospectus, a summary will be provided pursuant to and in compliance with Prospectus Regulation.

3.2.1.3. Regular investor reports, including relevant data on the credit quality and performance of underlying exposures, trigger events, cash flow modelling and information about risk retention

Scope: investor reports should contain the following:

(i)all materially relevant data on the credit quality and performance of underlying exposures;

(ii)information on events which trigger changes in the priority of payments or the replacement of any counterparties, and, in the case of a securitisation which is not an ABCP transaction, data on the cash flows generated by the underlying exposures and by the liabilities of the securitisation;

(iii)information about the risk retained, including information on which of the modalities provided for in Article 6(3) has been applied, in accordance with Article 6.

Detailed information on investor reports which has to be made available in non-ABCP securitisation is specified in Annex XII of Securitisation Disclosure RTS and in ABCP securitisation is specified in Annex XIII Securitisation Disclosure RTS. The table below summarises the templates available and their applicability for each type of securitisation.

Annexes of Securitisation Disclosure ITS		Securitisation type	Reporting sections
Annex XII	Investor report	Non-ABCP	• Securitisation • Test/triggers • Cash flows
Annex XIII	Investor report	ABCP	• Securitisation programme • Transaction • Test/triggers

Frequency: quarterly reports in case of non-ABCP securitisation basis shall be made available simultaneously each quarter at the latest one month after the due date for the payment of interest or, in the case of ABCP transactions, monthly reports shall be made available simultaneously at the latest one month after the end of the period the report covers.

Information timeliness: Where a securitisation is not an ABCP securitisation, the information made available under reports shall not have a data cut-off date later than two calendar months prior to the submission date. Where a securitisation is an ABCP securitisation: (a) the information specified in the 'transaction information section' in Annex XIII of Securitisation Disclosure RTS shall not have a data cut-off date later than two calendar months prior to the submission date; (b) the information specified in all sections of Annex XIII of Securitisation Disclosure RTS other than the 'transaction information section' shall not have a data cut-off date later than one calendar month prior to the submission date.

3.2.1.4. Inside information which the manufacturers are required to make public, or information on significant events, such as material breaches of obligations under the securitisation transaction documents and/or changes in the securitisation, such as its structural features or risk characteristics

Scope: in case there is a public securitisation, inside information and information on significant events which has to be made available in public non-ABCP securitisation is specified in Annex XIV of Securitisation Disclosure RTS and in public ABCP securitisation is specified in Annex XV of Securitisation Disclosure RTS.

In case there is a private securitisation, the investors should be informed about the followingsignificant events:

(i)a material breach of the obligations provided for in the documents made available in accordance with point (b), including any remedy, waiver or consent subsequently provided in relation to such a breach;

(ii)a change in the structural features that can materially impact the performance of the securitisation;

(iii)a change in the risk characteristics of the securitisation or of the underlying exposures that can materially impact the performance of the securitisation;

(iv)in the case of STS securitisations, where the securitisation ceases to meet the STS requirements or where competent authorities have taken remedial or administrative actions;

(v)any material amendment to transaction documents.
The table below summarises the templates available and their applicability for each type of securitisation.

Annexes of Securitisation Disclosure ITS		**Securitisation type**	**Reporting sections**
Annex XIV	Inside information or significant events	Non-ABCP	• Securitisation • Tranches/bonds • Accounts • Counterparties • Ratings per counterparty • CLO information • CLO managers • Protection instruments • SPV collaterals • Collaterals • Additional information
Annex XV	Inside information or significant events	ABCP	• Securitisation • Transactions • Tranches/bonds • Accounts • Counterparties

Information granularity in public securitisation: in non-ABCP securitisation the information under Annex XIV of Securitisation Disclosure RTS will be made available on the following – the tranches/bonds in securitisation, accounts, counterparties and others as listed in Article 8(1) of Securitisation Disclosure RTS. For ABCP securitisation the information under Annex XV of Securitisation Disclosure RTS will be made available pursuant to Article 8(2) of Securitisation Disclosure RTS.

Information timeliness: Where a securitisation is an ABCP securitisation: (a) the information specified in Annex XV of Securitisation Disclosure RTS shall not have a data cut-off date later than two calendar months prior to the submission date; (b) the information specified in all sections of Annex XV of Securitisation Disclosure RTS other than the 'transaction information section' shall not have a data cut-off date later than one calendar month prior to the submission date.

Timing: without prejudice to MAR Regulation, the information shall be made available without delay.

3.2.2. Entity under obligation of disclosure requirements

Originator, the sponsor and the SSPE shall agree among themselves which of them will be a designated entity to be the first point of contact for potential investors, holders of securitisation position and competent authorities, and to carry out the disclosure requirements pursuant to Article 7 of the Securitisation Regulation. In addition, a such designated entity responsible for reporting the information has to be indicated in the securitisation documentation.

3.2.3. Method of information disclosure

There are no regulatory requirements on the form or method how information should be disclosed to the investors, when there is a private securitisation. In case there is a public securitisation, the information to the investors should be disclosed by means of a securitisation repository. The list of securitisation repository could be found on ESMA website[5]. Information about the securitisation repository has to be indicated in the securitisation documentation as well.

The method of disclosure varies depending on whether the requisite information pertains to public or private transactions. Following this, the mechanisms for disclosure depend on the type of the transaction:

(i)in public securitisations, the information to the investors should be disclosed by means of a securitisation repository. As of 30 June 2021, the following entities are registered as Securitisation Repositories for the EU: (a) European DataWarehouse GmbH based in Germany; and (b) SecRep B.V. based in the Netherlands. The whole list of securitisation repository could be found on ESMA website[6]. Information about the securitisation repository has to be indicated in the securitisation documentation as well; and

(ii)in private securitisations, there are no regulatory requirements on the form or method how information should be disclosed to the investors. Thus, the required information should be provided directly to investors and to the competent authorities upon theirs request.

[5] https://www.esma.europa.eu/sites/default/files/library/esma_register_secr.xlsx
[6] https://www.esma.europa.eu/sites/default/files/library/esma_register_secr.xlsx

3.2.4. Protection of personal data and confidentiality

When complying with this disclosure requirements, the originator, sponsor and SSPE of a securitisation shall comply with national and Union law governing the protection of confidentiality of information and the processing of personal data to avoid potential breaches of such law as well as any confidentiality obligation relating to customer, original lender or debtor information, unless such confidential information is anonymised or aggregated. As a result, the originator, sponsor and SSPE of a securitisation has to comply with the following:

(i)personal data: personal data must be processed in accordance with the provisions of applicable legal acts of Lithuania as well as the GDPR, which requires: (a) legal and fair data processing; (b) limited data collection and purpose; (c) data accuracy and security; (d) respect for data subject rights; (e) consent when needed; (f) risk assessments for high-risk processing; (g) data breach reporting.

(ii)information confidentiality: in applicable legal acts of Lithuania, it is stated that the SPV must keep a commercial secret and all information received during the securitisation confidential. This information may be provided to the third parties who provide services related to the collateral assets if confidentiality agreements have been signed. In addition, it is specified that disclosure of information constituting the secret of a bank[7], central credit union, credit union, payment institution, electronic money institution to the SPV is not considered disclosure of the secret of a bank, central credit union, credit union, payment institution, electronic money institution, if such information is disclosed for the purpose of to execute securitisation.

3.3. Originator and CRR

The Chapter 5 “Securitisation” of CRR sets the rules for how securitisation must be assessed when calculating capital requirements, both for the credit institution that carries out the securitisation (originator) and for the credit institution that invests in the financial instruments created during the securitisation (investor).
Sponsor or originator institutions may exclude securitized exposures from risk-weighted exposure amount (RWEA) calculations if either of the following conditions is fulfilled:

- significant credit risk arising from the securitized exposures is deemed to have been transferred to third parties according to CRR (Section 2 "Recognition of Significant Risk Transfer", especially Articles 244 and 245)
- the originator institution applies a 1250% risk weight to all securitisation positions it holds in the securitisation or deducts these securitisation positions from Common Equity Tier 1.

Where an originator institution has transferred significant credit risk associated with the underlying exposures of the securitisation it shall calculate the risk-weighted exposure amounts as set out in Chapter 5 “Securitisation” of CRR for the positions that it may hold in the securitisation (for more detailed information see section “Credit institutions as investors and CRR” below).

*[7] **Bank secret** is any non-public information related to the European Central Bank system and other information used in the activities of the Bank of Lithuania, which by its importance does not constitute a state and official secret, but whose illegal disclosure or loss may have negative consequences for the functioning of the Bank of Lithuania and its execution activities, to harm the legitimate interests of other persons.*

Otherwise, the underlying exposures must be treated as if they were not securitised.

Originator institution shall not be required to calculate risk-weighted exposure amounts for any position it may have in the securitisation but shall continue including the underlying exposures in its calculation of risk-weighted exposure amounts and, where relevant, expected loss amounts as if they had not been securitised.

EBA Guidelines on Significant Credit Risk Transfer clarify that it should no longer be sufficient for originator institutions to execute transactions for capital relief simply by applying the mechanistic tests, but that such transactions will be subject to the scrutiny of National Competent Authorities (NCAs) to demonstrate how the risk transferred is not only significant but also commensurate to the level of capital relief being sought. Banks should have a robust SRT set-up, not only at origination but also throughout the life of the transaction.

Article 250 of CRR sets out restrictions on providing implicit support. For more detailed information refer to CRR and EBA Guidelines on Implicit Support for Securitisation Transactions.

Additional guidelines have been prepared for banks that are under direct supervision by ECB:

- ECB Guidelines on the Recognition of Significant Credit Risk Transfer; and
- ECB Guidelines on information on transactions which go beyond the contractual obligations of a sponsor institution or an originator institution.

CHAPTER 4

TRADITIONAL SECURITISATION AND INVESTORS

Since the Securitisation Regulation establishes a general framework for securitisation, nonetheless it in particular sets out detailed due diligence (including risk retention and other verification requirements) that must be conducted by institutional investors (other than the originator, sponsor or original lender) before and whilst holding an exposure to a securitisation. The aim of this section is to provide a guidance to the Securitisation Regulation due diligence requirements and to explain, in broad terms, what the due-diligence requirements are and additionally to provide potential investors with some practical guidance as to what information should be obtained and where this information can be obtained from.

Under Article 5 of the Securitisation Regulation, an institutional investor (other than the originator, sponsor or original lender) is required:

(i)prior to holding a securitisation position, to verify compliance with credit granting standards and the risk retention and transparency requirements,

(ii)prior to holding a securitisation position, to carry out a due diligence assessment which enables it to assess the risks involved; and

(iii)while holding a securitisation position, to establish and perform ongoing monitoring, stress tests and internal reporting and recording.

An institutional investor may delegate its due diligence obligations to an investment manager, who would become subject to the applicable sanctions and/or remedial measures which may be imposed by the relevant supervisory authority in the applicable Member State if it fails to fulfil such obligations, instead of the institutional investor, following Article 5(5) of the Securitisation Regulation.

For more detailed information see:

(i)Article 5 of the Securitisation Regulation;

(ii)CRR Risk Retention RTS;

(iii)EBA Report on Securitisation Risk Retention, Due Diligence and Disclosure;

(iv) Targeted consultation on the functioning of the EU securitisation framework.

4.1. Investor's own due diligence process prior to holding securitisation position

According to Article 5 of the Securitisation Regulation, prior to holding a securitisation position an institutional investor is required to carry out a due-diligence assessment which enables the investor to assess the risks involved in both the securitisation position and the underlying exposures. The due-diligence assessment also includes verification of the risk retention requirements an originator, sponsor or original lender has now a direct obligation to comply with.

In broad terms, an institutional investor needs to confirm the following:

(i)The investor needs to assess whether the originator (or original lender) complies with the credit granting requirements. Investors should be aware that the Securitisation Regulation specifies different credit granting criteria dependent upon whether the originator / original lender is a credit institution and / or whether it is based in the EU or a third-country (Articles 5(1)(a) and 5(1)(b) of the Securitisation Regulation):

a)If the originator or original lender established in the EU and is not a credit institution or an investment firm as defined in points (1) and (2) of Article 4(1) of the CRR[8], the investor needs to assess whether the originator or original lender grants all the credits giving rise to the underlying exposures on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits and has effective systems in place to apply those criteria and processes in accordance with Article 9(1) of the Securitisation Regulation (Article 5(1)(a) of the Securitisation Regulation);

b)If the originator or original lender established in the non-EU, the investor needs to assess whether the originator or original lender grants all the credits giving rise to the underlying exposures on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits and has effective systems in place to apply those criteria and processes to ensure that credit-granting is based on a thorough assessment of the obligor's creditworthiness (Article 5(1)(b) of the Securitisation Regulation).

[8] **'credit institution'** means an undertaking the business of which consists of any of the following:

(a) to take deposits or other repayable funds from the public and to grant credits for its own account;

(b) to carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/, where one of the following applies, but the undertaking is not a commodity and emission allowance dealer, a collective investment undertaking or an insurance undertaking: (i) the total value of the consolidated assets of the undertaking is equal to or exceeds EUR 30 billion; (ii) the total value of the assets of the undertaking is less than EUR 30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in that group that individually have total assets of less than EUR 30 billion and that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU is equal to or exceeds EUR 30 billion; or (iii) the total value of the assets of the undertaking is less than EUR 30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in the group that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU is equal to or exceeds EUR 30 billion, where the consolidating supervisor, in consultation with the supervisory college, so decides in order to address potential risks of circumvention and potential risks for the financial stability of the Union; for the purposes of points (b)(ii) and (b)(iii), where the undertaking is part of a third-country group, the total assets of each branch of the third-country group authorised in the Union shall be included in the combined total value of the assets of all undertakings in the group.

'investment firm' means an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU which is authorised under that Directive but excludes credit institutions.

(ii)Check that the originator, original lender or sponsor (the risk retention holder) complies, or will be complying once the transaction closes, with the 5% risk retention requirements (Article 5(1)(c) of the Securitisation Regulation). Institutional investors should note the risk retention requirements also apply to third country (i.e.: non-EU) risk retention holders as well (Article 5(1)(d) of the Securitisation Regulation), although the obligations do differ slightly for a EU-based risk retention holder.

a)If the originator or original lender established in the EU, the institutional investor should check whether the originator, sponsor or original lender retains on an ongoing basis a material net economic interest in accordance with Article 6 of the Securitisation Regulation (Risk retention) and check whether the originator, sponsor or SPV has made all the required disclosures regarding risk retention and disclosed it to the institutional investor in accordance with Article 7 of the Securitisation Regulation (Article 5(1)(e) of the Securitisation Regulation);

b)If the originator or original lender established in a non-EU, the institutional investor should check whether the originator, sponsor or original lender retains on an ongoing basis a material net economic interest which, in any event, shall not be less than 5 %, determined in accordance with Article 6 of the Securitisation Regulation, and discloses the risk retention to institutional investors;

Institutional investors should be able to verify compliance with the risk retention requirements by looking at the disclosure set out in the prospectus, or, with respect to transactions not requiring a prospectus, the underlying transaction documents or risk retention memo customarily provided by legal counsel, and in regular investor reports.

(iii)Check that the originator, sponsor or SPV has made all the required disclosures as required under the Securitisation Regulation (see section 3.2 Disclosure Requirements Originator, Sponsor and SPV of the Guidelines).

Once the part of due diligence is completed under Article 5(1) of the Securitisation, the institutional investor has to look at the actual assets and has to assess the risk involved (Article 5(3) of the Securitisation Regulation). When assessing the risks involved, at the very least, the following need to be taken into account:

a)the risk characteristics of the individual securitisation position;

b)the risk characteristics of the underlying exposures; and

c)all the structural features of the securitisation that can materially impact the performance of the securitisation position (e.g., the contractual priorities of payment, priority of payment-related triggers, credit enhancements, liquidity enhancements, market value triggers, and transaction-specific definitions of default).

STS securitisation: if the securitisation has (or will have on close) an STS designation, an institutional investor may place some reliance on this STS notification, and on the information disclosed by the originator, sponsor or SPV about its compliance with the STS requirements. However, institutional investors should be aware that reliance by the institutional investor on the STS designation should not in any way be considered as a substitute for completing their own due diligence required under the Securitisation Regulation (Article 3(c) of the Securitisation Regulation).

Sources of the relevant information

An initial set of documents that any investor initiating their due diligence process should start with is a list of the minimum information an originator, sponsor or SPV is legally required to provide to an investor under Article 7 of the Securitisation Regulation. These disclosures are expected to emerge as a minimum that regulators will require the institutional investors to consider when analysing securitisation investments.

To assess the risk of the individual securitisation position an investor should also look at the: i) representation of standard cash flow sequence (waterfall) of the transaction; ii) details of structural triggers leading to different waterfalls being activated; and iii) potential for conflict with other investors, particularly where concepts such as controlling class are utilised in determining voting rights. This information can be found in the prospectus (if public securitisation), transaction summary (if applicable) or underlying transaction documentation.

An investor can get a good idea of the risk of the exposures underlying the securitisation position by looking at:

(i)loan level data appropriate to underlying asset type. It should be noted that under the Securitisation Regulation transparency requirements, EU-established originator, sponsor or SPV is required to provide template-based quarterly loan-level and investor reporting and certain ad hoc disclosures in the case of a significant change (please see Section Reporting to Investors);
(ii)portfolio stratification tables, analysed for identification of any notable patterns or concentrations;
(iii)representation of borrower credit quality particularly in transactions backed by non-granular loan portfolios or backed by unsecured borrowings such as credit cards; and
(iv)external credit rating agency assessments.

4.2. Investor's own due diligence process while holding securitisation position

An institutional investor is required to perform due diligence on an ongoing basis once position in securitisation is held. Thus, an institutional investor, holding a securitisation position, shall at least:

(i)establish appropriate written procedures in order to monitor performance of the securitisation position and of the underlying exposures (Article 5(4)(a) of the Securitisation Regulation). For example, those written procedures could include monitoring of the exposure type, the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure, recovery rates, repurchases, loan modifications, payment holidays, collateral type and occupancy, and frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification, frequency distribution of loan to value ratios with band widths that facilitate adequate sensitivity analysis, etc.
Where the underlying exposures are themselves securitisation positions, as permitted under Article 8 of the Securitisation Regulation, institutional investors shall also monitor the exposures underlying those positions.

(ii)regularly perform stress tests on the cash flows and collateral values of the underlying exposures or on loss assumptions (Article 5(4)(b) of the Securitisation Regulation). The stress tests could take the form of sensitivities on loss assumptions such as reverse stress testing to understand the impact of the probability of default (PD) and the loss given default (LGD). These also need to take into account structural features such as triggers, priorities of payments etc.

(iii)must have in place an appropriate governance framework that identifies the risks associated with securitisation investments and ensures that senior management is informed of how these risks are managed (Article 5(4)(d) of the Securitisation Regulation).

(iv)be able to demonstrate, to its competent authorities, that it has a comprehensive and thorough understanding of the securitisation position and its underlying exposures and that it has implemented written policies and procedures for the risk management of the securitisation position and for maintaining records of the verifications and due diligence in accordance Article 5 of the Securitisation Regulation and of any other relevant information (Article 5(4)(e) of the Securitisation Regulation). Thus, the investors need to have suitable systems in place to facilitate the necessary record keeping. Documentation will need to cover related processes and procedures, for example risk manuals and Securitisation Regulation compliance checklists for different transaction types.

In case of fully supported ABCP programme, an institutional investor, holding a securitisation position, shall at least regularly perform stress tests on the solvency and liquidity of the sponsor and be able to demonstrate to its competent authorities, upon request, that it has a comprehensive and thorough understanding of the credit quality of the sponsor and of the terms of the liquidity facility provided (Article 5(4)(f) of the Securitisation Regulation). Investors need to understand the nature of liquidity support, when it will be activated and to what extend it covers defaults as well as dilutions on assets.

4.3. Credit institutions as investors and CRR

Securitisation exposures are the subject to hierarchy of approaches for determining regulatory capital as set out in Chapter 5 “Securitisation” of CRR.

Institutions shall use one of the methods to calculate risk-weighted exposure amounts in accordance with the following hierarchy:

(i)where the conditions set out in Article 258 are met, an institution shall use the SEC-IRBA;

(ii)where the SEC-IRBA may not be used, an institution shall use the SEC-SA;

(iii)where the SEC-SA may not be used, an institution shall use the SEC-ERBA for rated positions or positions in respect of which an inferred rating may be used.

(iv) Securitization exposures to which none of these approaches can be applied must be assigned a 1250 percent RW (i.e., 100 percent capital charge).

For rated positions or positions in respect of which an inferred rating may be used an institution shall use the SEC-ERBA instead of the SEC-SA in cases described in Article 254 of CRR.

Additional information is provided in the following documents:

- EBA Guidelines on the Determination of the WAM of the contractual payments due under the tranche;
- ITS on Supervisory Reporting amendments with regards to COREP securitisation.

CHAPTER 5

ACCOUNTING FOR SECURITIZATION OF LOANS

5.1.The content of the accounting section

This chapter contains descriptions of the accounting treatment of a securitisation in the balance sheet and profit and loss statement in;

- The separate financial statements of the Bank (section 5.3)
- The consolidated financial statements of the Bank, being the sponsor/originator of the structure (section 5.4)
- The separate financial statements of the securitisation vehicle (section 5.5)

The document also provides information on the principles in IFRS for the accounting for issued or held financial guarantees, sometimes referred to as “synthetic securitisations” (section 5.6).

In the last section (section 7) the accounting treatment for the holder of the notes issued by the SPV is discussed.

5.2.Assumptions

In some jurisdictions it is a requirement that the originator, sponsor, or original lender of a securitisation has to retain a minimum economic interest in the securitisation on an ongoing basis. This is for instance the case in the EU where the Securitisation regulation ("SECR", EU 2017/2402) requires not less than a 5% interest. The originator or sponsors retention of risk in the underlying assets raises question around whether the assets can be derecognised or not. In this section it is assumed that the Bank retains exposure to risk of the transferred assets by issuing financial guarantees. In section 4 below it instead assumed that the Bank retains its exposure to risk by investing in some of the notes issued by the SPV as illustrated in Figure 1 below.

The descriptions in the sections below build on an assumption that the Bank has originated mortgage loans and sells the originated loans to a securitisation vehicle (SPV). We assume that the SPV has raised capital in order to finance the purchase of the loans from the Bank by issuing notes. We also assume that these notes are divided into three different tranches. Graphically, the scenario can be illustrated in the following way:

Figure 1 Illustration of some aspects of the assumed structure of the securitisation

The cash flows of the issued notes will depend on how much of the contractual cash flows of the purchased mortgages are ultimately collected. Therefore, the return to the holder of the notes will be affected by the credit losses that are incurred by the SPV. The junior note is the note whose cash flow to the holder will be first affected by the credit losses of the SPV, and the senior notes the last.

It should be noted that, according to IFRS 9, an accounting transfer may be achieved through a "pass-through arrangement" meeting the criteria in IFRS 9.3.2.5, in addition to a transfer of legal title to the loans. However, this document only discusses the situation where a transfer of a legal title to the mortgage loans has taken place even if it in practice is common to use "pass-through arrangements" rather than a legal sale of the loans.

Hence, we assume that the rights to the cash flows of the underlying loans have been transferred from the Bank to the SPV. This means that the criteria of IFRS 9.3.2.4(a) have been met.

We also assume that the cash flows have been transferred in their entirety and that the derecognition principles should be applied to the group of assets in their entirety (IFRS 9.3.2.2).

The examples in section 3 are based on a transfer of short-term loans since this requires less complex analysis of the transfer of variability in cash flows of the transferred asset.

5.2.1. Steps of the IFRS derecognition decision tree that are not covered by this guidelines

The steps of the derecognition decision tree in IFRS 9B.3.2.1 that are subject to the analysis and visualization in section 3 are shown in Figure 3.

We have excluded from further analysis and discussion the steps of the derecognition tree that can be seen in Figure 2, for reasons explained in the following sub-sections.

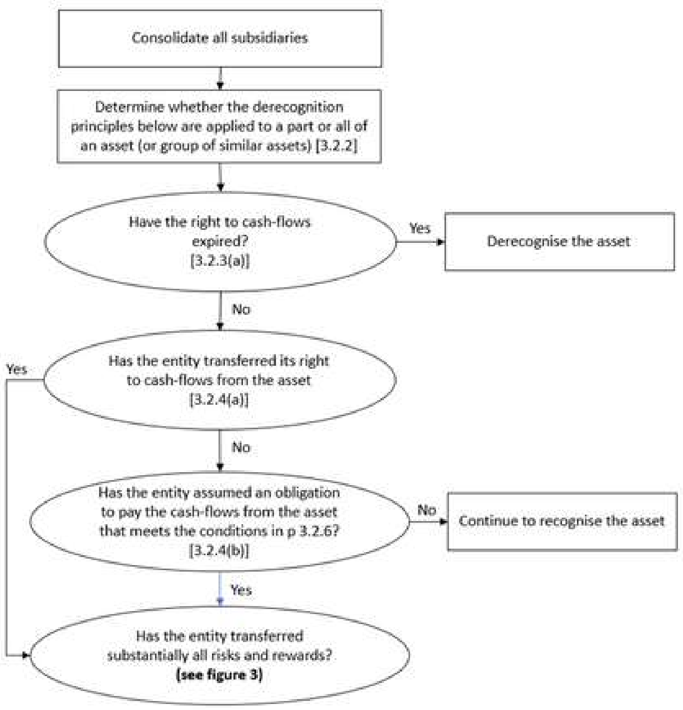


Figure 2 Other aspects of the derecognition decision tree of IFRS 9 that are not covered in this guidelines

5.2.1.1. Consolidate all subsidiaries

In section 3 when the matter of derecognition is discussed for the separate financial statements of the Bank, the matter to consolidate all subsidiaries is not relevant.. The matter of whether the SPV should be consolidated or not is covered in section 4 where the accounting in the consolidated financial statements of the Bank is discussed.

5.2.1.2. Application to part or all of an asset

In the examples used in this guidelines, we have assumed that all the cash flows of the loans have been sold in their entirety by the Bank to the SPV. Therefore, there is no doubt in that the derecognition principles should be applied to the assets in their entirety.

However, if the sale only relates to some assets or some part of the assets, this matter needs to be analysed and determined as an initial step before performing the analysis of the transfer of risks and rewards.

It should be noted that if the Bank were to retain its 5% exposure to the risk of the portfolio by randomly selecting 5% of the assets by name (i.e. retaining 100% of the risk of the selected 5% of the assets and no exposure to the risks of the remaining 95% of the individual assets), the Bank would continue to recognise the selected 5% of the assets and derecognise the remaining 95% of the individual assets.

5.2.1.3. Has the right to cash flows of the asset expired?

If the rights to cash flows of an asset have expired, the asset is derecognised. It is not possible to sell such an asset. Therefore, this matter is not covered any further by this Guidelines.

5.2.1.4. Has the entity transferred its right to the cash flows of the asset?

This guidelines builds on the example of a sale of assets from a Bank to a SPV i.e. that the Bank has transferred its right to cash flows from the portfolio. We are therefore not elaborating in how it should be determined if Bank has transferred its rights to cash flows from the portfolio of loans.

5.2.1.5. Has the entity assumed an obligation to pay the cash flows from the asset that meets the conditions in 3.2.4(a)

It could instead be the case that the Bank does not transfer its rights to the cash flows from the loans (for instance by transfer of legal title to the loans) but instead assumes a contractual obligation to pay those cash flows to one or more entities, where the criteria of IFRS 9.3.2.5 are met (a so-called “pass-through-arrangement”).

Determining whether these criteria are met or not sometimes requires judgement, and the Bank may need to consult with its auditors, lawyers and/or advisors to conclude on this.

Since the examples in this guidelines build on the assumption that the Bank sells the loans (i.e. transfers legal title of the loans) to the SPV, we do not elaborate on how to determine if the conditions in IFRS 9.3.2.(a) are met.

5.3.The accounting treatment in the separate financial statements of the Bank

In this section we discuss the matter of derecognition in the stand-alone financial statements of the transferor (i.e. the Bank) based on the following steps of the "derecognition decision tree" illustrated in IFRS 9.B3.2.1.

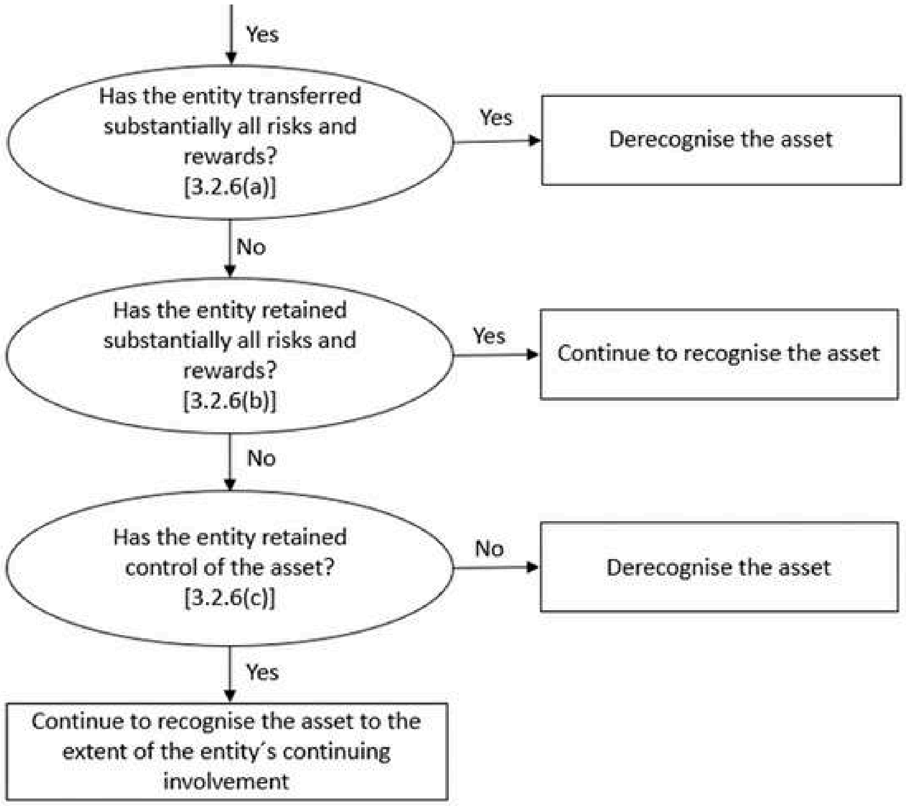


Figure 3

Relevant aspects of IFRS 9 on derecognition that are relevant in the separate financial statements of the transferor (the Bank)

As can be seen in Figure 3 above, the assessment of the transfer of the risks and rewards of the loans to the SPV is an important step when assessing derecognition.

The risks and rewards analysis is performed by comparing the entity's exposure, before and after the transfer, to the variability in the present value of the future net cash flows from the financial asset. An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (IFRS 9.3.2.7).

Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. Examples of when transferor has transferred substantially all the risks and rewards of ownership are according to IFRS 9.B5.3.4:

a)an unconditional sale of a financial asset;

b)a sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and

c)a sale of a financial asset together with a put or call option that is deeply out of the money (i.e. an option that is so far out of the money it is highly unlikely to go into the money before expiry).

In the case of the Bank's sale of its loans to the SPV this would mean that in addition to a)-c) above, the Bank has not invested in notes issued by the SPV that by amount and nature of the notes invested in gives the Bank more than an insignificant exposure to the risks and rewards of ownership of the underlying loans.,

If the Bank has transferred substantially all the risks and rewards, the loans will be derecognised.

On the contrary, it would be obvious that the Bank has retained the significant risks and rewards of the transferred assets in, for instance, the following situations mentioned in IFRS 9.B3.2.6:

a)a sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;

b)a securities lending agreement;

c)a sale of a financial asset together with a total return swap that transfers the market risk exposure back to the Bank;

d)a sale of a financial asset together with a deep in-the-money put or call option (i.e. an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and

e)a sale of short-term receivables in which the Bank guarantees to compensate the SPV for credit losses that are likely to occur.

If the Bank has retained substantially all the risks and rewards, the loans will not be derecognised.

5.3.1. Computations of transferred and retained variability

As mentioned in the previous section, it is sometimes necessary to perform a computation when comparing the transferor's exposure to the variability in cash flows (and timing of cash flows) before and after the transfer to determine if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset.

A computation would probably be needed in the case of the Bank's transfer of mortgage loans to the SPV if the Bank, for instance:

(i)has invested in any of the notes issued by the SPV,
(ii)has issued any financial guarantees to the SPV that are related to the transferred loans and/or
(iii)receives other types of additional compensation that is contingent on the performance of the transferred assets.

According to IFRS 9.3.2.8, the computation and comparison is made using an appropriate current market interest rate as the discount rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

The complexity of the computation will depend on the nature of the transferred assets, the type of risks that are involved and the ways in which the transferor continues to be exposed to the risks of the transferred assets.

For the purpose of illustrating the general logic of such a computation, an illustrative example is found in section 3.2 below. In order to keep this as simple as possible for the purposes of clearly show the logic of the calculation, the fact pattern and assumption deviate significantly from the situation when the Bank transfers receivables to the SPV. For the same purpose of keeping this illustration as simple as possible, the transferred assets are short-term loans and not mortgage loans as illustrated in Figure 1.

5.3.2. Illustrative examples based on three different cases

5.3.2.1. Facts and circumstances

To illustrate how computations can be made to assess the transfer of the variability in the cash flows of the loans from the Bank to the SPV, we have designed three illustrative examples that build on the assumptions described below. The computations that are made based on these assumptions can be found in Figure 4, Figure 5 and Figure 6 below. The computations of the comparison of the Bank's exposure to the variability in the present value of the future net cash flows from the short-term loans before and after the transfer builds on an example provided by EY in Illustration 3-1 section 3.7.4 of Chapter 47 in International GAAP 2023. Many of the facts and circumstances of that example have, however, been changed.

The example portfolio is a portfolio of short-term loans. The reason for selecting this as an example of the quantitative computation is that it requires fewer scenarios to be considered and it is less complicated to explain the general mechanics of the computation technique than if the transferred portfolio would be mortgage loans. In section 4.2, we will, however, return to the example of the securitisation of mortgage loans when discussing computations of variability in returns for the purposes of determining whether the SPV should be consolidated or not.

In the examples below, the Bank issues a financial guarantee to the SPV that will cover the first credit losses from the loans at different levels. The financial guarantee issued by the Bank, meets the definition of a financial guarantee contract in IFRS 9 (see 6.1.1 below).

We assume that the only risk that needs to be assessed is credit risk. Other risks could require consideration in reality – for instance, late payment risk, interest rate risk and/or foreign currency risk. When that is the case, all the relevant risks of the transferred asset need to be taken into consideration in this evaluation. The computations in the figures below illustrate an example of a possible approach for computing the exposure to the variability in the amounts. Depending on the nature of the exposures and risks involved, the computation might, in reality, need to become more or less complex.

The Bank sells to the SPV a portfolio of short-term loans with a principal value of 10 MEUR and an average due date of 90 days from the issuance of the loans. Again, for the purposes of providing for simplified examples of computations of risk transfer, the portfolio is close-ended and does not revolve which often is the case in securitisations. As the receivables are relatively short-term, the calculations below focus on credit risk.

The assets carry interest at 10% per annum payable at maturity. In the examples in the figures below this means that the holder's right to contractual cash flows at maturity amounts to 10 + 10*10%/4 = 10,25 MEUR (**A**). After the sale, the Bank does not retain any residual beneficial interests in the loans but guarantees losses on the transferred portfolio up to a percentage of the total principal amount. Default losses, including late payments, as a percentage of the principal amount including interest on the principal amount, have ranged historically from 2% to 6%.

The Bank has determined a range of scenarios with possible outcomes for credit losses that are reasonably possible to occur (**B**). The Bank computes the expected future cash flows for each scenario (**C**) (i.e. the contractual cash flow minus the expected credit losses for a particular scenario), discounted using an appropriate current market rate. For simplicity reasons, the effects of discounting have, however, been ignored. In (**E**) in the table below, the Bank has documented the probabilities of each of the scenarios in (**B**) occurring. The assessment of what range of scenarios needs to be provided and what probabilities that should be assigned to the individual scenarios may, in practice, prove to be complex, especially in those cases when the transferor has little or no historical experience of the historical performance of similar assets. In the next step (**F**), the probability weighted discounted cash flow is calculated by multiplying (**C**) with (**E**).

The expected variability is then calculated using an appropriate statistical technique. In the examples below, this is made by calculating the variability (**G**) and the probability weighted negative variability (**H**) and positive variability (**I**) respectively.

The variability (**G**) is calculated as the difference between the discounted expected future cash flow (**C**) and the sum of the probability weighted discounted cash flows for all scenarios (**F**). The probability weighted negative (**H**) and positive (**I**) variability, respectively, are calculated by multiplying the probability of a certain scenario (**E**) with the variability of that scenario (**G**).

The same steps are then repeated for the cash flows that the Bank remains exposed to after the transfer (**C**). These are negative amounts since they represent payments from the Bank to the SPV due to the issued financial guarantees.

As a last step, the exposure to expected variability of net cash flows after the transfer (**L**) is compared to the corresponding expected variability before the transfer (**K**).

5.3.3. Has the Bank transferred substantially all the risks and rewards?

5.3.3.1. Case A - The Bank guarantees first losses on the portfolio up to 3% of the total principal amount and interest

In this case the Bank guarantees the first losses in the portfolio up to 3%. The outcome of the variability analysis will depend on the probabilities of the used scenarios. These probabilities can be seen in (D) in Figure 4 below. If a change would be made to these probabilities, the resulting calculation of retained variability in cash flows would be directly affected, and potentially also the answer to the question on whether the Bank has transferred substantially all risks and rewards from the transferred mortgage loans.

There is no concrete guidance in IFRS 9 on the matter of what constitutes 'substantially all' risks and rewards of ownership from a quantitative perspective. Therefore, judgement is needed to assess what is 'substantially all' in each particular situation considering, for example, the sensitivity of the calculation to certain changes in assumptions. We have in the illustrative example for Case A assumed that "substantially all risks and rewards" equal to a transfer of 90% of the variability in the amounts and timing of the cash flows.

Before the transfer

Principal amount and interest (A)	10 250 000							
Scenario for credit loss	Discounted expected future cash flows	Credit loss	Probability of credit loss scenario	Probability weighted discounted cash flows	Variability	Probability weighted negative variability	Probability weighted positive variability	Expected credit losses
B	C = A - [AxB]	D = A - C	E	F = CxE	G = C-Σ(F)	H = GxE if G<0	I = GxE, if G>0	J = DxE
2,0%	10 045 000	205 000	2,0%	200 900	206 025	-	4 121	*4 100*
3,0%	9 942 500	307 500	27,0%	2 684 475	103 525	-	27 952	*83 025*
4,0%	9 840 000	410 000	40,0%	3 936 000	1 025	-	410	*164 000*
5,0%	9 737 500	512 500	30,0%	2 921 250	- 101 475	- 30 443	-	*153 750*
6,0%	9 635 000	615 000	1,0%	96 350	- 203 975	- 2 040	-	*6 150*
			100,0%	9 838 975		**- 32 482**	**32 482**	**411 025**
						K	K	

After the transfer

Scenario for credit loss	Discounted expected future cash flows	Credit loss	Probability of credit loss scenario	Probability weighted discounted cash flows	Variability	Probability weighted variability	Probability weighted positive variability	Expected credit losses
B	C = - [AxB] max 3%*A	D = -C	E	F = CxE	G = C-Σ(F)	H = GxE if G<0	I = GxE, if G>0	J = DxE
2,0%	- 205 000	205 000	2,0%	- 4 100	100 450	-	2 009	*4 100*
3,0%	- 307 500	307 500	27,0%	- 83 025	- 2 050	- 554	-	*83 025*
4,0%	- 307 500	307 500	40,0%	- 123 000	- 2 050	- 820	-	*123 000*
5,0%	- 307 500	307 500	30,0%	- 92 250	- 2 050	- 615	-	*92 250*
6,0%	- 307 500	307 500	1,0%	- 3 075	- 2 050	- 21	-	*3 075*
			100,0%	- 305 450		**- 2 009**	**2 009**	**305 450**
						L	L	
Percentage of the variability retained by the Bank = L/K						6%	6%	

Figure 4 Computation of transferred variability in cash flows: 3% financial guarantee

Under these assumptions including the guarantee of the first 3% losses, the Bank has retained 6% of the variability of the cash flows and concludes that it has transferred substantially all risks and rewards of the ownership of the transferred assets (100% - 6% = 94%).

5.3.3.1.1. Discussion on transfer of variability in cash flows

According to the calculations in Figure 4 above the Bank has transferred 94% of the variability in cash flows, and hence substantially all of the risks and rewards of the assets (assuming a threshold of 90%). In absolute numbers the Bank has however retained an expected credit loss of 370 250 EUR (Σ J) after the transfer out of 500 125 EUR (Σ J) before the transfer, i.e. the proportion retained in absolute terms is 74%. It may seem counter intuitive to conclude that the Bank has transferred substantially all risks and rewards when it has retained that high a level of expected credit losses in absolute terms. The explanation for this is that the assessment of the transfer of risks and rewards is based on the variability in cash flows rather than of the absolute levels.

5.3.3.2. The accounting consequences of a transfer of substantially all the risks and rewards

The consequence of the Bank's transfer of substantially all the risks and rewards is that the transferred assets are derecognised in their entirety from the balance sheet of the Bank. The Bank credits the balance sheet with the previous carrying amount of the mortgage portfolio, debits cash with the cash consideration received, debits the balance sheet for the fair value of other types of consideration received, credits the balance sheet for the fair value of the issued financial guarantee (IFRS 9 3.2.11), and the difference between these transactions is recognised in profit or loss.

5.3.4. Has the entity retained substantially all the risks and rewards?

If instead, and in contrast to the example in Figure 4 above, the Bank does not transfer substantially all the risks and rewards of the transferred portfolio of mortgage loans (as illustrated in Figure 5 and Figure 6 below), the next step in the derecognition decision tree in Figure 3 above, is to determine whether the Bank has retained substantially all risks and rewards.

5.3.4.1. Case B – The Bank guarantees first losses on the portfolio up to 5% of the total principal amount and interest.

In this case the Bank guarantees the first losses in the portfolio up to 5%. When changing the condition from a 3% financial guarantee to a guarantee of the first losses up to 5% whilst maintaining all other assumptions, the result is the following;

Before the transfer								
Principal amount and interest (A)	10 250 000							
Scenario for credit loss	Discounted expected future cash flows	Credit loss	Probability of credit loss scenario	Probability weighted discounted cash flows	Variability	Probability weighted negative variability	Probability weighted positive variability	Expected credit losses
B	C = A - [AxB]	D = A - C	E	F = CxE	G = C-Σ(F)	H = GxE if G<0	I = GxE, if G>0	J = DxE
2,0%	10 045 000	205 000	2,0%	200 900	206 025	-	4 121	4 100
3,0%	9 942 500	307 500	27,0%	2 684 475	103 525	-	27 952	83 025
4,0%	9 840 000	410 000	40,0%	3 936 000	1 025	-	410	164 000
5,0%	9 737 500	512 500	30,0%	2 921 250	- 101 475	- 30 443	-	153 750
6,0%	9 635 000	615 000	1,0%	96 350	- 203 975	- 2 040	-	6 150
			100,0%	9 838 975		- 32 482	32 482	411 025
						K	K	

After the transfer								
Scenario for credit loss	Discounted expected future cash flows	Credit loss	Probability of credit loss scenario	Probability weighted discounted cash flows	Variability	Probability weighted variability	Probability weighted positive variability	Expected credit losses
B	C = - [AxB] max 5%*A	D = -C	E	F = CxE	G = C-Σ(F)	H = GxE if G<0	I = GxE, if G>0	J = DxE
2,0%	- 205 000	205 000	2,0%	- 4 100	205 000	-	4 100	4 100
3,0%	- 307 500	307 500	27,0%	- 83 025	102 500	-	27 675	83 025
4,0%	- 410 000	410 000	40,0%	- 164 000	-	-	-	164 000
5,0%	- 512 500	512 500	30,0%	- 153 750	- 102 500	- 30 750	-	153 750
6,0%	- 512 500	512 500	1,0%	- 5 125	- 102 500	- 1 025	-	5 125
			100,0%	- 410 000		- 31 775	31 775	410 000
						L	L	
Percentage of the variability retained by the Bank = L/K						98%	98%	

Figure 5 Computation of the retention of variability in cash flows; 5% financial guarantee

As can be seen in Figure 5, the Bank retains 98% of the variability in the expected cash flows from the transferred portfolio. Applying the same threshold for what is considered to be the quantitative measure "substantially all risks and rewards" as for Case A above (i.e. a 90% threshold), the Bank concludes that it has retained substantially all risks and rewards of the transferred assets.

5.3.4.2.The accounting consequences of a retention of substantially all the risks and rewards

The accounting consequence of the retention of substantially all the risks and rewards of the transferred assets is that the assets continue to be recognised in the balance sheet of the Bank and the consideration received for the sale of the portfolio is recognised as a liability. The Bank does not recognise any separate liability for the issued financial guarantees since that risk is already reflected by the Bank continuing to recognise the transferred assets. The Bank also continues to recognise interest income using the effective interest rate method, expected credit losses etc. for the transferred portfolio that is not derecognised.

5.3.5. Has the entity retained control of the asset?

If the answer to the previous two questions in the decision tree is "No", i.e. the Bank has neither transferred nor retained substantially all the risks and rewards of the mortgage loans, the next and final step in the derecognition decision tree in Figure 3 above, is to determine whether the Bank has retained control of the transferred portfolio of assets.

5.3.5.1. Case C – The Bank X guarantees first losses on the portfolio up to 4% of the total principal amount and interest.

A case when the Bank would not have transferred nor retained substantially all risks and rewards of the mortgage loans would be if the Bank issues a financial guarantee to cover the first 4% of losses, all other facts and assumptions equal to previous cases. The calculation of the transfer of variability (all other assumptions and facts equal) would look like the following;

Before the transfer								
Principal amount and interest (A)	10 250 000							
Scenario for credit loss	Discounted expected future cash flows	Credit loss	Probability of credit loss scenario	Probability weighted discounted cash flows	Variability	Probability weighted negative variability	Probability weighted positive variability	Expected credit losses
B	C = A - [AxB]	D = A - C	E	F = CxE	G = C-Σ(F)	H = GxE if G<0	I = GxE, if G>0	J = DxE
2,0%	10 045 000	205 000	2,0%	200 900	206 025	-	4 121	4 100
3,0%	9 942 500	307 500	27,0%	2 684 475	103 525	-	27 952	83 025
4,0%	9 840 000	410 000	40,0%	3 936 000	1 025	-	410	164 000
5,0%	9 737 500	512 500	30,0%	2 921 250	- 101 475	- 30 443	-	153 750
6,0%	9 635 000	615 000	1,0%	96 350	- 203 975	- 2 040	-	6 150
			100,0%	9 838 975		- 32 482	32 482	411 025
						K	K	
After the transfer								
Scenario for credit loss	Discounted expected future cash flows	Credit loss	Probability of credit loss scenario	Probability weighted discounted cash flows	Variability	Probability weighted variability	Probability weighted positive variability	*Expected credit losses*
B	C = - [AxB] max 4%*A	D = -C	E	F = CxE	G = C-Σ(F)	H = GxE if G<0	I = GxE, if G>0	J = DxE
2,0%	- 205 000	205 000	2,0%	- 4 100	173 225	-	3 465	4 100
3,0%	- 307 500	307 500	27,0%	- 83 025	70 725	-	19 096	83 025
4,0%	- 410 000	410 000	40,0%	- 164 000	- 31 775	- 12 710	-	164 000
5,0%	- 410 000	410 000	30,0%	- 123 000	- 31 775	- 9 533	-	123 000
6,0%	- 410 000	410 000	1,0%	- 4 100	- 31 775	- 318	-	4 100
			100,0%	- 378 225		- 22 560	22 560	378 225
						L	L	
Percentage of the variability retained by the Bank = L/K						69%	69%	

Figure 6 Computation of the retention of variability in cash flows; 4% financial guarantee

In this case the Bank has retained 69% of the variability of the transferred cash flows which is neither to transfer nor retain substantially all risks and rewards from the ownership of the transferred mortgage loans.

Whether the Bank has retained control of the transferred assets depends on the SPV's ability to sell the portfolio. If the SPV has the practical ability to sell the portfolio in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the Bank has retained control (IFRS 9.3.2.9).

According to IFRS 9.B3.2.8, the transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is often what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:

a)a contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset, and
b)an ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:

i.the transferee's ability to dispose of the transferred asset must be independent of the actions of others (i.e. it must be a unilateral ability), and

ii.the transferee must be able to dispose of the transferred asset without needing to attach restrictive conditions or 'strings' to the transfer (e.g. conditions about how a loan asset is serviced or an option giving the transferee the right to repurchase the asset).

It is common practice for contractual restrictions preventing the SPV from selling or pledging the financial assets to be in place, , because when a structured entity is set up for a securitisation transaction the financial assets are also used as collateral. In our view, to meet the criterion that the entity has not retained control of the transferred assets, the structured entity cannot be prevented from selling the financial assets by means of any predetermined autopilot rules or pre-agreements.

According to IFRS 9.B3.2.9 the fact that a transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset.

5.3.5.2. Accounting consequences

5.3.5.2.1. The Bank has lost control of the transferred assets

If the SPV can freely sell the portfolio of mortgage loans without any interference from the Bank or other parties, and it has been assessed that there is a market for the assets, the Bank has lost control of the transferred assets, which should be derecognised in full from the balance sheet of the Bank. Instead, the Bank accounts for a financial guarantee initially measured at fair value and the difference between the consideration received from the SPV, the carrying amount of the transferred assets and the fair value of the issued financial guarantee liability is recognised in profit or loss (as is the case under Case A when the Bank has transferred substantially all risks and rewards).

5.3.5.2.2. The Bank retains control of the transferred assets

If, on the other hand, the Bank concludes that it has retained control of the assets (for instance due to an option to repurchase the assets) the Bank continues to recognise the transferred loans to the extent of its continuing involvement (IFRS 9.3.2.16). In our experience, entities typically structure the securitisation so that it either transfers substantially all risks and rewards and achieves full derecognition or retains substantially all risks and rewards and does not derecognise at all. If the transfer results in continuing involvement, accounting experts should be consulted. In our experience, such accounting is rare, often complex and can vary hugely depending on each structure. We highlight below how our example would be dealt with under continuing involvement accounting.

If for example, an entity's continuing involvement takes the form of guaranteeing the transferred asset (as is the case in this illustrative example), the extent of the entity's continuing involvement is the lower of (i) the amount of the asset, and (ii) the maximum amount of the consideration received that the entity could be required to repay ('the guarantee amount'). In Case C above, the maximum amount that is payable for the Bank to the SPV is 410 000 EUR (1 500 000 EUR * 4%) which is the lower amount in comparison to the amount of the transferred assets.

When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in IFRS 9, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:

a. the amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost, or
b. equal to the fair value of the rights and obligation (IFRS 9.3.2.17)

Other examples of continuing involvement of transferred assets are according to IFRS 9.3.2.16:

-When the entity's continuing involvement takes the form of a written put or purchased call option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price (see paragraph B3.2.13).

-When the entity's continuing involvement takes the form of a cash-settled option or similar provision on the transferred asset, the extent of the entity's continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.

The accounting treatment in the consolidated financial statements of the Bank

In the case of the consolidated financial statements of the Bank, the IFRS 9 derecognition decision tree starts with the instruction to consolidate all subsidiaries (see Figure 3 above).

The principles for consolidation can be found in IFRS 10. According to IFRS 10.6, "An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee." The control model in IFRS 10 can be illustrated in the following way;

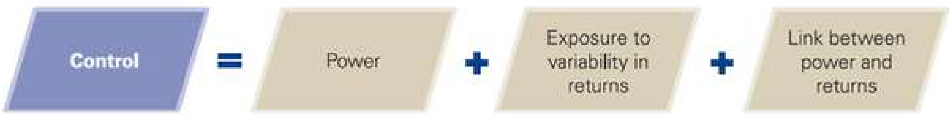


Figure 7

The elements of IFRS 10s control model
(source "First impressions: Consolidated financial statements" published by KPMG May 2011)

5.3.6. Assessment of the Bank's power over the SPV

According to IFRS 10.10 "an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's returns". This means that it is necessary to:

- Identify the relevant activities of the SPV, and
- Determine by whom and how the decisions on the relevant activities made.

After the establishment of the SPV, the relevant activities of the SPV can, for instance, be decisions in relation to:

- Who manages assets, including collection of bad debt (decisions on forbearance, seizing collateral etc.),
- Purchases of new assets,
- Sales of assets,
- Determination of new sources of financing, and/or
- Replacement of the manager of the assets and other changes to decision making powers

The first step in the assessment of power is to make an inventory of all relevant activities of the SPV. It should be noted that the relevant activities only need be those that affect the variability in returns from the SPV to investors (see section 4.2 below). As a next step, those relevant activities that the Bank has power over need to be identified. In this context it needs to be evaluated if the Bank can unilaterally exercise these powers or if it requires the consent of another party. Furthermore, it needs to be evaluated if these powers and rights of the Bank are substantive or if they only are protective. For the purpose of assessing power, only substantive rights held by the Bank and other parties are considered. For a right to be substantive, the holder must have the practical ability to exercise that right (IFRS 10.B22).

Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example, when power results from one or more contractual arrangements (IFRS 10.11).

If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee (IFRS 10.13).

If the Bank continues to manage the transferred assets and/or unilaterally has several of the decision-making powers over the relevant activities, an important question arises: can the Bank be replaced as the manager of the assets and/or be deprived of its decision-making powers (i.e. be “kicked out”)? Can this be done without cause or only in the case of the Bank breaching its commitments according to established contracts? If the Bank can be kicked out without cause its powers are severely undermined, whereas if it can only be made in the case of a breach of contract, the rights to kick out the Bank is only protective. According to IFRS 10.B9, only substantive rights and rights that are not protective shall be considered for the purpose of assessing power.

5.3.7. Assessment of the Bank’s exposure to variability in returns from the SPV

In assessing whether the Bank controls the SPV, the Bank also needs to consider whether it is exposed to, or has rights, to variability in returns from its involvement with the SPV (IFRS 10.7(b)). If the Bank is not involved at all with the SPV after the transfer of the mortgage loans, then there is no variability in returns and the criteria for “control” in IFRS 10.7 are not met. Therefore, the conclusion can be drawn that the Bank should not consolidate the SPV.

Common types of involvement that a sponsor/originator such as the Bank can have with a securitisation vehicle are

- investments in some of the notes issued by the vehicle;
- deferred consideration. Deferred consideration constitutes payments made by the SPV to the Bank in addition to the initial purchase price, and often with amounts that depend on how much of the cash flows of the transferred assets are collected by the vehicle;
- fees for managing the assets that vary in response with the value of the assets and/or how well the assets perform.

According to IFRS 10.15, an investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

According to IFRS 19.B72, in evaluating its exposure to variability of returns from other interests in the investee, a decision maker shall consider the following:

(a)the greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal;
(b)whether its exposure to variability of returns is different from that of the other investors and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, an investee.

The decision maker shall evaluate its exposure relative to the total variability of returns of the investee. This evaluation is made primarily on the basis of returns expected from the activities of the investee but shall not ignore the decision maker's maximum exposure to variability of returns of the investee through other interests that the decision maker holds. Therefore, it is the aggregated economic interests of the Bank that need to be evaluated.

How is variability measured?

When IFRS 10.15 notes that "an investor is exposed, or has rights, to variable returns from its involvement with the investee (…)", this refers to the same type of variability that is referred to in IFRS 9.2.6(a)-(b) but on a consolidated level where the variability analysis will also need to consider other sources of variability such as variable fees from managing the assets. With regards to the applied mathematical methodology, the examples in Figures 4-6 above can serve as guidance. However, it should be noted that IFRS 10.B72(a) requires the aggregated interests and remunerations to be considered in this analysis.

5.3.7.1.1. What is the magnitude of variability below which the Bank would not have to consolidate the SPV?

Whether the Bank needs to consolidate the SPV will depend on an assessment of the magnitude of, and the variability associated with its retained aggregated interests and remunerations and the strength of the Bank's powers over the relevant activities i.e. the linkage between its powers and the retained variability. This will be discussed in more detail in section 4.3 below.

5.3.7.1. Examples of sources of variabilities in returns

In some jurisdictions it is a requirement that the originator, sponsor, or original lender of a securitisation has to retain a minimum economic interest in the securitisation on an ongoing basis. This is for instance the case in the EU where the Securitisation regulation ("SECR", EU 2017/2402) requires not less than a 5% interest.

In order to retain the minimum level of exposure to risk of the transferred assets in order to meet the criteria of the Securitisation regulation, it likely that the Bank in some cases will invest in some of the notes issued by the SPV in order to hold at least 5% of the nominal amounts of the issued notes.

In the figure below we have illustrated three examples of how the Bank can retain at least a 5% interest by holding notes issued by the SPV. The notes are tranched in the same way as is illustrated in Figure 1 above. The payments from the SPV to the holder of the instrument are dependent on the performance of mortgage loans held by the SPV. The figure below ignores the existence of any other sources of variability in returns to the Bank than the notes held by the Bank.

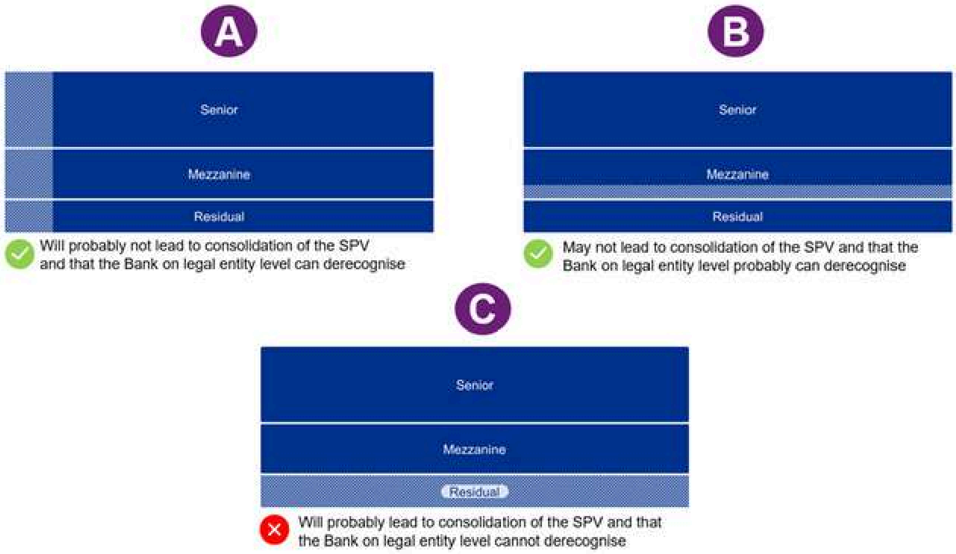


Figure 8 three examples on how the Bank retains its interest by holding notes issued by the SPV

5.3.7.2.1. A - The Bank buys 5% of each type of note in a vertical manner

If the Bank buys 5% of each type of note in a vertical way (i.e. so that it holds 5% of each tranche), it is likely that the Bank holds an aggregate interest in the variability in the SPV's cash flows that, regardless of how strong the Bank's power to control the relevant activities of the SPV is, the SPV will not be consolidated. This conclusion will obviously be affected by other interests and fixed or variable remunerations from the SPV to the Bank.

In this scenario, it is also likely that the Bank can derecognise the assets that have been sold to the SPV in its stand-alone financial statements.

B - The Bank only buys part of the mezzanine tranche

If the Bank retains its 5% interest in the assets in the SPV by purchasing only part of the mezzanine tranche, it is also probable that it does not have to consolidate the SPV and can derecognise the assets that have been transferred in its separate financial statements.

However, this depends on how "thin" the "slice" of the total expected losses that the junior tranche is designed to take. If the junior tranche would take only a very "thin slice" of the expected credit losses, then this would change the situation so that the Bank potentially is exposed to variability to the extent that it might need to consolidate the SPV. Again, this would be affected by other interests and variable remunerations from the SPV to the Bank. Careful analysis of the exposure to the variability in returns that the Bank is exposed to may be needed in cases where the junior tranches slice of the total expected credit losses is thin.

Furthermore, in the assessment of retained vs. transferred variability on the legal entity level of the Bank, it will depend on how "thin" or "thick" the slice of the expected credit losses that have been designed to be absorbed by the junior tranche. In a typical securitisation, the junior note is designed to absorb at least the weighted average expected losses, i.e. has a "thick slice" of the expected credit losses, which means that the Bank on a legal entity level would be able to derecognise the loans sold to the SPV.

C – The Bank holds the entire residual/junior note

In case the Bank would hold a 100% share of the residual interest of the SPV (such as a holding of all the junior notes, or by receiving deferred consideration), this would probably lead to a conclusion that the Bank has to consolidate the SPV in the consolidated financial statements. However, this requires the Bank to have power of those relevant activities that affect the return from the notes and other variable payments from the SPV.

For the stand-alone financial statements of the Bank, it would probably also mean that the Bank cannot derecognise the loans sold to the SPV.

5.3.8.Link between power and returns

According to IFRS 10.B58, when an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority (see paragraphs 17 and 18). Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

Providing that there is a linkage between the Bank's powers over the SPV and the returns generated by exercising these powers, the larger the Bank's share of the total variability in returns from the SPV, the more likely it is that the Bank will be viewed as a principal which would lead to consolidation. Likewise, vice versa, the smaller the Bank's share of the total variability of the cash flows of the SPV, the more likely it is that the Bank will be determined to act as an agent, which would not lead to consolidation. The relationship between power and variability can be illustrated in the following way:

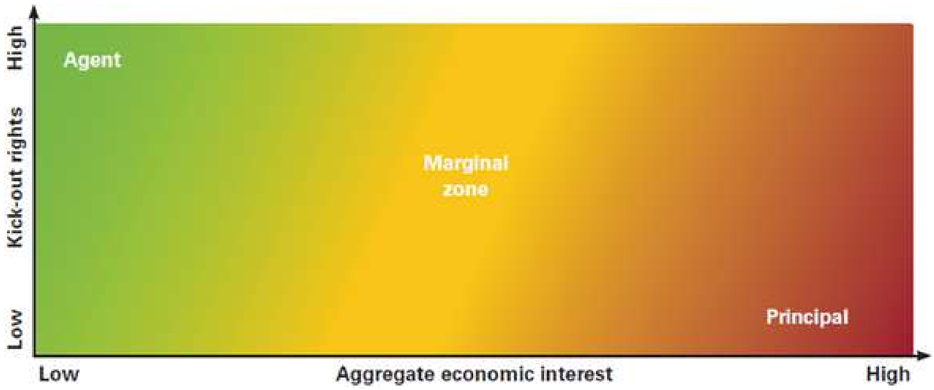


Figure 9 The trade-off between kick-out rights and aggregated economic interest (source: Applying the consolidation model to fund managers, by KPMG March 2012)

The table below summarizes the assumptions and results of the examples in IFRS 10.B72. As can be seen, in situations with a low degree of variability in aggregate interest, it does not matter if the Bank faces no kick-out rights and its power to determine the relevant activities is strong. The conclusion is in these situations is that the decision maker acts as an agent rather than as a principal (examples 13 and 14A) with the consequence that the decision maker does not consolidate the investee.

The examples 14B and 14C illustrate a dividing line for how much variability that the decision maker can be exposed to before consolidation is required. In both examples, the decision maker is exposed to 37% of the variability of the investee. In case the decision maker cannot be kicked out (example 14B) the decision maker is viewed as being the principal and needs to consolidate the investee. If on the contrary the decision maker can be kicked out without cause (example 14C), the decision maker is concluded to act as an agent and should not consolidate the investee since does not exert control.

Example	Variability[4]	Kick-out rights	Agent/Principal
13	11%	Zero	Agent
14A	22%	Zero	Agent
14B	37%	Zero	Principal
14C	37%	Without-cause	Agent
15	42%	Widely dispersed	Principal
Effect Analysis	45%	Zero	Principal

Figure 10 The combined effect of variability in interests and remuneration and the strength of kick out rights

5.4. The accounting treatment for the SPV

5.4.1.The Bank has transferred substantially all risks and rewards

In the example in section 3.3, it is concluded that the Bank has transferred substantially all the risks and rewards of ownership of the mortgage loans to the SPV and the loans are derecognised in full from the balance sheet of the Bank. The SPV therefore recognises the entire portfolio of mortgage loans in its balance sheet. This means that the SPV accounts for the assets in accordance with its business model for the assets (most likely at amortised cost) and recognises interest revenue as well as expected credit losses unless the assets are measured at fair value through profit or loss. The SPV also needs to consider how to account for the reimbursement right that the financial guarantee it holds gives rise to (see section 6.2.1 below).

5.4.2. The Bank has retained substantially all risks and rewards

To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset (IFRS 9.B3.2.15). In the example in section 3.4, the Bank retains substantially all the risks and rewards of the loans that have been transferred to the SPV. The Bank does not derecognise any part of the transferred assets, and as a consequence the SPV should not recognise the purchased mortgage loans on its balance sheet. The SPV instead derecognises the cash or other consideration paid to the Bank and recognises a receivable from the Bank (sometimes referred to as a "deemed loan"). If the transferor has both a right and obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure its receivable at amortised cost, provided the criteria in IFRS 9.4.1.2 are met.

5.4.3. The Bank has neither transferred nor retained substantially all risks and rewards

5.4.3.1.The Bank has lost control of the transferred assets

In the case where the Bank has lost control of the transferred asset, the accounting treatment for the SPV (and the Bank) will mirror the accounting treatment where the Bank has transferred substantially all the risks and rewards. The SPV credits cash and accounts for the purchased portfolio of mortgage loans on its balance sheet and considers how to account for the reimbursement right that the SPV has from the Bank due to the financial guarantee.

5.4.3.2. The Bank has retained control of the transferred assets

It is less clear how the SPV should account for a situation where the Bank has neither transferred nor retained substantially all of the risks and rewards to the transferee (such as in section 3.5 above) and retains control over the assets.

In the case of the example in section 3.5, a literal reading and application of the first sentence in IFRS 9.B3.2.15 ("To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset") may seem to imply that the SPV should recognise a part of the transferred asset at an amount of 9 590 000 EUR (being the difference between the fair value and carrying amount of the whole portfolio of 10 000 000 EUR and the 410 000 EUR that the Bank continues to recognise in its balance sheet (as discussed in 3.5.2.2 above).

There is however little guidance in IFRS 9 and in the literature of the large accounting networks on the accounting by the transferee in a continuing involvement situation. Particular care therefore needs to be taken, and the Bank should consult with its auditors or other advisors on how to resolve the matter based on the facts and circumstances at hand.

5.5. The accounting treatment of synthetic securitisations

5.5.1.The accounting treatment from the issuer's perspective

This section discusses the implications for the issuer's accounting for financial guarantee contracts and credit derivatives.

A synthetic securitisation is so named because the issuing entity is generally not exposed directly to the credit risk of the underlying assets. For example, if the SPV is sold 100 of reference loan assets by the Bank and issues notes, the securitisation is known as a "cash" securitisation because the SPV is exposed directly to the risks and rewards of the reference assets. On the other hand, the SPV could replicate that position synthetically. For example, instead of the SPV using the cash generated from issuing notes to purchase the reference assets from the Bank, it could write a credit default swap to the Bank referencing the 100 assets and put the cash into very low risk government bonds. The effect is to synthetically create the same exposure to the 100 reference assets as the "cash" securitisation.

5.5.1.1. Issued financial guarantee contracts

According to the defined terms in IFRS 9, a financial guarantee contract is "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument."

Sometimes it is straight forward to conclude that a contract is a financial guarantee contract, but sometimes it is less clear. There may, in practice, be several challenges in interpretation and it is therefore important that the analysis is performed carefully.

A financial guarantee contract meets the definition of an insurance contract in IFRS 17. If an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either IFRS 9 or IFRS 17 to such financial guarantee contracts (see paragraphs B2.5–B2.6). This means that if the company has not previously explicitly asserted that it regards such contracts as insurance contracts, the issuer accounts for the issued financial guarantee contract in accordance with IFRS 9.

According to IFRS 9.5.1.1, financial assets and liabilities should be measured at fair value on initial recognition (plus or minus, in the case of a financial asset or financial liability not at measured at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability). This means that an issued financial guarantee contract issued by a Bank should be recognised at its fair value upon initial recognition.

After initial recognition, the issuer of a financial guarantee contract shall, according to IFRS 9.4.2.1(c) (unless IFRS 9.4.2.1(a) or (b) applies), subsequently measure it at the higher of:

- the amount of the loss allowance determined in accordance with Section 5.5 of IFRS 9, and
- the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

The reference to a loss allowance determined in accordance with Section 5.5 means that the issuer applies the principles for accounting for expected credit losses in accordance with IFRS 9, and in case the allowance for the expected credit losses is higher than the amount that was initially recognised that has not been amortised as revenue in profit or loss, the amount of the liability will be the amount of the loss allowance.

5.5.1.2. Issued credit derivatives

According to the defined terms in IFRS 9, a derivative is "a financial instrument or other contract within the scope of this Standard with all three of the following characteristics.
(a)its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').
(b)it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
(c)it is settled at a future date."

If the issued contract will require a payment to be made from the issuer to the holder when the credit rating of the underlying referenced debt instrument has fallen under a certain level, then the contract is a derivative since it generally would meet all three criteria above.

However, this needs to be carefully analysed in each case based on the actual terms of the instrument.

If, on the other hand, the issued contract requires the issuer to pay an amount to the holder only for "a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument" then the contract most likely meets the definition of a financial guarantee contract and should be accounted for in accordance with 6.1.1 above.

The credit derivative is measured at fair value through profit or loss by the issuer (IFRS 9.4.2.1). Since subsequent measurement differs between issued financial guarantees and derivatives, it is important that the contract is correctly classified.

5.2.2.The accounting treatment from the holder's perspective

The sections below discuss some of the relevant aspects of IFRS with regards to the accounting for financial guarantee contracts and credit derivatives. This section discusses the implications for accounting according to IFRS of financial guarantee contracts and credit derivatives that are held by the Bank in a synthetic securitisation.

The sections below are equally relevant for the case that it is the Bank that has issued the credit risk protection and it is the SPV that is the holder.

5.5.2.1. Held financial guarantee contracts

Financial guarantee contracts held are not within the scope of IFRS 9 because they are insurance contracts. However, IFRS 4 and IFRS 17 do not apply to insurance contracts that an entity holds either.

The IFRS Interpretations Committee discussed credit enhancements in the measurement of ECLs. The Committee noted that an entity includes the cash flows expected from a credit enhancement in the measurement of ECLs if the credit enhancement is part of the contractual terms of the related debt instrument and not recognised separately.

The implications of these discussions is that the holder of a financial guarantee that is regarded as integral to the underlying asset(s) it protects, should, when measuring ECLs, take into consideration the amounts that will be received from the issuer of the financial guarantee. This means that a financial guarantee contract held which is considered to be an integral component of the guaranteed debt instrument will be accounted for as part of the ECL on that debt instrument.

It is not clear how narrow "contractual terms" should be understood. According to 7.1.132.30 in Insights into IFRS 20th Edition 2023/24 published by KPMG, "In our view, to be integral, a financial guarantee does not have to be explicitly included in the contractual terms of the debt instrument. Judgement may be required in assessing whether a financial guarantee held is part of the contractual terms of an instrument."

The IFRS Interpretations Committee also concluded in its discussions that conversely, an entity cannot include in the measurement of ECLs the cash flows expected from a credit enhancement that is required to be recognised separately by the Accounting Standards. The entity applies the relevant accounting standard to determine whether it is required to recognise a credit enhancement separately. [IFRS 9.B5.5.55, IFRIC Update – March 2019]. A held non-integral financial guarantee contract is generally not in the scope of IFRS 9. Instead, the holder should account for such a financial guarantee contract as a prepayment of the guarantee premium and a compensation right, by analogy to the guidance for reimbursements in IAS 37.

Hence, the holder of a financial guarantee contract which is not considered to be integral to the underlying debt instrument will need to develop an accounting policy in accordance with the 'hierarchy' in IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors. In developing a policy, entities may, as mentioned by the IFRS Interpretations Committee, look to the requirements of IAS 37 dealing with contingent assets or reimbursement assets, at least as far as recoveries under the contract are concerned. In certain situations, it may also be appropriate for the holder of a financial guarantee contract to account for it as an asset at fair value through profit or loss. This might be the case if the guaranteed asset has itself been classified as at fair value through profit or loss.

When developing its accounting policy for held non-integral financial guarantee contracts it is important that the company consults with its auditors and/or other advisors on their views on how held financial guarantee contracts should be accounted for.

5.5.2.2. Held credit derivatives

A derivative asset that is a credit derivative is measured at fair value through profit or loss since it is a debt instrument where the contractual terms do not only give rise on specified dates to cash flows that payments of principal and interest on the principal amount outstanding (IFRS 9.4.1.2, 4.1.2A and 4.1.4).

5.5.2.2.1. Applying the fair value option to the underlying assets

It should be noted that it may be possible to designate the underlying assets that are subject to the protection from the held credit derivative at fair value through profit or loss (the "fair value option").

This could at least in theory be done by applying the general principles in IFRS 9.4.1.5 that require the designation (i) is made at initial recognition, (ii) is maintained until maturity and (iii) eliminates or significantly reduces a measurement or recognition inconsistency. Otherwise, the fair value option may potentially be applied under the more relaxed requirements in IFRS 9.6.7 when certain criteria are met.

According to IFRS 9.6.7 “If an entity uses a credit derivative that is measured at fair value through profit or loss to manage the credit risk of all, or a part of, a financial instrument (credit exposure) it may designate that financial instrument to the extent that it is so managed (i.e. all or a proportion of it) as measured at fair value through profit or loss if:

(a) the name of the credit exposure (for example, the borrower, or the holder of a loan commitment) matches the reference entity of the credit derivative (‘name matching’); and
(b) the seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.

An entity may make this designation irrespective of whether the financial instrument that is managed for credit risk is within the scope of this Standard (for example, an entity may designate loan commitments that are outside the scope of this Standard). The entity may designate that financial instrument at, or subsequent to, initial recognition, or while it is unrecognised. The entity shall document the designation concurrently.” These criteria would probably be hard to meet with regards to the “name of the credit exposure” for bilateral loan agreement and are designed to be applied for securities.

The reason for applying the fair value option would be to mitigate the effect in profit or loss by measuring the held credit derivative at fair value through profit or loss. This would, however, come at the expense of a higher volatility in profit or loss due to changes in the benchmark rate in the case of fixed rate assets. In addition, it might not be possible to write credit derivatives for a portfolio of loans so that they meet the requirements of IFRS 9.6.7.

5.6.The accounting treatment of investments in the notes issued by the SPV

According to IFRS 9 the classification of an investment in a debt instrument is mainly determined by:

- the entity's business model for managing the financial assets, and
- the contractual cash flow characteristics of the financial asset.

If the holder’s business model for managing the financial asset is either to hold financial assets in order to collect the contractual cash flows or to both hold and sell, an assessment of the characteristics of the cash flows will determine the classification.

If the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (“SPPI”), the asset is measured at either amortised cost or fair value through OCI depending on the entity´s business model. It should be noted that IFRS 9.4.1.5 allows for a voluntary irrevocable designation as at fair value through profit or loss (“fair value option”) in case doing so eliminates or significantly reduces an accounting mismatch. If the contractual cash flows of the financial asset do not meet the SPPI-criteria, the asset is mandatorily measured at fair value through profit or loss.

With regards to the classification of investments in contractually linked instruments (such as credit-linked notes), IFRS 9.B4.1.20- B4.1.26 provides specific guidance when determining whether the SPPI-criteria are met or not. The contractually linked instruments guidance in IFRS 9 does not apply if an entity issues only a single tranche. It also does not apply to instruments that are not tranches.

According to B4.1.20, in some types of transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches. This type of arrangement is illustrated and discussed in section 4.2.2 above.

According to IFRS 9. B4.1.21, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

a) the contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g. the interest rate on the tranche is not linked to a commodity index);

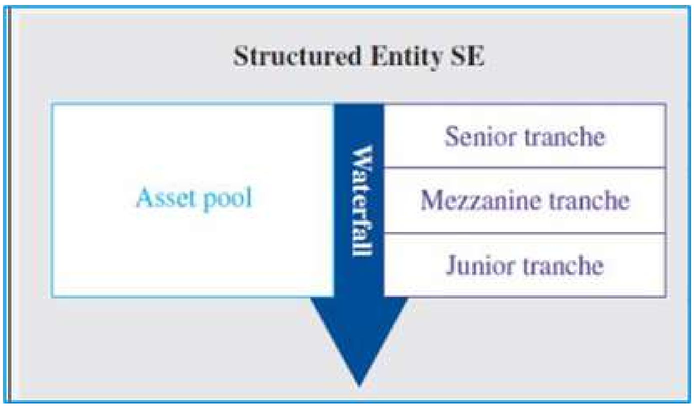
b) the underlying pool of financial instruments has the cash flow characteristics set out in paragraphs B4.1.23 and B4.1.24; and

c) the exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, the credit rating of the tranche being assessed for classification is equal to or higher than the credit rating that would apply to a single tranche that funded the underlying pool of financial instruments).

If these conditions are not met, the investment is mandatorily measured at fair value through profit or loss.

The following guidance is provided by KPMG in their publication Insights into IFRS 20th Edition 2023/24;

7.4.340.16 Structured Entity SE holds a pool of assets and issues three tranches of notes: a junior tranche, a mezzanine tranche, and a senior tranche. If the asset pool does not generate sufficient cash flows to pay the holders of the mezzanine or junior tranches, then this is not a breach of contract for those tranches because their contractual cash flows are reduced. However, if the asset pool does not generate sufficient cash flows to pay the holders of the senior tranche, then this is a breach of contract for the senior tranche.



7.4.340.17 An investor in the senior notes concludes that the guidance on contractually linked instruments applies to its investment because:

- the structure includes prioritisation of payments;
- the senior, mezzanine and junior instruments are contractually linked; and
- each of these three series of notes is a tranche.

The guidance in IFRS 9.B4.1.20- B4.1.26 is summarized in the decision tree below;

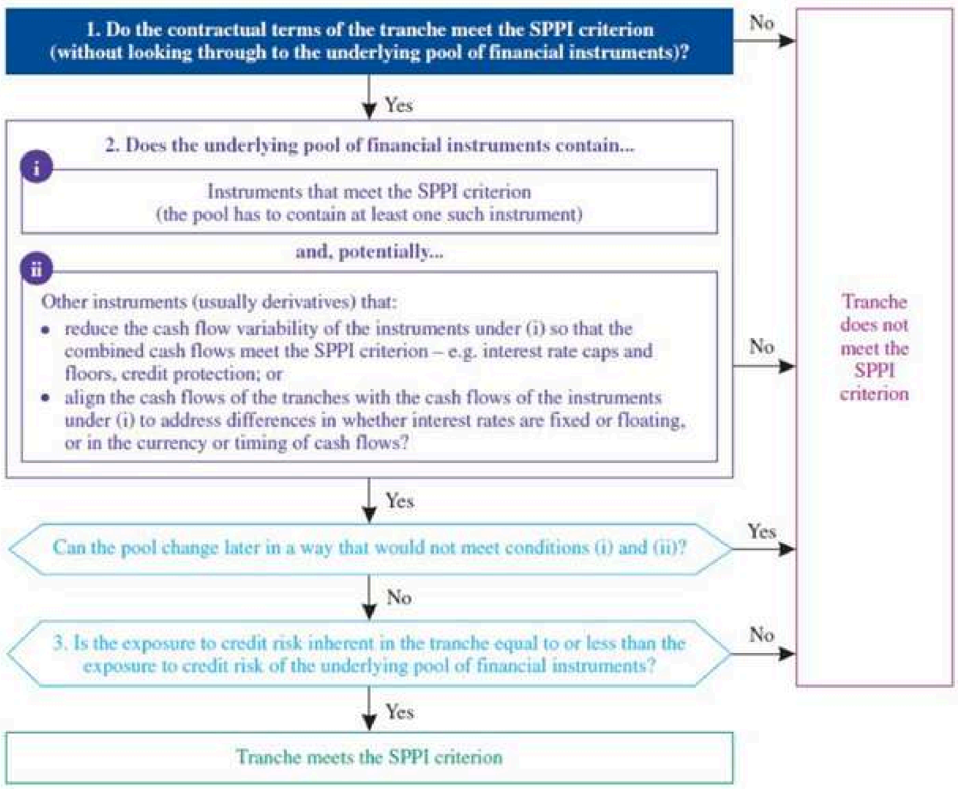


Figure 11 Contractually linked instruments and SPPI (source KPMG Insights into IFRS 20th Edition 2023/24)

5.6.1. Implications of the effective interest rate method

If the SPPI-criteria are met for the investment in a contractually linked instrument and the Bank's business model for managing the assets is either to hold and collect the contractual cash flows or to hold and sell, interest income from the investment should be recognised using the effective interest rate method.

According to the defined terms in IFRS 9 the effective interest rate is defined as:

"The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the ***expected cash flows*** *by considering all the* ***contractual terms*** *of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1-B5.4.3), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments)."* (emphasis added)

This means that the holder needs to establish the original effective interest rate by (i) estimating the expected cash flows from the investment and (ii) deriving the interest rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount (generally the fair value of the investment normally being the consideration given for the purchase).

Going forward the holder applies the guidance in B5.4.6 for fixed rate assets and B5.4.5 for floating rate assets (however also considering some of the guidance in B5.4.6.

According to IFRS 9.B5.4.6 *"If an entity **revises its estimates** of payments or **receipts** (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall a**djust the gross carrying amount** of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. **The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate** (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. The adjustment is recognised in profit or loss as income or expense."* (emphasis added)

This means that the holder needs to continuously monitor and revise its estimates of the cash flows to be received from the note and to adjust the gross carrying amount upwards (giving rise to a gain in profit or loss) if the expected receipts of cash flows have increased, or downwards (giving rise to a loss in profit or loss) if the expected receipts of cash flows have decreased.

CHAPTER 6

GLOSSARY

AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, as amended[9]
CRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012, as amended[10]
CRR Risk Retention RTS	Commission Delegated Regulation (EU) No 625/2014 of 13 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council by way of regulatory technical standards specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk[11] (Chapters I, II and III and Article 22 of the CRR Risk Retention RTS)
Draft Securitisation Regulation RTS	EBA Final Draft Regulatory Technical Standards Specifying the requirements for originators, sponsors, original lenders and servicers relating to risk retention pursuant to Article 6(7) of Regulation (EU) 2017/2402 as amended by Regulation (EU) 2021/557, published on 1 April 2022[12]
EBA Consultation Paper on RTS on Risk Retention	EBA Consultation Paper on Draft Securitisation Regulation RTS[13]
EBA Guidelines on Implicit Support for Securitisation Transactions	EBA Guidelines on Implicit Support for Securitisation Transactions[14]
EBA Guidelines on Significant Credit Risk Transfer	EBA Guidelines on Significant Credit Risk Transfer relating to Articles 243 and Article 244 of Regulation 575/2013[15]
EBA Guidelines on the Determination of the WAM of the contractual payments due under the tranche	EBA Guidelines on the determination of the weighted average maturity (WAM) of the contractual payments due under the tranche in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013[16]

[9] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32011L0061
[10] https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32013R0575
[11] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0625&from=EN
[12]https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2022/EBA-RTS-2022-04%20RTS%20on%20risk%20retention%20requirements%20for%20securitisations%20/1030491/Final%20Draft%20RTS%20on%20Risk%20Retention%20in%20securitisation.pdf
[13] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2063496/49114831-9db2-4127-a890-d1af5a2377c9/Consultation%20Paper%20on%20RTS%20on%20risk%20retention%20%28EBA-CP-2017-22%29.pdf
[14] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1603711/b2f467dd-569e-4024-ae1d-8cafc2fe32f1/Final%20report%20on%20Guidelines%20on%20implicit%20support%20for%20securitisation%20transactions%20%28EBA-GL-2016-08%29.pdf?retry=1
[15] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/749215/5355e9d3-a565-4c58-bd93-0e888407306e/EBA-GL-2014-05%20Guidelines%20on%20Significant%20Risk%20Transfer.pdf?retry=1
[16]https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20the%20determination%20of%20the%20weighted%20average%20maturity%20of%20the%20tranche/883213/Guidelines%20on%20WAM.pdf

EBA Report on Securitisation Risk Retention, Due Diligence and Disclosure	EBA Report on Securitisation Risk Retention, Due Diligence and Disclosure under Article 410(1) of the CRR, adopted on 12 April 2016[17]
EBRD	European Bank for Reconstruction and Development
EBRD Introduction of a Covered Bond and Securitisation Framework	EBRD Introduction of a Covered Bond and Securitisation Legal and Regulatory Framework in Lithuania, adopted on April 2017[18]
ECB Guidelines on the Recognition of Significant Credit Risk Transfer	ECB Guidelines on the Recognition of Significant Credit Risk Transfer, adopted on 24th March 2016[19]
ECB Guidelines on information on transactions which go beyond the contractual obligations of a sponsor institution or an originator institution	ECB Guidelines on information on transactions which go beyond the contractual obligations of a sponsor institution or an originator institution, adopted on 28th July 2017[20]
ESAs' Opinion on Securitisation Regulation	The European Supervisory Authorities' Opinion to the European Commission on the Jurisdictional Scope of Application of the Securitisation Regulation[21]
ESMA Q&As on the Securitisation Regulation	ESMA Questions and Answers on the Securitisation Regulation, Version 9, last updated on 19/11/2021[22]
GDPR	General Data Protection Regulation[23]
Guidelines on the STS criteria for ABCP and non-ABCP securitisation	These Guidelines provide a harmonised interpretation of the criteria for the securitisation to be eligible as simple, transparent, and standardised (STS). The Guidelines, which cover both non-asset-backed commercial paper (ABCP) and ABCP securitisation, clarify and ensure a common understanding of all the STS criteria, including those related to the expertise of the originator and servicer, the underwriting of standards, exposures in default and credit impaired debtors, and predominant reliance on the sale of assets.[24]
Investor	A natural or legal person holding a securitisation position.
ITS on STS Notifications	Commission Implementing Regulation (EU) 2020/1227 of 12 November 2019 laying down implementing technical standards with

[17] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1359456/b8e21666-1a75-4e59-a04c-e8ad1b6c9606/EBA-OP-2016-06%20Report%20on%20Securitisation%20Risk%20Retention%20Due%20Diligence%20and%20Disclosure.pdf
[18] https://finmin.lrv.lt/uploads/finmin/documents/files/Lithuania%20ABS%20CB%20Final%20Concept%20Paper.pdf
[19] https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2016/guidance_significant_risk_transfer.en.pdf
[20]https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2017/ssm.2017_guidance_on_implicit_support.en.pdf
[21]https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2021/964573/JC%202021%2016%20-%20ESAs%20Opinion%20on%20Jurisdictional%20Scope%20of%20Application%20of%20the%20Securitisation%20Regulation%20%28003%29.pdf
[22] https://www.esma.europa.eu/sites/default/files/library/esma33-128-563_questions_and_answers_on_securitisation.pdf
[23] https://eur-lex.europa.eu/eli/reg/2016/679/oj
[24] https://www.eba.europa.eu/regulation-and-policy/securitisation-and-covered-bonds/guidelines-on-the-sts-criteria-for-abcp-and-non-abcp-securitisation

	regard to templates for the provision of information in accordance with the STS notification requirements[25]
ITS on Supervisory Reporting amendments with regards to COREP securitisation	Implementing Technical Standards (ITS) amending Regulation (EU) No 680/2014 on Supervisory Reporting aim at aligning the reporting of securitisations with the new EU securitisation framework – the Securitisation Regulation (Regulation (EU) No 2017/2402) and the Regulation (EU) No 2017/2401 amending the CRR[26]
IORPs	Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast)
Joint Committee Q&As relating to the Securitisation Regulation	Joint Committee Q&As relating to the Securitisation Regulation (EU) 2017/2402[27]
Law on Securitisation and Covered Bonds	Law on Securitisation and Covered Bonds of the Republic of Lithuania
Market Abuse Regulation	Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast)
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012
NPE securitisation	means a securitisation backed by a pool of non-performing exposures the nominal value of which makes up not less than 90 % of the entire pool's nominal value at the time of origination and at any later time where assets are added to or removed from the underlying pool due to replenishment, restructuring or any other relevant reason.
OECD	Organisation for Economic Cooperation and Development
Originator	An entity which: (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or (b) purchases a third party's exposures on its own account and then securitises them.
Private securitisation	Private securitization involves the issuance of securities backed by a pool of assets to a limited group of institutional investors. The securities are not offered to the general public and are often negotiated directly

[[25] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R1227
[26] https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/its-on-supervisory-reporting-amendments-with-regards-to-corep-securitisation
[27] https://www.esma.europa.eu/sites/default/files/library/jc_2021_19_jcsc_qas_on_securitisation_regulation.pdf

	between the SPV and the investors. This form of securitization may involve less regulatory oversight compared to public securitization.
Public securitisation	Public securitization refers to the issuance of securities backed by a pool of assets that are offered to the public or admitted to trading on a regulated market as it is defined in the Prospectus Regulation. These securities are registered with relevant regulatory authorities, subject to comprehensive disclosure requirements, and made available to a broad range of investors, including institutional and retail investors. Public securitization is characterized by increased regulatory scrutiny and transparency.
Risk Retention in Securitisation and Empty Creditors	European Banking Institute Working Paper Series 2021 – No. 91. Evgenia Chouliara, Edoardo D. Martino. Risk Retention in Securitization and Empty Creditors[28]
RTS on homogeneity of the underlying exposures in securitisation	Commission Delegated Regulation (EU) No 2019/1851 of 28 May 2019 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards on the homogeneity of the underlying exposures in securitisation[29]
RTS on STS Notifications	Commission Delegated Regulation (EU) No 2020/1226 of 12 November 2019 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council and laying down regulatory technical standards specifying the information to be provided in accordance with the STS notification requirements, published on 3 September 2020[30]
RTS on STS Notifications for on-balance-sheet synthetic securitisations	Commission Delegated Regulation (EU) 2022/1301 of 31 March 2022 amending the regulatory technical standards laid down in Delegated Regulation (EU) 2020/1226 as regards the information to be provided in accordance with the STS notification requirements for on-balance-sheet synthetic securitisations[31]
RTS on the cooperation, exchange of information and notification obligations between competent authorities and ESMA, the EBA and EIOPA	Commission Delegated Regulation (EU) 2021/1415 of 5 May 2021 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards on the cooperation, exchange of information and notification obligations between competent authorities and ESMA, the EBA and EIOPA
Securitisation Disclosure ITS	Commission Implementing Regulation (EU) No 2020/1225 of 29 October 2019 laying down implementing technical standards with regard to the format and standardised templates for making available the information and details of a securitisation by the originator, sponsor and SSPE, published on 3 September 2020[32]
Securitisation Disclosure RTS	Commission Delegated Regulation (EU) No 2020/1224 of 16 October 2019 supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical

[28] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3824733
[29] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R1851
[30] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02020R1226-20220815
[31] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022R1301&qid=1664983094253
[32] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2020.289.01.0217.01.ENG&toc=OJ:L:2020:289:TOC

	standards specifying the information and the details of a securitisation to be made available by the originator, sponsor and SSPE, published on 3 September 2020[33]
Securitisation Regulation	Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012[34], as amended, which is applied to all securitisation products and includes due diligence, risk retention and transparency rules together with a clear set of criteria to identify STS securitisation
Solvency II Directive	Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast)
SPV	A corporation, trust or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SPV from those of the originator
STS securitisation	Simple, transparent, and standardised securitisation
Targeted consultation on the functioning of the EU securitisation framework	Targeted consultation on the functioning of the EU securitisation framework 23 July 2021 – 17 September 2021[35]
UCITS	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as amended[36]
XML schemas for required Securitisation Disclosures	The XML schemas for these templates and accompanying technical reporting instructions and validation rules[37]

[33] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2020.289.01.0001.01.ENG&toc=OJ:L:2020:289:TOC
[34] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2402&from=EN
[35] https://finance.ec.europa.eu/system/files/2022-09/2021-eu-securitisation-framework-summary-of-responses_en.pdf
[36] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32009L0065
[37] https://www.esma.europa.eu/esmas-activities/markets-and-infrastructure/securitisation#title-paragrah-4