

Structured Finance and Derivatives Junior Bankers Masterclass Series



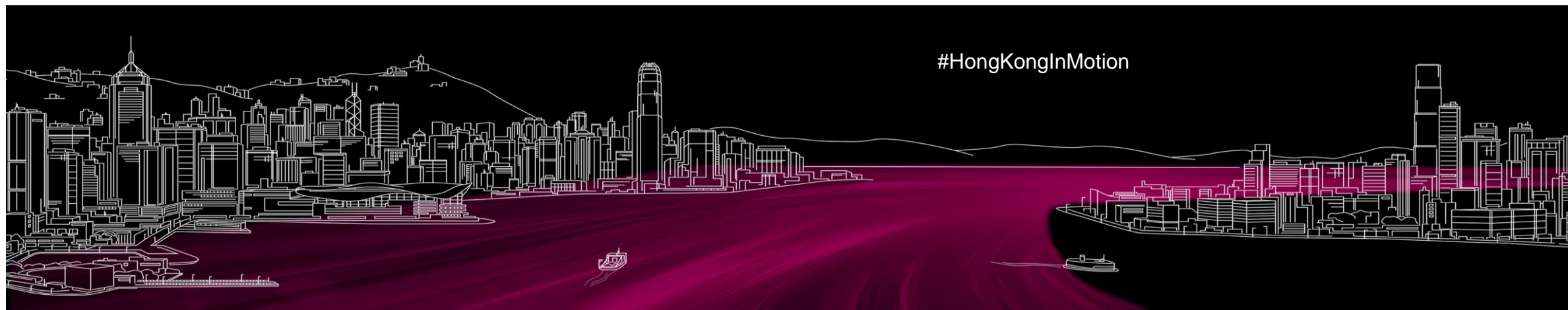
Launching structured notes

Introduction to Securitisation



Repackaging 101

Certificates of Deposit & Commercial Paper



Structured Finance and Derivatives Junior Bankers Masterclass Series

Session 3: Introduction to Securitisation



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27 June 2023

Webinar housekeeping



CPD eligibility: 1.0 Law Society of Hong Kong accredited CPD point have been applied for. For CPD accreditation purposes, you will need to attend the entire webinar **via WebEx** and attend at least 50 minutes of this session to fulfil the requirements by the Hong Kong Law Society. You will have to enter your full name and email address when joining. Phone call-in will not be eligible for CPD point.



All attendees will be **automatically muted** when joining the webinar.



We intend to **record both video and audio** of this session for training purposes.



Questions can be posed at anytime at the bottom right-hand corner of the screen.



Post session feedback.

Agenda

Introduction to Securitisation

- > What is securitisation and why?
- > Common structures and related products.
- > Basic framework and participants.
- > Key documentation.

Selected structural and regulatory considerations

- > Credit enhancement and Cashflow
- > Tax considerations
- > Specific Legal and documentation issues:
 - > EU and UK Securitisation Regulations.
 - > US risk retention rules and Volcker.
 - > Other regulatory issues.

Specific China issues

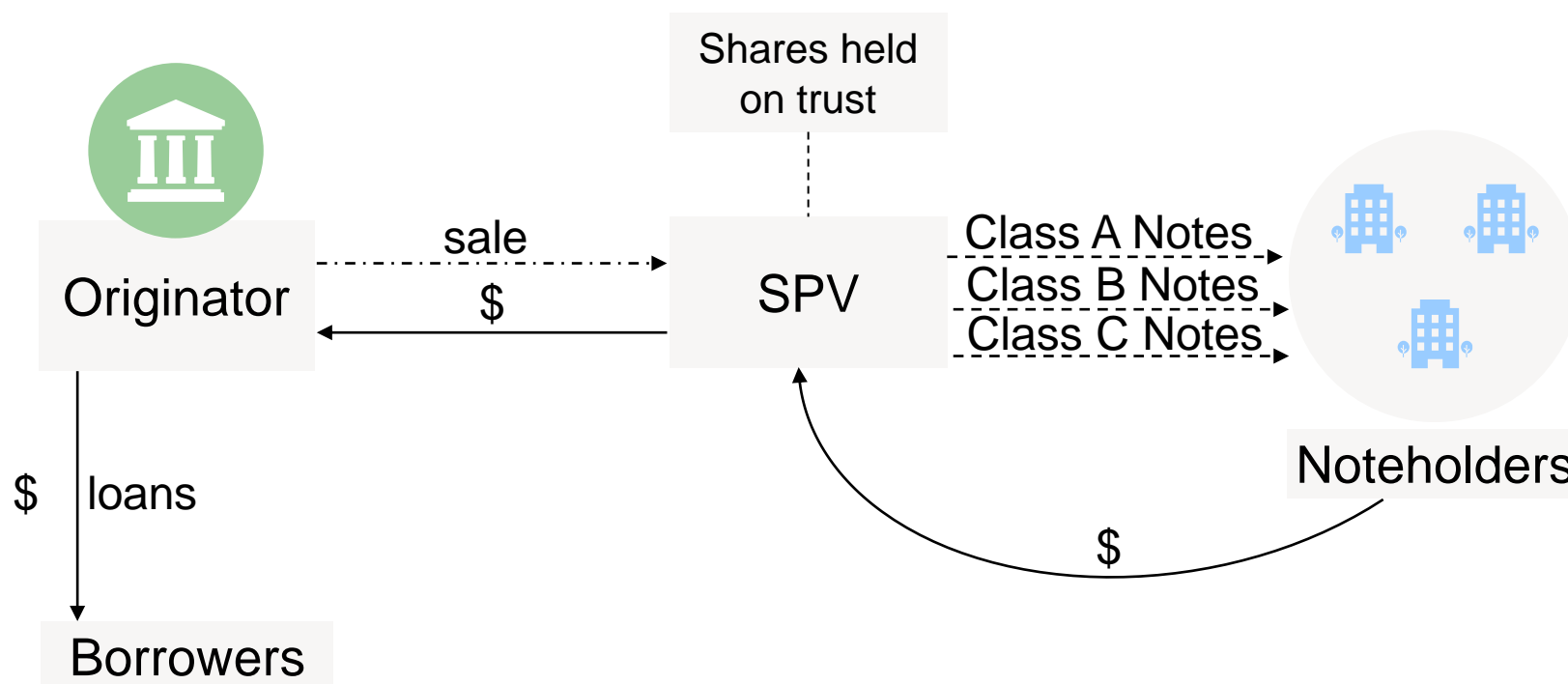
- > China's domestic ABS
- > Bank ABS
- > ABS/ABN
- > Possible Structures for Cross Border ABS

Introduction to Securitisation



What is Securitisation?

A financing technique which takes a **cash flow generated by receivables** and uses it to fund future payments of interest and principal due under **an issue of debt securities**.



Why Securitisation?

> Originators

- **cheaper**, longer term funding than traditional routes if the portfolio of receivables is large enough (typically US\$200m or more)
- potentially **off balance** sheet financing
- access to capital markets / **diversification** of funding (even for unrated originator)

> Investors

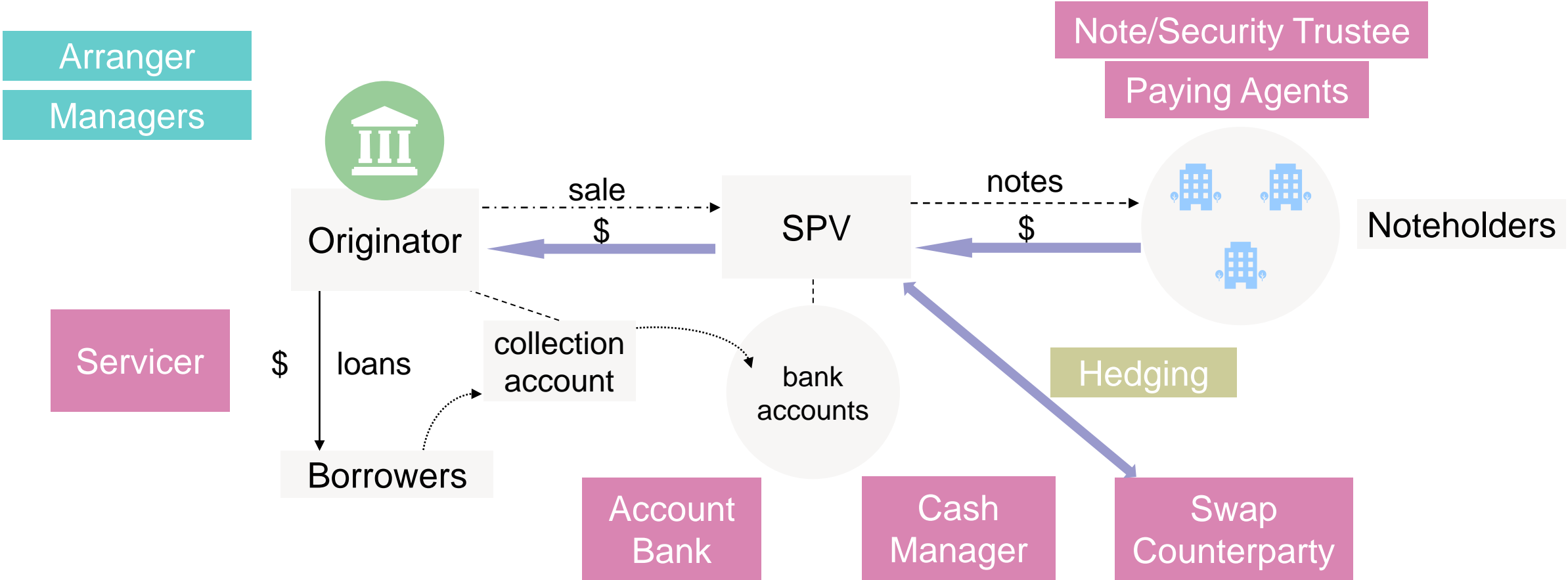
- Access to **new asset classes** and diversification of investment
- Different tranches in a securitisation attractive to investors with **different risk profiles**



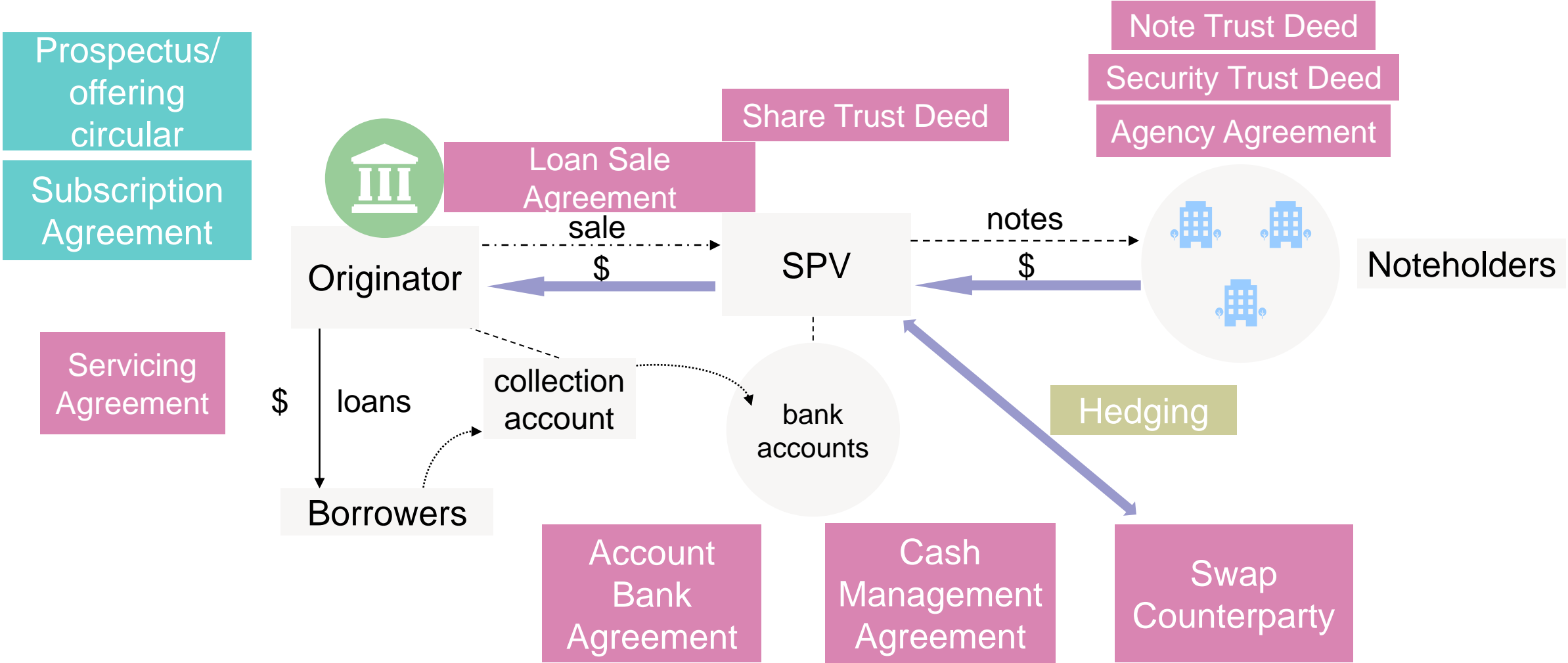
Common structures and similar products

- 1 RMBS (residential mortgage-backed securities).
- 2 CMBS (commercial mortgage-backed securities).
- 3 ABS (asset-backed securities) e.g., consumer receivables, auto loans, auto leases, credit card receivables.
- 4 NPLs (non-performing loans).
- 5 CLO (collateralised loan obligations).
- 6 Whole Business (more a hybrid of a secured loan and securitisation).
- 7 Asset-backed commercial paper.
- 8 Warehouse funding.
- 9 Covered bonds.

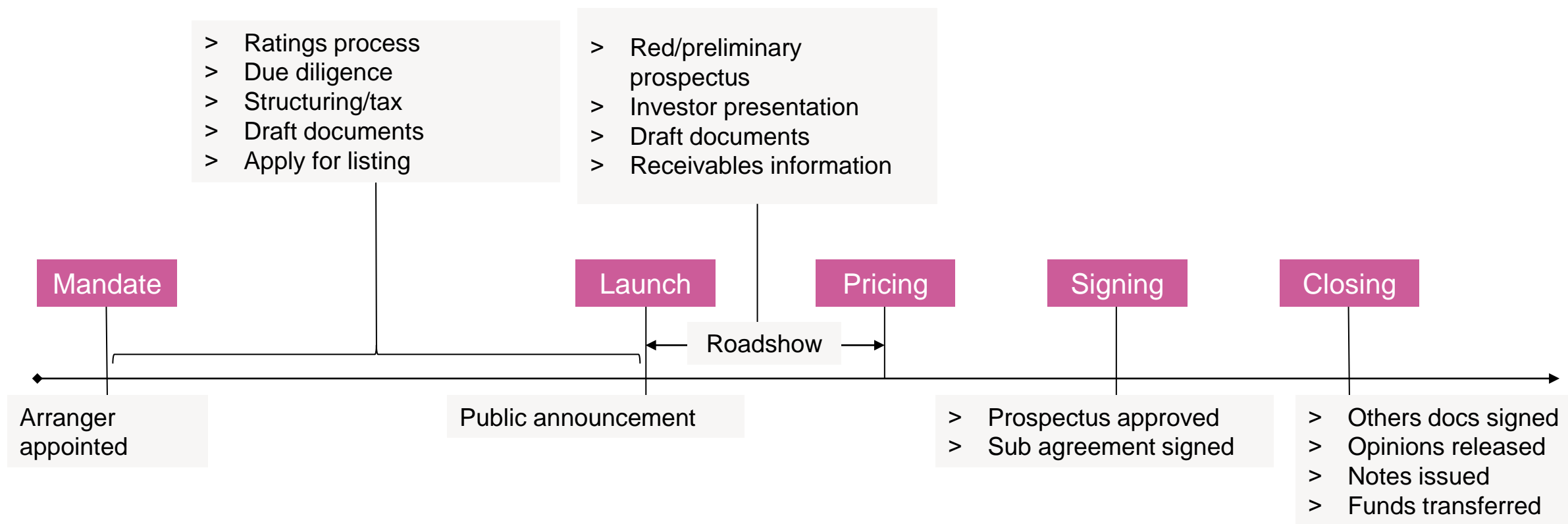
Parties



Documents



Timeline



The Prospectus

- 1 Regulatory information, high level summaries of transaction.
- 2 Risk factors.
- 3 More detailed summaries of key aspects of the transaction.
- 4 Regulatory disclosure.
- 5 Description of key parties.
- 6 Description of portfolio (including strat tables).
- 7 Summary of transaction documents including credit structure and cashflows, terms and conditions of notes set out in full.
- 8 Maturity and prepayment considerations (WALs).
- 9 Use of proceeds, tax, subscription sale and transfer and general information.

Sale of the Loans: Loan Sale Agreement



- > Obligation to sell/purchase the loans
- > Purchase price (initial and deferred)
- > Conditions precedent
- > Representations and warranties (including loan warranties)
- > Originator's obligation to repurchase/indemnify for breach of loan warranty
- > Perfection events – when will borrowers be told about the transaction?

Servicing and Cash Management

- > **Servicing Agreement**

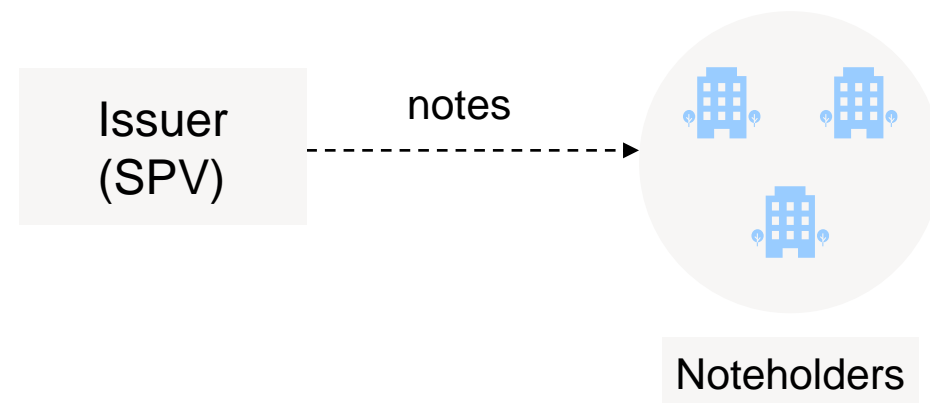
- > Originator typically remains as the Servicer (sometimes with a third-party back-up servicer appointed)
- > Duties of the servicer (collection, managing defaults etc.) and servicing standard
- > Cash collection - commingling risk, “cash sweep” and trust over collection account
- > Servicer replacement triggers

- > **Account Bank Agreement and Cash Management Agreement**

- > Govern issuer’s transaction accounts (may include reserve account(s) and swap collateral account(s))
- > Cash manager manages issuer’s accounts and payments to transaction parties / reserves

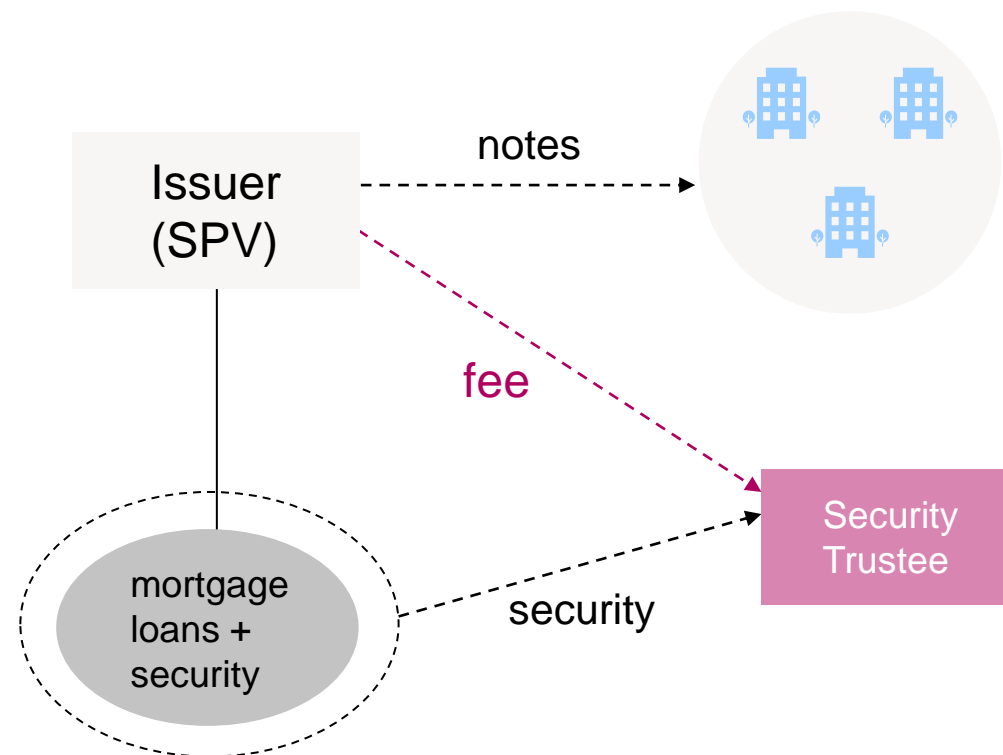
Note Trust: Note Terms and Conditions

- > Redemption:
 - > unscheduled amortisation/passthrough (most common).
 - > scheduled amortisation (master trust/revolving period).
- > Interest on lower classes deferrable.
- > **Events of default: non-payment, breach, insolvency.**
- > Intercreditor language between classes of notes.
- > Bankruptcy remoteness; limited recourse; non-petition.

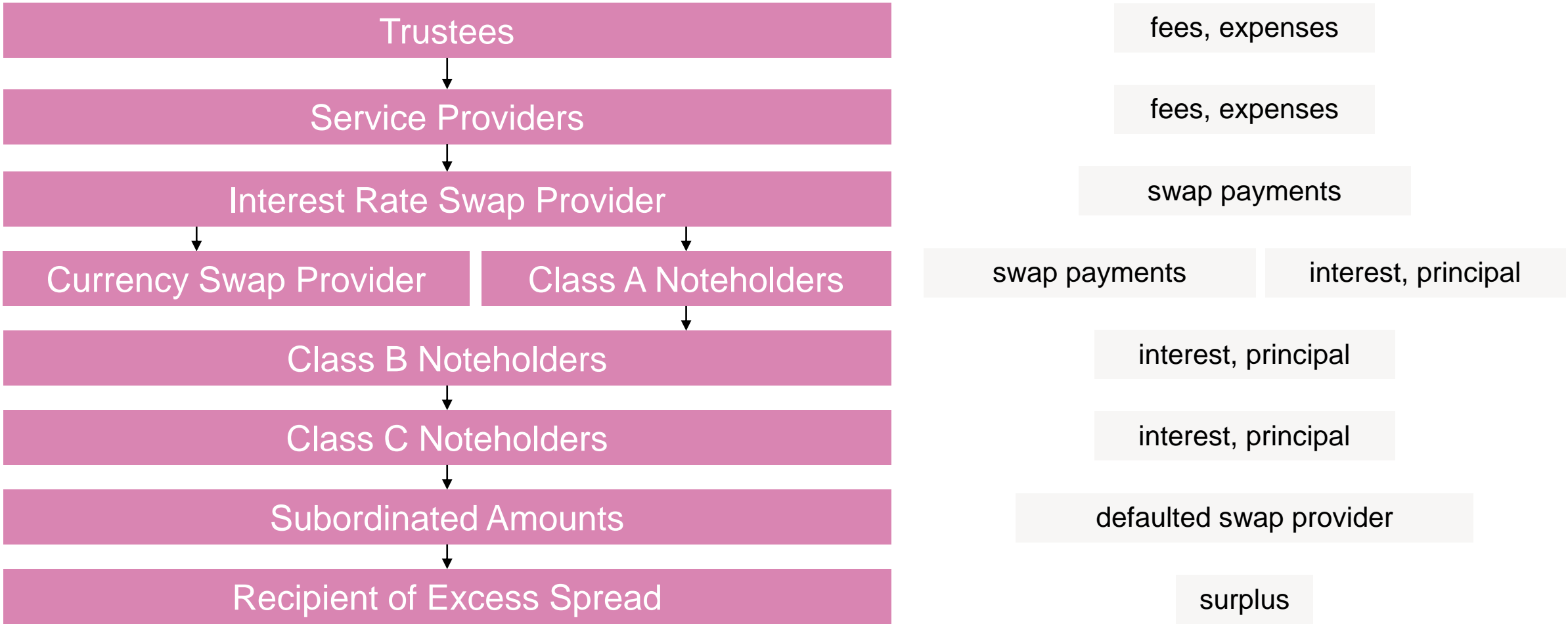


Security Trust

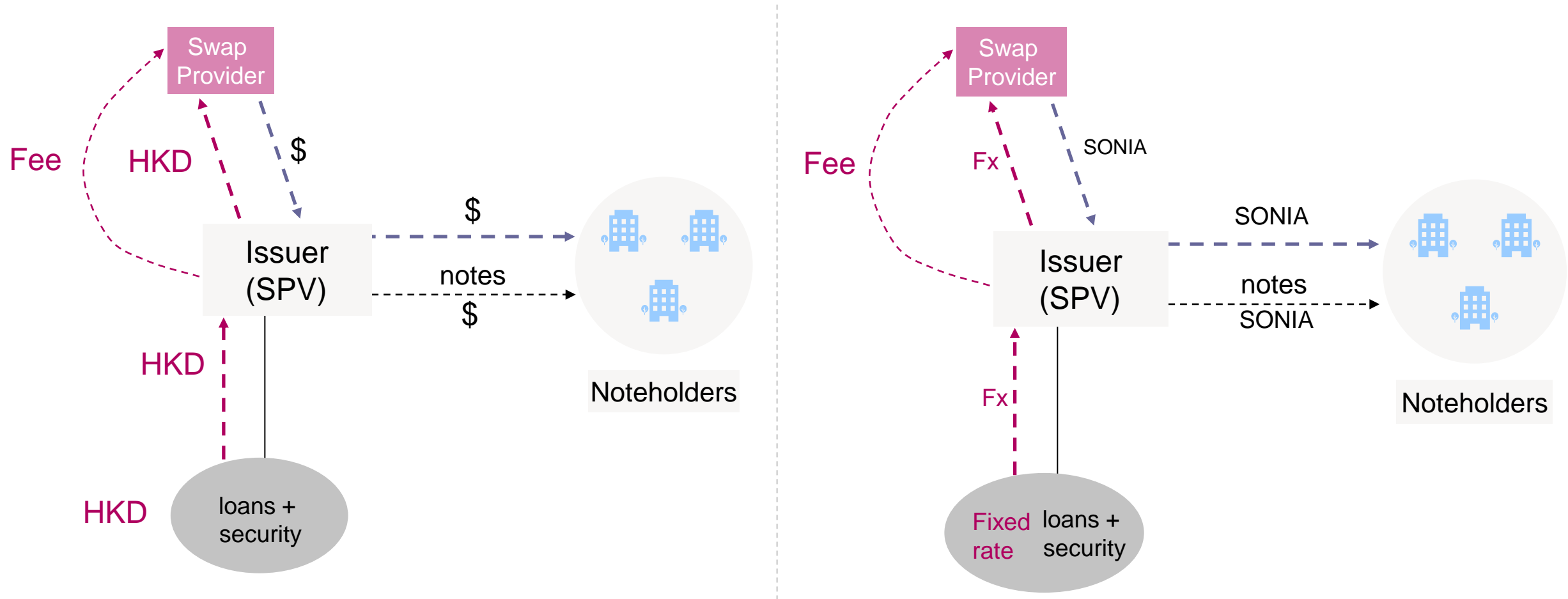
- > Security trustee holds security for all secured creditors.
- > Single trustee vs. fluctuating group of secured creditors.
- > Inter-creditor provisions to determine who can instruct.
- > Limited recourse and non-petition.
- > Post-enforcement waterfall.



Security Trust: Post-Enforcement Waterfall



Swaps: Currency and Interest Rate



Swaps: Key Provisions

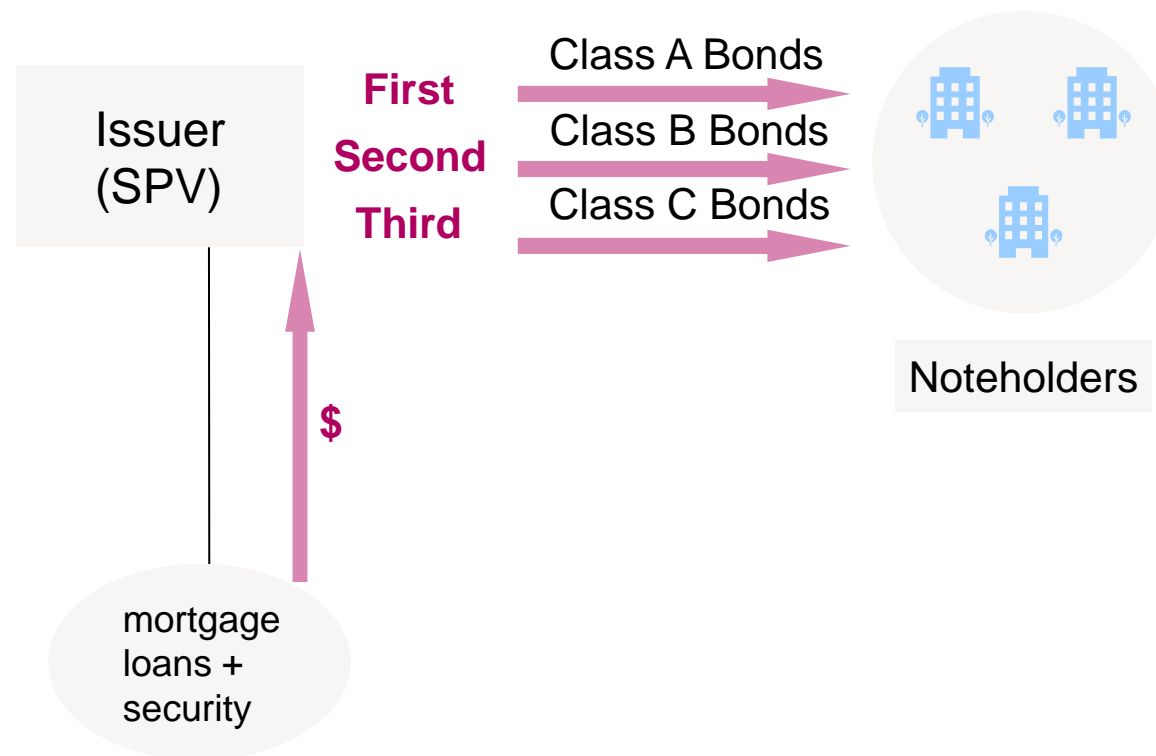
- > Restricted termination events and events of default.
- > No tax gross up for issuer.
- > Minimum ratings for swap provider...
- > ...and if downgraded, must:
 - > provide collateral; or
 - > procure guarantee; or
 - > transfer to replacement swap provider.

Selected Structural Issues

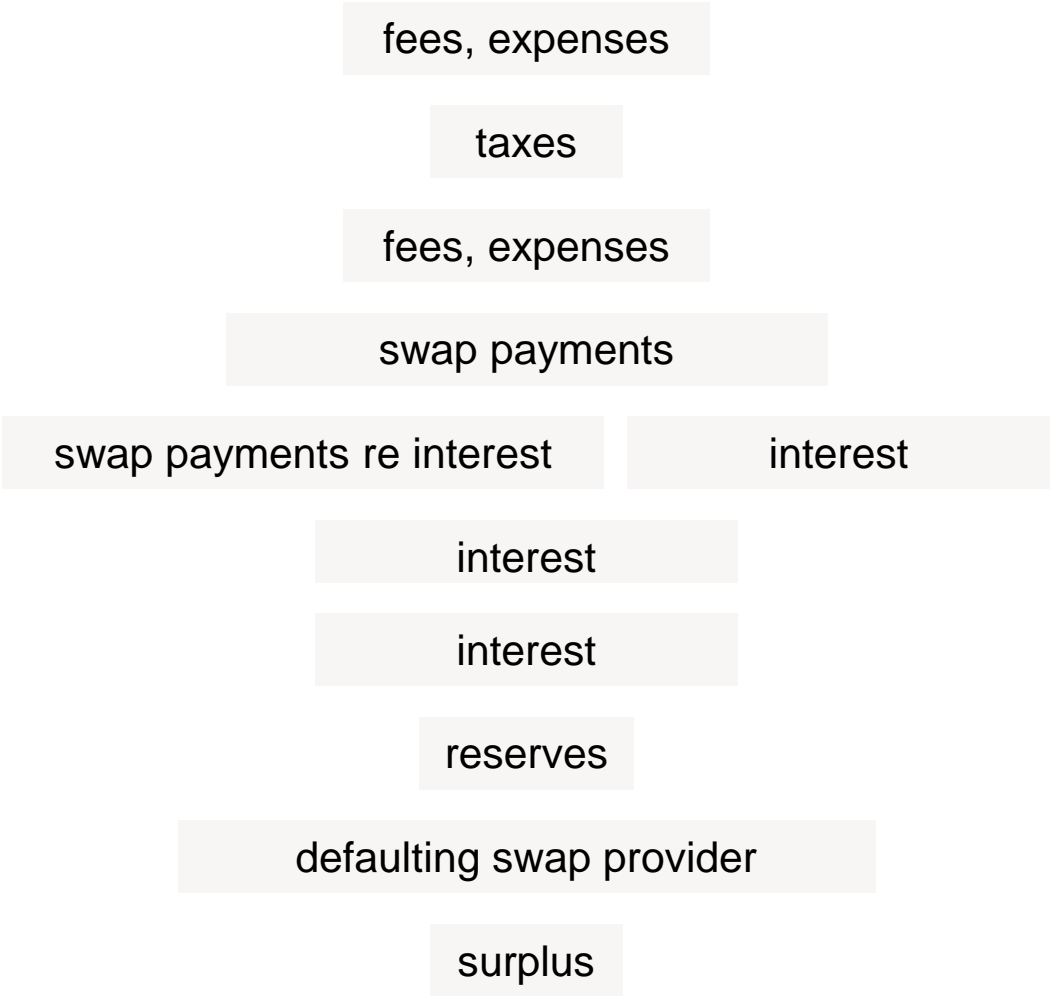
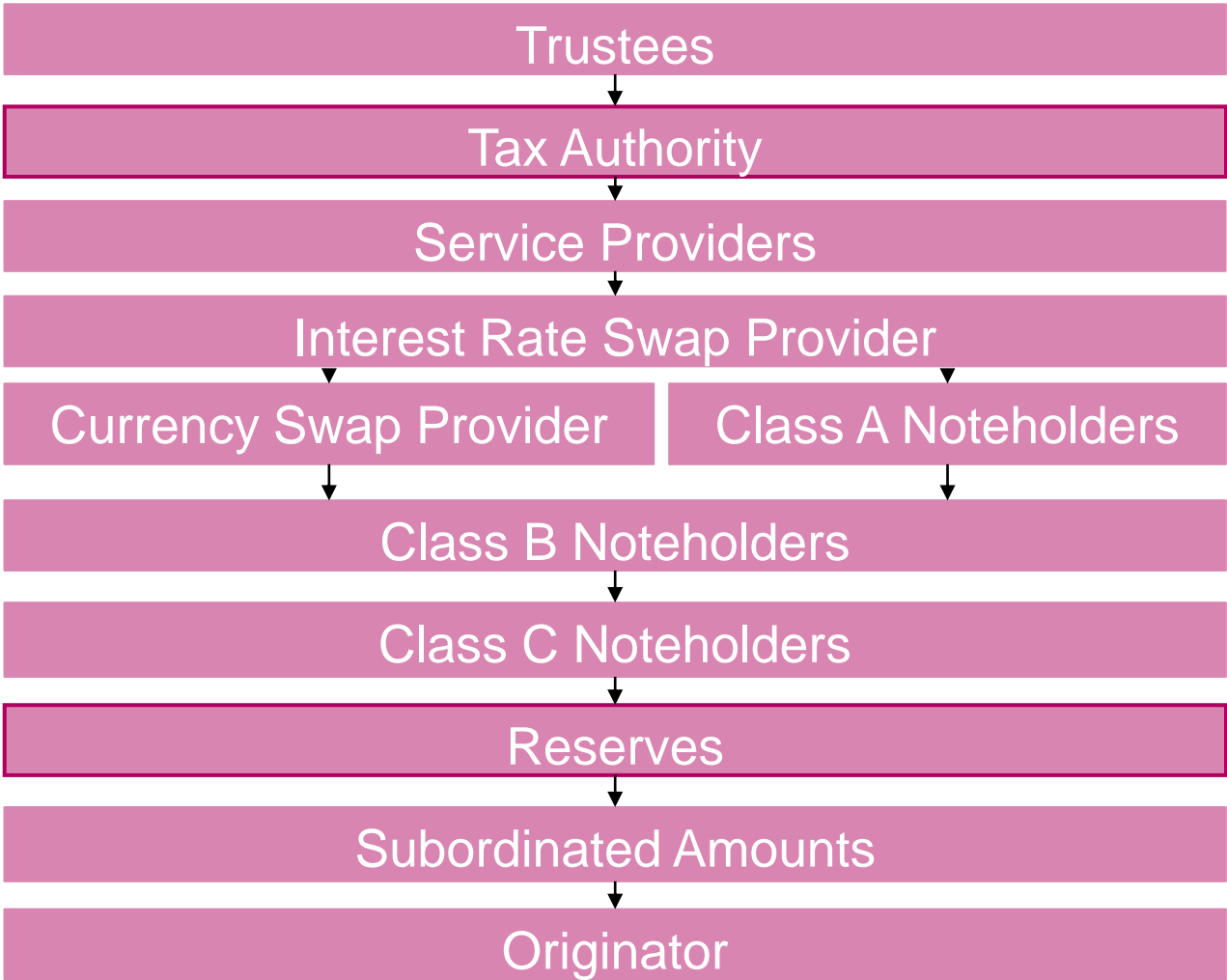


Credit Enhancement and Cashflows

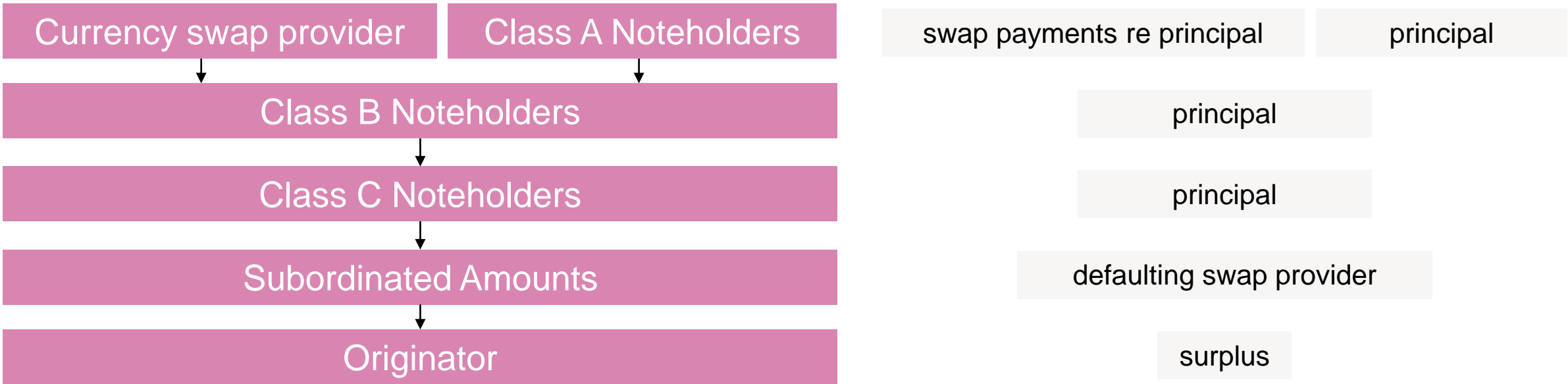
- > Overcollateralisation.
- > Tranching.
- > Reserves.
- > Principal deficiency ledger.
- > Principal to pay interest.



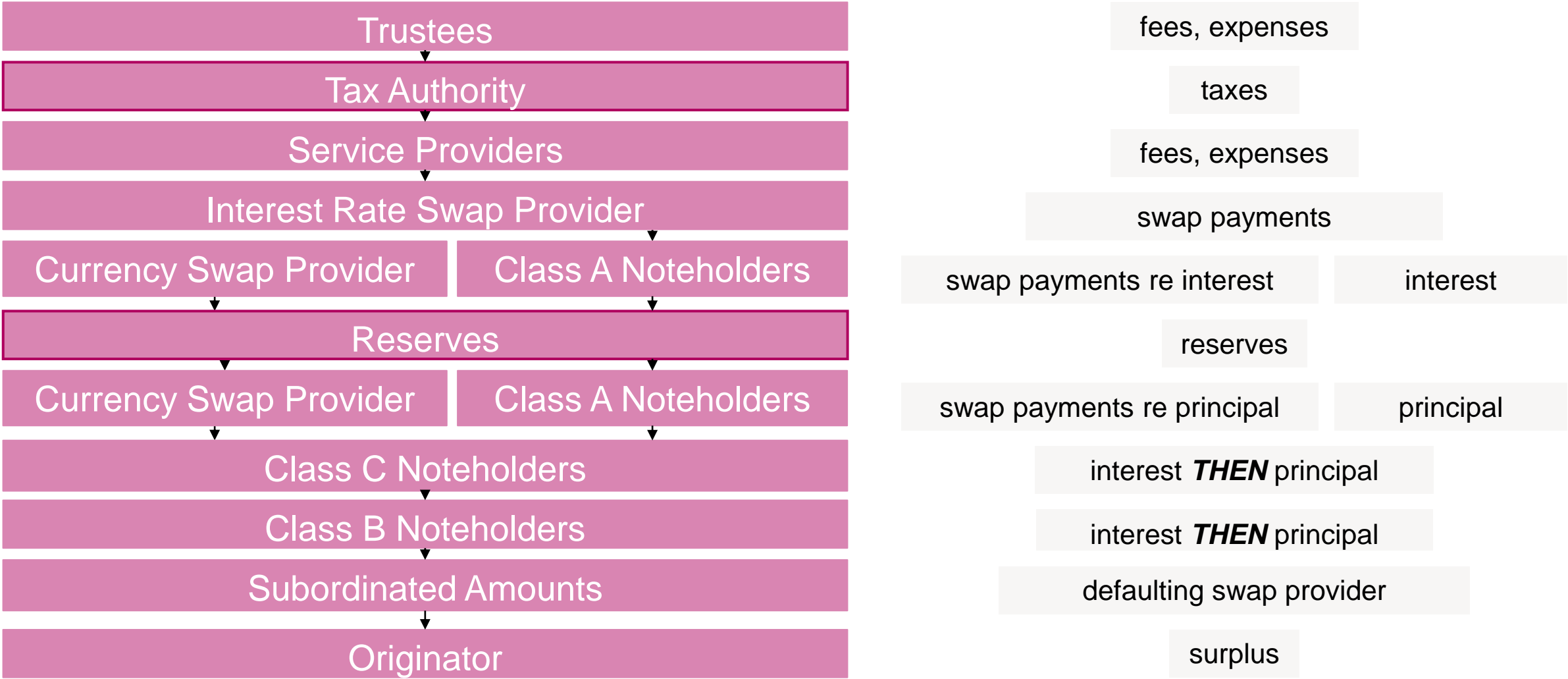
Cash Management: Revenue Waterfall



Cash Management: Principal Waterfall



Cash Management: Single Pre-Enforcement Waterfall



Tax

- > Withholding tax on interest payments:
 - > under the loans;
 - > under the notes;
 - > listing (the “quoted Eurobond exemption”).
- > Tax treatment of the SPV issuer.
- > Rating agencies will usually require an opinion on tax matters.

Rating Agencies

- > At least two rating agencies involved, ratings assess:
 - > repaying note principal on legal final maturity date;
 - > paying note interest on time.
- > Economic risks – data work.
- > Legal risks – transaction documents and opinions.
- > Enquiries into originator and servicer data systems.

Selected legal and regulatory issues



The UK and EU Securitisation Regulations

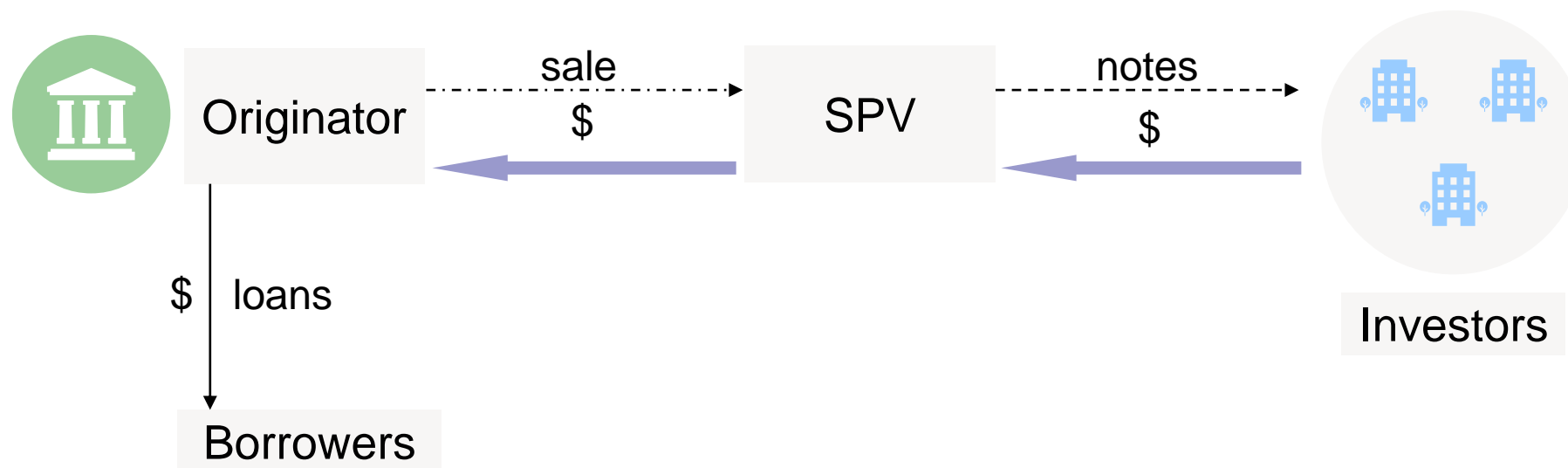
Originator, sponsor or original lender must:

- > retain 5% interest (Article 6 of the EU Sec Reg);
- > provide extensive reporting (Article 7 of the EU Sec Reg – see next slide);
- > comfort on underwriting.

Investors must:

- > conduct initial due diligence;
- > monitor, understand and report on securitisation.

STS regime



Transparency and disclosure requirements

Set out in Article 7 of the EU Sec Reg (for EU securitisations):

- > Providing key underlying documentation to investors **pre-pricing**.
- > Asset-level disclosure and investor reports.
- > Inside information and significant events.

Are the Securitisation Regulations relevant to “APAC securitisations”?

Is there tranching?

Is there any EU nexus?

- > The Securitisation Regulations impose direct compliance obligations on EU/UK originators, managers/sponsors, original lenders and issuers.
- > They also imposes compliance regulations on certain EU entities **investing in securitisations**.
- > APAC securitisations are likely to be indirectly affected by the Securitisation Regulations if:
 - > certain parties' EU/UK entities are involved; or
 - > parties intend to (i) offer securitised products to EU institutional investors or (ii) structure securitisations funded by EU institutional investors.

US risk retention

Section 15G of the U.S. Securities Exchange Act of 1934 (the “**US Credit Risk Retention Rules**” or “**USCRRR**”) created risk retention requirements for securitisations.

In general, unless either an exception or exemption applies or the foreign safe harbor applies, the USCRRR require that a “sponsor” of an asset-backed security issuance or its majority-owned affiliate retain an economic interest equal to at least 5% of the aggregate credit risk of the securitized assets collateralizing the ABS issuance, which is similar to what the Securitisation Regulations require.

The sponsor is responsible for compliance with the USCRRR.

“Sponsor” means a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.

Other regulatory issues

Local regulations may apply, depending on the structure, assets and entities involved.

Margining for OTC derivatives used in the securitisation?

In HK, certain regulations may be relevant:

- > Money lending under MLO.
 - > SFO licencing.
 - > PDPO.

Other issues:

CIS/AIFMD.

Credit Risk Retention under HKMA rules.

China Securitisation



China's Domestic ABS

Currently there are three main types of ABS in China:

- > Credit asset securitisation (Bank ABS) (PBOC, CBIRC regulated).
- > Asset-Backed specific plan (ABS) (CSRC regulated).
- > Asset-backed notes (ABN) (PBOC, NAFMII).

Bank ABS

Bank ABS

- > Issuing vehicle: **Special Purpose Trust**, insolvency remoteness of trust assets protected under PRC Trust Law.
- > Eligible trustee: a licensed PRC trust company.
- > Underlying assets:
 - > no clear definition for “**credit assets**”;
 - > possibly include corporate loans, mortgage loans, auto loans, rental receivables, trade receivables, credit card receivables and local government loans.
- > Trading venue: **Inter-bank bond market**.

ABS/ABN

Originators:

- > ABS: FI or corporates.
- > ABN: corporates.

Issuing vehicle:

- > ABS: Asset Management Plan managed by securities companies or subsidiaries of fund management companies.
- > ABN: mostly use SPT.

A variety of underlying assets including:

- > Receivables: trade receivables, consumer loans.
- > Rights of return: public utility income, business revenue.
- > Real estate income.

Trading venue:

- > ABS: Stock Exchanges; NEEQ; Inter-agency Quotation and Service System; OTC.
- > ABN: CIBM.

Possible Structures for Cross Border ABS

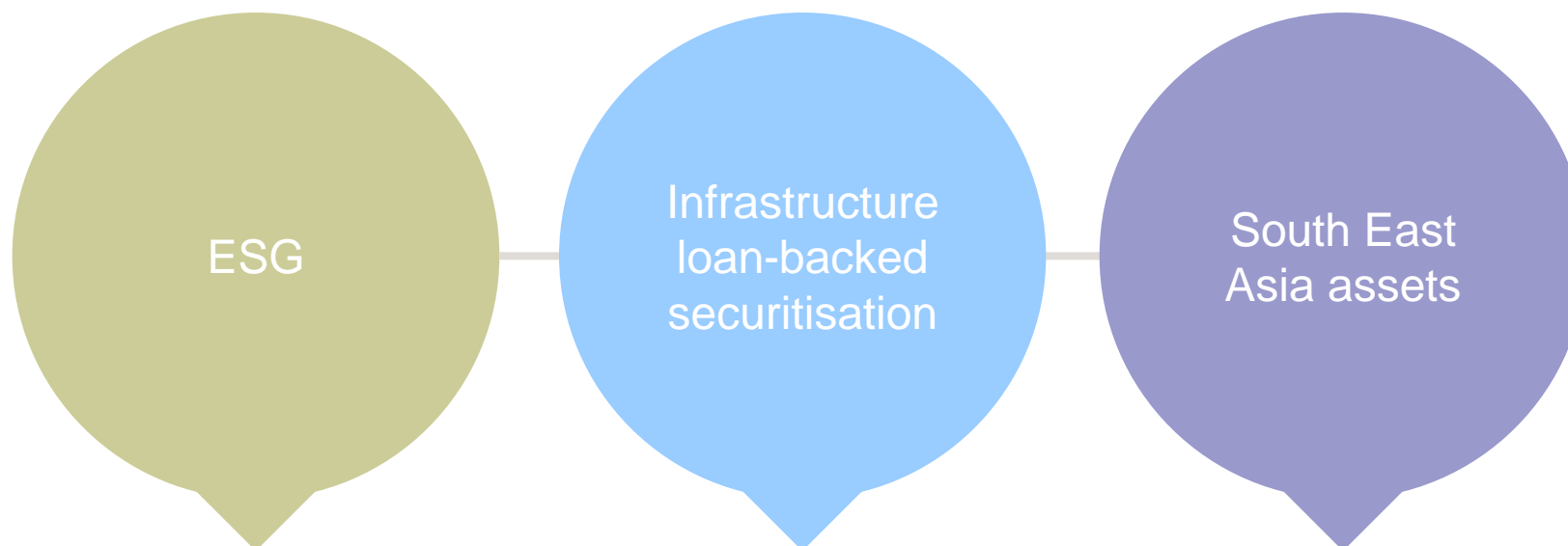
ABS backed by bonds traded on China's Interbank Bond Market ("CIBM Bonds")

- > Current channels to acquire CIBM Bonds:
 - > Northbound Bond Connect, CIBM Direct, QFII/RQFII.
- > Securitisation issuer: not an eligible investor and may need to hold through an asset manager.
- > Security typically taken at the custodian level so no perfection requirements in Mainland China (CCDC/SCH rules provide for registration only if created by holder of account at CCDC/SCH).
- > Need to comply with non-trade transfer restriction and enforcement sale in the name of the asset manager.

ABS backed by interest in Qualified Foreign Limited Partnership ("QFLP")?

- > QFLP schemes: pilot programmes by a number of local authorities, providing a channel for foreign investors to make equity or other types of permitted investment in China.
- > Form: partnership or investment management enterprise with foreign investor as LP or shareholder.
- > Investor eligibility requirements are being gradually relaxed under many QFLP schemes (e.g. Shenzhen, Hainan).
- > A variety of assets classes are eligible for investment, e.g. the Shanghai QFLP scheme allows investment in preferred shares, privately placed equity, convertible debt instruments, mezzanine debt obligations, NPLs.
- > Issues relating to creating security interest over LP interest under PRC law.

Future Trends



Questions?



SFD Junior Bankers Masterclass Series Curriculum

Further sessions will be announced later in the year. Please stay tuned and feel free to contact us at AsiaClientSeminars@linklaters.com if you have any questions.

Session 1	Launching Structured Notes <i>(completed March 2023)</i>
Session 2	Repackaging 101 <i>(completed April 2023)</i>
Session 3	Introduction to Securitisation <i>(this session)</i>
Session 4	Certificates of Deposit & Commercial Paper



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