Securitisation has become an essential part of many jurisdictions’ financial markets and economies. Like many other markets, securitisation markets have been severely hit by the global financial crisis. Although unsound lending practices are generally considered the primary cause of the global financial crisis, securitisation and re-securitisation (together with their derivative cousins, credit default swaps) were in fact responsible for spreading the losses much further than they would otherwise have reached. However, because of the importance of securitisation in generating liquidity (see below, Reasons for doing a securitisation), rejuvenation of the securitisation markets is considered an important step to economic recovery. Because of its part in the financial crisis, there will be changes in securitisation practice. However, they will probably relate to matters such as capital adequacy, risk management, leverage, due diligence, transparency, rating agency methodology and asset quality, rather than to the basic structure and other key aspects of a securitisation transaction, as set out in this Model Guide. That said, it is unlikely that the more opaque and multi-layered types of securitisations (see below, Other securitisation structures and table, Classes of receivables, Re-securitisation CDOs) will revive any time soon, if at all.

Securitisation is at different stages of development around the world. Many governments have legislated to make securitisations possible or easier to carry out. This global spread remains a work in progress. Some jurisdictions have only recently enacted securitisation laws, while others are still drafting them. Other jurisdictions are amending existing laws to develop their securitisation markets and, more recently, to introduce regulations to eliminate unsound market practices.

For information on the current state of the market and the legal regime in particular jurisdictions, see Country Q&A, Questions 1 (www.practicallaw.com/1-500-7835) and 2 (www.practicallaw.com/1-500-7835).

This model guide explains:

> **What a securitisation is.** This section describes what a securitisation is and explains the commercial motivations for securitisations.

> **Standard securitisation structural and legal issues.** This section analyses a standard securitisation structure and common features found across many jurisdictions. Areas where there are likely to be variations between jurisdictions have been identified throughout and information on jurisdiction-specific issues is set out in the Country Q&A (www.practicallaw.com/1-500-7835) in this Handbook.

> **Other securitisation structures.** This section provides a description of variations to the standard securitisation structure, including variations on how the securities are issued and the type of SPV used.

**What is a securitisation?**

Securitisation is a structured finance technique typically characterised by the following:

> A special purpose vehicle (SPV) (typically a company) is established to raise funds by issuing debt securities (typically bonds) to investors.
> The proceeds of the securities issued are used by the SPV to purchase receivables. These are rights in respect of financial obligations arising from the obligation of a debtor to pay his creditor amounts in respect of a debt. Receivables may arise from payments owed on loans, monies owed for the purchase of goods or services, or any other circumstance creating a financial obligation (see table, Classes of receivables).

> Before their sale to the SPV, the receivables are generated and/or owned by an established business entity (typically a financial institution or a large company) (originator).

> The SPV’s obligations to the investors under the securities are limited to and secured by a security interest created by the SPV over the receivables purchased by the SPV from the originator.

> When amounts payable in respect of the receivables are received by the SPV, they are used to fund the payment obligations of the SPV under the issued securities, and to meet any other costs in the structure.

As a result:

> The originator manages to obtain funding without incurring a liability by selling the receivables to the SPV.

> The investors receive a return on their investment which is funded and secured by the receivables acquired by the SPV.

**Reasons for doing a securitisation**

There are a number of reasons why an originator may decide to securitise its receivables. These include:

> Cheaper borrowing and credit arbitrage.

> Balance sheet benefits.

> Capital adequacy.

> Alternative source of funding.

**Cheaper borrowing and credit arbitrage**

By using securitisation techniques to separate a pool of underlying receivables, the originator may be able to generate a lower cost of borrowing than it can through other forms of borrowing. This is because the receivables are typically of a better credit quality than that of the originator itself (against whom investors have no recourse if the receivables fail to perform). Without securitisation, the originator would finance itself through borrowing based on its own creditworthiness. This “swapping” of one credit for another is known as credit arbitrage, and may arise for any of the following reasons:

> The debtors under the receivables contracts are a better credit risk than the originator. For example, if the originator is A-rated and sells and delivers goods to AA-rated trade buyers (the debtors) on one-month credit terms and the originator’s rights under the credit agreements represent the receivables, the short-term debt obligations of the AA-rated trade buyers, when isolated from the other rights and obligations of the originator, provide a better credit risk than the obligations of the A-rated originator to which the debt is owed.

> A pool of receivables, when isolated from the general credit risk of the originator and broken down into its component parts, may, with the benefit of credit enhancement (see below, Credit enhancement) and liquidity support (see below, Risk management and liquidity support) provide a statistically more reliable credit risk than the credit of the originator (and a better credit risk than any single debtor under a receivables contract). That is, the probability that a specified percentage of all debtors in the pool will default is more certain, and therefore can be more efficiently priced, than:

- the probability that any one debtor in the pool will default; or

- the probability that the originator will default.
In addition, because it is possible to isolate different risks associated with the receivables, they can be parcelled off to parties who are best able to manage and price them, so increasing the investor base to which the securities can be sold (see below, Tranching the securities).

The differential pricing of receivables due to the relative credit quality of the structure (less the costs of implementing the structure) is the credit arbitrage between the structured and the unstructured debt (see below, Ratings scales).

However, carrying out a securitisation can be expensive. If the reason for doing a securitisation is for the SPV to make a return on the receivables which exceeds the cost of funding the securities issued, as in an arbitrage securitisaton, it is important that the structuring costs do not outweigh the intended return.

Balance sheet benefits

Securitisation accelerates cash receipts from the receivables while removing the receivables from the originator's balance sheet. This reduces the originator's gearing (that is, the ratio of its debt to equity) so that it is:

> Better able to comply with financial covenants in respect of its on-balance sheet borrowing.
> Able to borrow more.
> Able to improve return on capital.

For examples of these benefits, see box, Examples of the benefits of off-balance sheet treatment.

The International Financial Reporting Standards (IFRS) (which replaced the International Accounting Standards (IAS)) have made securitisation structures that allow an originator to remove receivables from its balance sheet harder to achieve. Whether or not these are applied, and the effect of other accountancy practices affecting off-balance sheet treatment, depends on the jurisdiction (see Country Q&A, Question 3 (www.practicallaw.com/1-500-7835)). However, balance sheet considerations continue to be an element of financial structuring.

To achieve off-balance sheet treatment, the originator may need to show:

> That it is not connected to the SPV, to ensure that the SPV's accounts do not need to be consolidated with its accounts.
> That it does not have a significant interest in the risks and rewards associated with the receivables.

However, the International Accounting Standards Board (which sets the IFRS) is currently reviewing these rules in light of recent events, and changes to off-balance sheet accounting rules are anticipated in the near future.

Capital adequacy

In most jurisdictions, minimum capital requirement rules require financial institutions to maintain a minimum level of capital (essentially equity, reserves and various forms of subordinated debt) against “risk-weighted” assets (that is, the value of assets taking into account a risk weighting which is based on the likelihood of the asset value being realised). The requirement is expressed as a ratio which is agreed with the relevant regulatory authority in the jurisdiction (Country Q&A, Question 3 (www.practicallaw.com/1-500-7835)) and represents the level of risk to which the institution is considered to be subject. The actual level may move up and down depending on the nature of the institution, but is based on an 8% capital adequacy ratio established by the Bank for International Settlements under globally accepted banking standards set out in the 1988 Basel Accord (Basel I). This was recently supplemented and modified by more detailed and risk sensitive measures under the Basel International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II). Following the recent turmoil in the global financial markets, capital adequacy requirements have come under scrutiny and are being reviewed.

As capital in the form of equity and subordinated debt requires a higher yield to be paid than other borrowings, it is relatively expensive to the institution. By securitisising assets so that they are no longer recorded in the originator's
balance sheet (see above, Balance sheet benefits) or required to be included in the institution’s regulatory returns, the institution can reduce the amount of capital it needs to hold and the associated expense, or can use that capital to create new business.

Under Basel II, detailed provisions apply to the quantification and measurement of capital required to be held in the context of securitisation.

The revised regime was implemented in Europe under the Capital Requirements Directive (CRD), which member states were meant to implement at the beginning of 2007. The CRD is in fact made up of two recast directives:

> Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (Banking Consolidation Directive).


> The European Commission has recently published proposals amending Basel II and the CRD. The proposals include higher capital requirements for re-securitisations and a strengthened supervisory process for complex re-securitisations. The proposed changes are expected to come into force nationally by the end of 2010.

The requirements of Basel II and the CRD are complex and need to be considered in the context of the particular securitisation activities carried on by any financial institution, whether as originator, intermediary or investor.

For jurisdiction specific information on capital adequacy requirements and implementation of Basel II, see Country Q&A, Question 3 (www.practicallaw.com/1-500-7835).

Alternative source of funding

If existing sources of funding have been fully used, or if an originator wants to diversify its funding sources, securitisation can provide an additional or alternative source.

Structural and legal issues

Outline of securitisation structure

In a standard securitisation, the method of gaining risk exposure (that is, investing to become subject to the risks attached to an asset, and the accompanying potential for gain and loss) to the underlying receivables is usually some form of true sale of the receivables to the SPV (see below, Transferring the receivables). This structure is known as a cash flow securitisation.

Exposure to the receivables can also be taken using derivatives, without the SPV having to acquire the receivables themselves. This is known as a synthetic securitisation (see below, Synthetic securitisations).

This section sets out the main structural features and legal considerations that are relevant to a standard cash flow securitisation, as follows:

> The originator.

> The SPV.

> The securities.

> Transferring the receivables.

> Security and risk.

> Cash flow in the structure.
The originator
The party behind a securitisation is the originator. This entity generates (originates) and/or owns the defined or identifiable cash flow (that is, an income stream from receivables) and wants to securitise this for some reason (see above, Reasons for doing a securitisation). The originator establishes an SPV for this purpose and uses an “arranger” (see table, Participants) to structure the transaction.

An example of an originator with assets that can be securitised is a retail bank. Retail banks generate receivables in many different ways, for example, through:

- Investing consumer deposits.
- Lending money to businesses.
- Lending money to consumers, through loans, overdrafts and credit cards.
- Mortgage lending to residential homeowners.

The bank can isolate any of the receivables streams it generates and use these for a securitisation. For example, the bank can isolate the principal and interest payments it receives from its mortgage lending (see Diagram 1):

The SPV
This section covers:

- Establishing the SPV.
- Ensuring the SPV is insolvency remote.
- Ensuring the SPV is treated separately from the originator.
Establishing the SPV

The legal status of the SPV depends on the jurisdiction where it is established. In many jurisdictions it is a thinly capitalised corporate entity (that is, a company that has a very low equity capital compared to the amount of debt it owes) and someone other than the originator holds its shares, typically a charitable trust. In other jurisdictions, such as those where the trust concept is not recognised, there may be legislation governing securitisation and the SPV may be set up according to its provisions. Such legislation may provide, for example, that the SPV can be established as a fund, without legal personality, mutually owned by the investors.

For jurisdiction specific information on setting up the SPV and its legal status, see Country Q&A, Question 4 (www.practicallaw.com/1-500-7835).

If a jurisdiction is unable to accommodate a required legal form for an SPV, or there are certain advantages to establishing it elsewhere, then it will be established outside the jurisdiction of the originator (offshore). Tax considerations (see below, Tax issues) are particularly important in choosing where to establish the SPV and they are often established, as a matter of course, in low-tax or no-tax jurisdictions, such as Ireland, Jersey, Luxembourg, the Netherlands and the Cayman Islands.

For jurisdiction specific information on where SPVs are usually established and any advantages to establishing the SPV in a particular jurisdiction, see Country Q&A, Question 5 (www.practicallaw.com/1-500-7835).

The reasons the SPV is established in such ways are so that it:

> Is not treated as a subsidiary of the originator.

> Is not affected by the insolvency of the originator.

> Does not need to have its balance sheet consolidated with the originator’s balance sheet (although this may depend on the accountancy practices and various other rules in the jurisdiction (see above, Balance sheet benefits)).

Ensuring the SPV is insolvency remote

It is important that the SPV is, as far as legally possible, insolvency remote (that is, the SPV is set up and operates so that it is highly unlikely that it will become subject to insolvency proceedings and, in any event, beyond the reach of the originator’s liquidators (or administrators, insolvency officer, examiner and so on) in the event of the originator’s insolvency (see below, Ensuring the transfer cannot be unwound if the originator becomes insolvent). What is necessary to achieve the insolvency remoteness of the SPV depends on the jurisdiction in which it is established (see Country Q&A, Question 6 (www.practicallaw.com/1-500-7835)). However, common steps to achieve insolvency remoteness include:

> Ensuring the SPV is operated on a solvent basis.

> Appointing directors (or a director) independent of the originator whose vote is required to pass a board resolution relating to the SPV’s insolvency.

> Placing restrictions on the SPV that prevent it from incurring liabilities outside those contemplated by the securitisation.

> Including non-petition and limited recourse wording in all significant transaction documents that restricts a counterparty’s ability to take unilateral enforcement action against the SPV and limits the counterparty’s recourse to those assets which the SPV actually holds and over which the counterparty has security.

Ensuring the SPV is treated separately from the originator

In some jurisdictions, the courts can treat the assets of an affiliate closely associated with a parent entity as if the assets are all held by the same entity. Consequently, the affiliate’s assets can be made available to meet the obligations of the parent if it becomes insolvent. This is commonly known as lifting (or piercing) the corporate veil (or substantive
consolidation in the US). The extent to which courts can do this and methods necessary to avoid such consolidation depend on the law of the relevant jurisdiction (see Country Q&A, Question 7 (www.practicallaw.com/1-500-7835)).

The securities
This section covers:

> Issuing the securities.
> Constituting the securities.
> Tranching the securities.

**Issuing the securities**

The newly incorporated SPV (also called the buyer or issuer) issues securities to investors to fund the purchase of the isolated receivables from the originator (see Diagram 2). The securities are usually bonds or notes or, occasionally, equity securities, and may be issued in several structured tranches (that is, different classes of securities with different payment priorities and characteristics, such as different credit ratings or interest rates (see below, Tranching the securities and Diagram 3)).

The securities may be privately or publicly issued, depending on the individual circumstances of a transaction. However, if publicly listed, various listing requirements must usually be complied with when issuing the securities. These depend on the particular rules of the regulated exchange on which the securities are listed (see Country Q&A, Questions 8 (www.practicallaw.com/1-500-7835) and 9 (www.practicallaw.com/1-500-7835)).

**Constituting the securities**

The benefit of the covenants and rights contained in the securities issued by the SPV is usually held by a party on behalf of all the investors. Where the trust concept is recognised, this rights-holder is typically a trustee (see table, Participants). For information on the rights-holder in jurisdictions where the trust concept is not recognised, see Country Q&A, Question 10 (www.practicallaw.com/1-500-7835).

The securities are usually constituted under a trust deed (see table, Documents) which sets out the terms and conditions of the issue and also the rights in the securities held by the trustee. Where the trust concept is not recognised, the securities and the rights under them may be constituted by another document (Country Q&A, Question 10 (www.practicallaw.com/1-500-7835)).

**Tranching the securities**

To optimise the risk profile of the securities and therefore maximise the range of investors to whom they can be sold, the securities are divided into different classes. These typically consist of several sequential tranches with differing
priorities as to payment of principal and interest, and carrying differing rates of interest (see Diagram 3). The more senior tranches have the right to priority of payment over more junior tranches, but the more junior tranches carry a higher rate of interest. More sophisticated transactions may include tranches of combination securities within the structure (that is, tranches made up of a combination of separate tranches).

Each tranche (or at least the most senior tranche) is generally given a credit rating by a credit rating agency (see below, The role of the rating agencies).

Securitisation transactions usually involve such multiple-tranche structures. As the sophistication of structured products and the combination of derivative and securitisation structures increases (see below, Synthetic securitisations), it has become possible for investors to specify credit, yield, maturity and currency characteristics for arrangers to structure, rather than wait for issuers with the desired credit quality and borrowing needs to issue appropriate securities.

The process by which investors approach banks or issuers with specific details of securities tailored to their individual needs is called reverse enquiry. Multiple-tranche structures are increasingly seen as a method to structure the profile of the securities to meet such specific requirements of the investors.

This ability to match investor requirements was one of the drivers of the rapid growth in certain segments of the structured finance market, such as structured issuance programmes (see below, Single or multiple issue structures), credit derivatives, asset swaps (see below, Synthetic securitisations) and collateralised debt obligations (CDOs) (see table, Classes of receivables).

In light of the global financial crisis, and its particular impact on structured finance transactions, it is expected that any recovery in the securitisation market will be reflected in the way investors seek greater influence, not only in the make up of a securitisation’s credit structure, but also the credit quality of the receivables, credit enhancement and liquidity features, even at the expense of lower returns.

Transferring the receivables
This section covers:

> Classes of receivables.

> The transfer of the receivables from the originator to the SPV.

> Sub-participation.

> Declaration of trust.

> Prohibitions on transfer.
Avoiding the transfer being re-characterised.

Ensuring the transfer cannot be unwound if the originator becomes insolvent.

Establishing the applicable law.

**Classes of receivables**

Receivables are rights in respect of financial obligations arising from the obligation of a debtor to pay its creditor amounts in respect of a debt (see above, What is a securitisation?). Receivables may arise in a number of different circumstances.

For a list of different types of receivables, see table, Classes of receivables.

For details of which classes of receivables are usually securitised in different jurisdictions, see *Country Q&A, Question 11* (www.practicallaw.com/1-500-7835).

**The transfer of the receivables from the originator to the SPV**

> The originator (seller) transfers the receivables to the SPV.

> The form of transfer depends on the jurisdiction. The most common method of transferring receivables in a securitisation is assignment. However, the precise mechanics of an assignment and the other methods of transfer available (such as novation) vary between jurisdictions. For more information, see *Country Q&A, Question 12* (www.practicallaw.com/1-500-7835).

> Some types of receivables are not recognised and cannot be transferred, such as future receivables. This depends on the jurisdiction (see *Country Q&A, Question 13* (www.practicallaw.com/1-500-7835)).

> The SPV pays the transfer price for the receivables immediately on the transfer (see Diagram 4).

> Whether or not any security interest attached to the receivables (for example, security interests in land attached to mortgage receivables) is transferred along with the receivables and any requirements relating to this depend on the jurisdiction and/or method of transfer (see *Country Q&A, Question 14* (www.practicallaw.com/1-500-7835)).

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**Diagram 4**

Transferring the receivables

- **Originator**
- **Receivables**
- **Credit**
- **Purchase Price**
- **Obligors in respect of receivables**
- **SPV**
- **Transfers rights to receivables**

The SPV uses the funds from the sale of the securities to buy receivables from the originator. Title to the receivables transferred passes to the SPV.
An alternative to a transfer of receivables is to transfer the economic interest in them. This can be done using a sub-participation (see below, Sub-participation), and also, in some jurisdictions, through a trust.

Synthetic arrangements, which use derivative contracts, are another, more complex, means of acquiring an interest in underlying (reference) assets without transferring them (see below, Synthetic securitisations).

**Sub-participation**

A sub-participation involves a transfer of the economic interest in the receivables, but does not transfer any of the originator’s rights, remedies or obligations in respect of the debtors. The structure is an entirely separate back-to-back, non-recourse funding arrangement (that is, a credit backed by another credit, where the creditors only have rights against their immediate debtor, and not against the underlying debtors).

In a funded sub-participation (see Diagram 5), the SPV:

- Places funds with the originator, and in return the originator agrees to pass on to the SPV the payments it receives from the debtors in relation to the underlying receivables.
- Takes a credit risk on both the originator and the underlying debtors.
- May require a security interest over the originator’s claims against the debtors in respect of the underlying receivables, and any amounts received through payments of those receivables.

**Declaration of trust**

In a trust structure (see Diagram 6):

- The originator sets up a trust of specified receivables in favour of the SPV as the beneficiary.
- The originator acts as settlor (that is, the entity that sets up the trust and settles or transfers the trust assets on or to the trustees, for the benefit of the beneficiaries) and trustee of the trust assets.
- The SPV obtains the beneficial interest in the receivables and in all rights arising from the receivables, without transferring the legal ownership of the receivables.
Prohibitions on transfer

Before the transfer, it is important to consider the express terms of the receivables contracts (or, if transferring a pool of receivables, a sufficiently representative sample) to ensure that the receivables can be transferred in the manner contemplated by the parties.

The transfer of the receivables may also be affected by legislative requirements, such as data protection or consumer protection laws in the relevant jurisdiction.

For jurisdiction-specific prohibitions or other issues restricting the transfer of receivables, see Country Q&A, Question 15 (www.practicallaw.com/1-500-7835).

Avoiding the transfer being re-characterised

While the character of the transfer of the receivables may seem straightforward, some of the commercial requirements of the transaction may result in doubt being cast on whether there has been a valid and effective transfer of title to the receivables (often referred to as a true sale of the receivables). For example, if the transaction has certain characteristics, such as the originator receiving a servicing fee calculated by reference to “profit” in the receivables pool, or having a right to re-purchase receivables to end the securitisation, the intended transfer may be re-characterised as a loan with a grant of security, rather than a true title transfer.

The risk that arises in such cases is that a security interest may need to satisfy certain formalities to be effective. If the transfer is re-characterised as a loan with security, the intended transfer would probably not have fulfilled the security requirements as these would not have been in the contemplation of the parties.

The risk of a transfer being re-characterised depends on the jurisdiction (see Country Q&A, Question 16 (www.practicallaw.com/1-500-7835)).

The following features may help to avoid an intended title transfer being re-characterised as a loan with security:

> The transfer agreement expressing, as clearly as possible, that the transfer is a sale.

> The transfer agreement being on arm’s-length terms (that is, it is as it would be if the parties were not related to one another) and including an appropriate purchase price.

> The transfer agreement clearly documenting the passing of ownership risk to the SPV.
> The transfer agreement not providing post-transfer rights to the originator over funds generated from the transferred receivables.

**Ensuring the transfer cannot be unwound if the originator becomes insolvent**

It is important to minimise the risk that the transfer of receivables is unwound at some future date by the originator, or a liquidator or other insolvency officer of the originator.

The grounds on which an insolvency officer can unwind a transaction with the SPV depend on the insolvency regime or other laws in the relevant jurisdiction (see Country Q&A, Question 17 (www.practicallaw.com/1-500-7835)).

Common grounds for unwinding a transaction include that it was a transaction at an undervalue or was fraudulent.

**Establishing the applicable law**

Identifying the applicable law relevant to the underlying transactions contemplated by the transaction documents is essential to determine the:

> Formalities that must be complied with.

> Rules of enforcement and priority that apply.

In cross-border receivables transactions, identifying the applicable laws depends on the private international law rules of the relevant jurisdiction(s).

For jurisdiction specific information on the law governing the transfer of receivables and on the recognition and effect given to choice of law clauses, see Country Q&A, Question 18 (www.practicallaw.com/1-500-7835).

**Security and risk**

This section covers:

> Creating security.

> Credit enhancement.

> Risk management and liquidity support.

**Creating security**

The receivables, and amounts received from them, are used as the basis of the security package securing the SPV’s obligations to pay the investors principal and interest and, also, any amounts owed to other parties (such as swap counterparties, insurance providers and liquidity support providers (see below, Risk management and liquidity support)) involved in the transaction.

In a typical security package in a securitisation, the SPV grants a range of security interests over the sum of its assets and rights (including its rights under the receivables, bank accounts and various transaction documents) in favour of its secured creditors.

It is important in a securitisation to analyse which property and rights should be used as security and to ensure the formalities for creating the security in the jurisdiction where the assets are located are complied with. Specific requirements for creating effective security over various types of assets are summarised in the Country Q&A (see Country Q&A, Question 19 www.practicallaw.com/1-500-7835).

For more detailed information on taking security over assets, see PLC Cross-border Finance Handbook 2010/11.

The security package is usually held by a security-holder (see Diagram 8). In jurisdictions where the trust concept is recognised, this is usually a security trustee (see table, Participants) under a trust established by the SPV in favour of
the investors. Where the trust concept is not recognised, alternative methods may have to be used (see Country Q&A, Question 20 (www.practicallaw.com/1-500-7835)).

**Credit enhancement**

The arranger in a securitisation may apply various credit enhancement techniques to improve the credit ratings of the securities so they appeal to the investors. For example, the originator may transfer receivables of a greater value than the consideration paid by the SPV, creating a reserve fund protecting against non-payment of part of the receivables pool (see Diagram 7).

This method of credit enhancement is called over-collateralisation. Other common methods of credit enhancement include:

> **Creating retained spread.** This is when the SPV’s liabilities (that is, the amounts due on the securities) are less than the amounts it receives in respect of the receivables. The SPV retains the excess income as a reserve fund to cover costs and expenses and so improve the creditworthiness of the securities it issues.

> **Creating subordinated tranches.** The senior tranche(s) of securities is credit enhanced by providing the holders with priority of payment over the more junior tranche holders (see above, Tranching the securities). Subordinated tranche holders will also absorb any losses before senior tranche holders.

> **Insurance.** This is when an external creditworthy source (usually a monoline insurer (see table, Participants)) contracts to make payments due on the securities issued by the SPV if the SPV is unable to do so. However, this is now rare, as monoline insurers have been severely affected by the financial crisis, and financial insurance from other sources is not readily available.

> **Letters of credit.** This is a means of payment, typically used in sale of goods contracts in the export trade, to guarantee the seller will receive payment. The buyer (obligor in respect of the receivables) and seller of goods (originator) enter into an agreement with a bank (or other financial institution) under which the bank promises to pay the seller the purchase price of the goods on the fulfilment of certain conditions (usually the presentation of specified documents). The bank then recovers the amounts paid from the buyer. Credit is enhanced in such cases as the receivables are guaranteed to be paid by a more creditworthy source than the obligor in respect of the receivables.
For information on variations to credit enhancement techniques in particular jurisdictions, see *Country Q&A, Question 21* (www.practicallaw.com/1-500-7835).

**Risk management and liquidity support**

Because the SPV is usually structured with very little residual capital, it may become subject to short-term cash flow timing problems. This is known as liquidity risk and arises when the SPV’s ability to meet its current liabilities is adversely affected. A number of factors can do this:

> **Credit risk.** This is the risk of the underlying debtors failing to pay their debts. (This is the main risk relevant to the creditworthiness of the securities issued by the SPV and is also dealt with using credit enhancement techniques (see above, Credit enhancement).)

> **Timing risk.** This is the risk of the underlying debtors making late payments of the receivables, one-off costs arising, or mismatches in the asset to liability profile of the portfolio (for example, if the maturity dates of the assets in the receivables pool do not match up conveniently for payment purposes with the maturity dates of the securities).

To manage such risks in the structure, the arranger must ensure that the SPV has adequate cash flows to pay amounts due on time, without unnecessary liquidation of assets in the receivables pool. It therefore arranges for the SPV to have a liquidity support facility (see Diagram 8). The following are common methods for providing this (for information on jurisdiction specific issues relating to liquidity support, see *Country Q&A, Question 22* (www.practicallaw.com/1-500-7835):

> **A loan from the originator to the SPV.**

> **A loan facility from a third party bank.** This is known as a bank-line and is usually in the form of an overdraft or revolving credit facility or liquidity swap.

> **Cash reserve funds.** This is when the SPV holds on to certain funds and invests them in highly liquid and secure assets (such as government bonds). A cash reserve fund may arise in a number of ways including, for example, from the SPV:

  - holding amounts received from the proceeds of the securities in reserve rather than paying them to the originator;

  - retaining amounts on an ongoing basis that it receives from the receivables that are above the amounts due on the securities.

In addition, although the risks of such defaults on individual debts are difficult to predict, it is often possible to predict the default characteristics of a large number of debts from statistical analysis with a high degree of confidence. As a result, it is possible to structure the underlying receivables into separate tranches for which the default rate is statistically predictable. This predictability, together with credit enhancement techniques, such as issuing the securities in different tranches (see above, Credit enhancement), ensure a sufficiently likely level of payments and enable a series of appropriate credit ratings to be applied to the securities.

Depending on the precise nature of the assets, the transaction may also be subject to:

> **Interest rate risk.** This may arise, for example, if the interest on the receivables is fixed rate, but on the securities it is floating rate.

> **Currency risk.** This may arise, for example, if the receivables are paid in one currency and the securities are paid in another.

Fluctuations in interest or currency exchange rates may therefore mean the SPV:

> Pays more interest on the securities than it receives from the receivables.
> Pays amounts due on the securities in a relatively more expensive currency than that in which it receives the proceeds from the receivables.

To manage these risks, the SPV enters into one or more derivative contracts with a swap counterparty, such as an interest rate and/or currency swap agreement (see Diagram 8).

Securitisation is also exposed to liquidity, market and credit risks, the effects of which have been starkly highlighted by the global financial crisis. No-one predicted the contagion effect one defaulting asset type would have on the market, and this having a direct impact on the robustness of securitisation structures where even senior tranches (meant to be immune from critical losses) have suffered total or near total losses.

**Diagram 8 Creating security and managing risk**

The SPV enters agreements to grant security and manage risk with the:
- Security-holder
- Liquidity Support Provider
- Swap Counterparty

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**Cash flow in the structure**
This section covers:

> Collecting the receivables.

> Distribution of funds.

> Profit extraction.

**Collecting the receivables**

The originator generally continues to administer the receivables (but on the SPV’s behalf under a servicing agreement and in return for a servicing fee) and maintains the original contact with the underlying debtors. It is important that the servicing fee is set at a realistic rate so that, if it is necessary to replace the originator, an alternative servicer can be found.

Generally, at any time before enforcement proceedings against an underlying obligor, the only physical evidence it has of the change in title to the receivables from the originator to the SPV is that payments are made into a specified account (which is usually charged in favour of the security trustee or other security holder (see above, Creating security)).
**Distribution of funds**

Various paying agents are used to transfer funds from the SPV to the parties in a securitisation (see Diagram 9). After the receivables are collected by the servicer and passed through the SPV's bank accounts to its paying agent(s), the paying agent(s) uses the receipts from the receivables to pay interest and principal due on the securities, and any other costs and expenses the SPV may have. Payments are made according to a priority order of payments specified in the transaction documents (often referred to as the cash flow waterfall) (see box, Cash flow index) (for jurisdictional differences, see Country Q&A, Question 23 (www.practicallaw.com/1-500-7835)).

**Profit extraction**

Any money left over after all such payments have been made is extracted from the SPV and passed back to the originator using various profit extraction techniques. These include:

> The originator taking fees for:

  - administering the receivables contracts and collecting the receivables;
  - arranging or managing the portfolio of receivables; and/or
  - acting as a swap counterparty.

> The SPV paying the originator deferred consideration on the receivables purchased.

> Originating, providing and receiving a fee from the SPV for credit enhancement arrangements.

> The SPV making loan payments on subordinated loans by the originator.

> The originator holding equity securities in the SPV.

When deciding how to extract profit, it is important to consider the reason for the securitisation, the tax consequences of the proposed method of profit extraction and the laws applicable to transferring receivables in the relevant jurisdiction. For example, in some jurisdictions, the originator may not be allowed to retain any rights to the transferred receivables under a securitisation law. Similarly, some jurisdictions may not recognise the SPV as insolvency remote from the originator, if the originator owns any equity securities in the SPV. In such cases, the “equity” element allowing for profit extraction is often characterised by a holding of subordinated notes which pay interest or principal, either at a high rate of interest or to the extent any surplus funds are available to be distributed. Such notes can offer a rate of return akin to an equity holding and are often referred to as the “equity piece”.

For jurisdiction specific information on profit extraction, see Country Q&A, Question 24 (www.practicallaw.com/1-500-7835).

Any final residual amount after all payments are made and profit extracted is distributed according to the transaction documents and/or the SPV's constitutional documents.
The role of the rating agencies
This section covers:

> Ratings scales.
> The ratings process.

**Ratings scales**

Rating agencies rate the securities to indicate whether the SPV has a strong or weak capacity to pay interest and principal. The three main rating agencies are:

> Standard & Poor’s.
> Moody’s Investor Services.
> Fitch Ratings.

Each rating agency has its own scale of ratings that range from a very strong credit rating, where the rating agency considers that there is a very small statistical probability of default, to a very weak credit rating where the securities are already in default. For example, Standard & Poor’s ratings range from AAA (extremely strong capacity to pay interest and repay principal) to D (securities in default). A security is said to be “investment grade” if it has a Standard and Poor’s rating of BBB or above.

If the main reason for doing a securitisation is to obtain cheaper borrowing (see above, Cheaper borrowing and credit arbitrage), the rating of the securities may be essential. This is because the interest rate on debt securities depends on their credit rating. If the credit rating is higher, the interest rate on them, and so the cost of borrowing through them, is lower. In a securitisation, a better credit rating for the securities can be achieved through securing (backing) them with a specified and secure cash flow than an originator could otherwise achieve through a normal debt securities issuance (see above, Cheaper borrowing and credit arbitrage). For this reason, if securities need to be, for example, AAA-rated to be saleable, the arranger must structure the transaction to achieve this. This may involve various credit enhancement techniques (see above, Credit enhancement).
The ratings process

The rating agencies provide a rating after carrying out detailed statistical analysis on the probability of defaults in the receivables and their effects on the SPV’s ability to comply with its payment obligations in respect of the securities. When doing this, because the structure of a securitisation legally isolates the receivables that will ultimately be used to make payments on the securities from the originator’s insolvency, the creditworthiness of the originator can be disregarded. The rating agencies, therefore, base their rating of the securities and focus their analysis on:

> The credit characteristics of the isolated receivables, such as default levels, timing of defaults and recovery levels.
> The legal commitment and creditworthiness of parties providing credit enhancement.
> The legal commitment and creditworthiness of parties providing liquidity support.
> The other parties involved in payments to, or from, the SPV (for example, the security trustee, account bank and investment manager (see table, Participants)).
> The security over, and procedures and mechanisms for administering, the underlying receivables and related cash flows.
> The legal integrity of the structure.

The rating of each tranche of securities is based on a statistical analysis of the probability of full payment of interest and principal and, in the case of senior tranches, the timely payment of interest. The analysis focuses on how much credit enhancement is needed, generally based on a multiple of historical losses in similar structures and underlying receivables pools, to achieve a given probability of full payment of principal and interest.

The ratings of the securities can also be affected by various country specific risks, such as:

> Legal certainty issues in a jurisdiction affecting the enforcement of rights under the receivables contracts.
> Political risks arising that may frustrate the transaction.

For more information on these jurisdiction specific risks, see Country Q&A, Question 25 (www.practicallaw.com/1-500-7835).

After doing their analysis, the rating agencies usually provide:

> A draft or preliminary rating during the structuring of the transaction, sometimes known as a shadow rating.
> A rating for the issue of the securities.
> Ongoing ratings during the life of the securitisation.

Investors could do this themselves, but the complexity of the product and the need for extensive underlying data make this impracticable.

Regulatory issues

Regulatory issues relevant to a securitisation depend on the jurisdictions in which the parties to particular parts of a transaction are located. Many jurisdictions have now legislated to make securitisation possible or to promote their securitisation market and so any securitisation laws in relevant jurisdictions must be taken into account (see Country Q&A, Question 2 (www.practicallaw.com/1-500-7835)).

Regulatory issues that may arise (whether as part of securitisation legislation or otherwise) include:

> Issues affecting the originator, such as accountancy practices and capital adequacy requirements (see Country Q&A, Question 3 (www.practicallaw.com/1-500-7835)).
> The structuring of the SPV (see Country Q&A, Question 4 (www.practicallaw.com/1-500-7835)).

> Whether any of the parties must be authorised or are subject to supervision by a regulatory body (for example, supervision of the originator or SPV by a regulatory authority (see Country Q&A, Questions 3 (www.practicallaw.com/1-500-7835) and 4 (www.practicallaw.com/1-500-7835))).

> The rules on offering and trading securities (see Country Q&A, Question 9 (www.practicallaw.com/1-500-7835)).

> Whether the underlying receivables contracts comply with relevant consumer credit requirements (see Country Q&A, Questions 12 (www.practicallaw.com/1-500-7835) and 15 (www.practicallaw.com/1-500-7835)).

> Data protection restrictions and confidentiality laws impacting on the proposed transfer of customer information accompanying the transfer of receivables (see Country Q&A, Questions 12 (www.practicallaw.com/1-500-7835) and 15 (www.practicallaw.com/1-500-7835)).

**Tax issues**

Tax is a jurisdiction specific issue dependent on the location of the parties and/or the relevant assets (see Country Q&A, Question 26 (www.practicallaw.com/1-500-7835)). The types of tax considerations that may arise in a securitisation include:

> **Transfer taxes.** These may apply to the transfer of receivables from the originator to the SPV. For example, depending on the types of receivables transferred, some form of stamp duty or value added tax may be payable.

> **Revenue taxes.** These may be an issue for the SPV and the originator. For example, tax liabilities may arise in relation to:

  - the SPV’s income from the receivables;
  
  - any income the originator receives through profit extraction (see above, Profit extraction).

> **Withholding tax.** This may apply in respect of:

  - **Liquidity loans made between entities.** If interest on such loans is paid gross, withholding tax may be payable (see above, Risk management and liquidity support).

  - **The issue of the securities.** The securities issued by the SPV are normally structured in such a way that withholding tax will not be payable in certain defined circumstances (these are normally set out in the terms and conditions of the securities).

**Synthetic securitisations**

In a synthetic securitisation structure, there is no transfer of the receivables to the SPV. Instead, some form of derivative product, such as a credit default swap (CDS), is used to gain risk exposure to a specified pool (or portfolio) of underlying receivables (reference assets).

These work by the swap counterparty in the CDS contract (often the SPV) agreeing to make good losses suffered by the owner of the reference assets (often the originator) if a credit event (such as a payment default) occurs in the reference assets. In return, the owner of the reference assets agrees to pay the swap counterparty premiums based on the perceived probability of credit events occurring in the reference assets. As a result, the swap counterparty gains exposure to the risks attached to the reference assets without title or any other rights in them passing to it.

Synthetic securitisations can be structured in many different ways depending on a variety of factors. Because of this, they can be very investor driven and were one of the key factors behind the growth and development of the securitisation market (see above, Tranching the securities). However, growth halted as a result of the credit crisis and the future use of this technique is now in doubt.

For information on country trends, see Country Q&A, Question 27 (www.practicallaw.com/1-500-7835).
Other securitisation structures
This section covers:

> Factors influencing structures.
> Single or multiple issues.
> Master trusts.
> Multi-seller conduits.
> SIVs and other structured credit vehicles.

Factors influencing structures

Securitisation markets in different jurisdictions are at very different levels of development, ranging from extremely sophisticated markets, to those where a securitisation has not yet taken place but legislation has been enacted (or is being prepared) to encourage its development (see Country Q&A, Questions 1 (www.practicallaw.com/1-500-7835) and 2 (www.practicallaw.com/1-500-7835)).

In addition to the standard securitisation structure outlined above, a number of other structures are used. Whether any of these variations on the standard securitisation structures have been used yet or are possible in a jurisdiction depend on:

> The sophistication of the market and the flexibility of the legal framework within which securitisations can be carried out.
> The strength (or existence) of an origination market for a class of receivables.
> The investor base in the jurisdiction, or access to investors in other jurisdictions (this depends a great deal on the ratings the securities can achieve (see Country Q&A, Question 25 (www.practicallaw.com/1-500-7835))).

For more information on the variety of securitisation structures that have taken place in particular jurisdictions, see Country Q&A, Question 28 (www.practicallaw.com/1-500-7835).

Single or multiple issue structures
The ways in which the SPV issues the securities can vary:

> Single issue structures. The SPV uses proceeds from a single issue of securities and the investors have the benefit of security over all the assets of the SPV.
> Multiple issue structures. The documents for the issue of the securities typically take the form of a debt issuance programme or euro medium-term note programme. The SPV issues notes from time to time secured by reference to a specific pool of underlying collateral or reference assets. The investors’ rights are limited to the specific collateral or reference assets identified for the specific issue of notes. They have no rights to other assets that may be held from time to time by the SPV.

Master trusts
This structure is only available in jurisdictions where the trust concept is recognised (see above, Establishing the SPV). The master trust structure involves establishing a trust which issues multiple series of securities, with each series having the benefit of the entire asset pool. The originator can introduce new assets into the asset pool and issue new series of securities over time.

Master trusts are particularly useful for short-term revolving receivables, such as credit cards, which can be used under this structure on a longer term basis.
**Multi-seller conduits**

In general:

> Multi-seller conduits are typically SPVs established and administered by banks and financial institutions (sponsors) for ongoing purchases of underlying receivables from several originators.

> The underlying receivables are subject to “eligibility criteria” set out in the programme documents, but typically are generated from:

  - trade;
  - credit cards;
  - auto loans;
  - leasing;
  - collateralised debt obligations (CDOs) (see table, Classes of receivables).

> The programme is funded through an issue of securities in the short-term money markets, typically, commercial paper. These are therefore referred to as asset-backed commercial paper (ABCP).

> Sponsors generally provide liquidity and credit enhancement on a programme-wide basis which supplements pool-specific liquidity and credit enhancement to achieve an appropriate rating for the programme.

> The aim of using conduits is to provide originators with low-cost funding while achieving a reduced risk-weighted capital requirement for the sponsor.

Due to limited liquidity available in the current market, these structures have little chance of flourishing.

**Structured investment vehicles (SIVs) and other structured credit vehicles**

SIVs are SPVs established to invest in a widely diversified portfolio of relatively low-risk assets. In general:

> The portfolio is dynamic and so is managed by a separate investment manager (see table, Participants).

> The SIV issues securities aiming to make arbitrage profits between the cost of funding (that is, the principal and interest due on the securities) and the return on the asset portfolio it has invested in.

> SIVs benefit from programme-wide reduced credit risk because of the collateral provided by the capital raised in the market and liquidity facilities provided by banks with appropriate short-term credit ratings.

> SIVs may be cash flow SIVs or synthetic SIVs, the latter taking a risk position in the relevant assets using credit derivatives (see above, Synthetic securitisations).

> Other structured credit vehicles are also being established which are capitalised through a combination of equity and market debt. These vehicles apply strict operating guidelines, agreed with the rating agencies, regulating the amount of capital that the vehicle requires for a given level of risk in its operating parameters. Such vehicles may invest in a range of investment categories and may be the subject of a very high level of leverage.

Due to limited liquidity available in the current market, these structures have little chance of flourishing.

**Cash flow index**

This index explains the cash flow around the standard securitisation structure shown in Diagram 9:

1. Payments from Investors to SPV for purchase of securities.

2. Payment from SPV to Originator for purchase of receivables.
3. Ongoing collection of receivables due from Obligors by servicer. The amounts collected are paid into a bank account for the SPV.

4. Transfer of monies collected from the receivables payments from the SPV's bank account to its principal Paying Agent for distribution.

5. Paying Agent(s) pays any costs and undertakes certain responsibilities in relation to relevant taxes (such as withholding tax) (see Tax issues). It then distributes amounts owed by the SPV to the various parties involved according to the priority order set out in the cash flow waterfall. The order depends on the type of securitisation and the allocation of risk, but generally ensures that essential payments required to maintain the structure are made first. It may also allow for deferral of payments in certain circumstances.

The following is a typical example of a cash flow waterfall:

- Payment of costs, fees and expenses of essential transaction parties, such as the trustee.
- Payment of essential administrative costs of the SPV, such as registration fees and mandatory taxes.
- Payments of fees, costs and expenses of other transaction parties (that are not equivalent to an equity return), such as the Liquidity Support Provider (payments will also be received from the Liquidity Support Provider and Swap Counterparty when required).
- Payments of interest on the most senior tranche of securities as they fall due.
- Payments of principal on the most senior tranche of securities as they fall due.
- Payments of interest on each succeeding junior tranche of securities as they fall due.
- Payments of principal on each succeeding junior tranche of securities as they fall due.
- Any other payments not covered above.
- Payments in respect of equity return.

> For any jurisdiction specific variations to the above waterfall, see *Country Q&A Chapters, Question 22* ([www.practicallaw.com/1-500-7835](http://www.practicallaw.com/1-500-7835)).

6. The Originator extracts any surplus amounts held by the SPV using various profit extraction techniques, such as acting as the servicer (see Profit extraction).

**Examples of the benefits of off-balance sheet treatment**

**Example 1: improving the originator’s debt to assets ratio**

Assume:

> The originator has receivables with a book value of US$100 and a bank debt of US$85. The ratio of its debt to assets is 1:1.18.

> Under a bank facility, the originator must have a debt to asset ratio in excess of 1.20.

If the originator sells US$20 of the receivables to a securitisation SPV and then uses the proceeds to reduce its debt to US$65, the ratio of debt to assets is improved to 1:1.23.

**Example 2: improved return on capital**

Assume:

> The originator has receivables with a book value of US$100 and bank debt of US$85.
The annual rate of interest on the receivables is 10% and on the bank debt it is 7%. The originator therefore receives net annual income of US$4.05 (10% of US$100 (US$10) minus 7% of US$85 (US$5.95)). This represents a return of 4.05% on the assets.

If the originator sells US$20 of receivables to a securitisation SPV and then uses the proceeds to reduce its debt to US$65, the originator will receive net annual income of US$3.45 (10% of US$80 (US$8) minus 7% of US$65 (US$4.55)), but the percentage return will be increased to 4.3%.

Classes of receivables

<table>
<thead>
<tr>
<th>Class</th>
<th>Receivables income usually made up from:</th>
<th>Reasons for using the receivables and any particular risks, benefits or other issues associated with them:</th>
</tr>
</thead>
</table>
| Real estate-/mortgage-backed securities (MBS) | Principal and interest payments owed on residential mortgages. | Freeing up capital for financial institutions to do more business.  
Originator can usually retain client contact and other economic benefits by acting as servicer (see above, Collecting the receivables).  
The securities are often highly rated and can be sold to a wider investor base as they usually also have the benefit of the property securing the mortgage as well as the mortgage payments. |
| Residential mortgage-backed securities (RMBS) | Lease and licence payments from commercial tenants. | CMBS are subject to additional risks as commercial tenants are susceptible to economic, market and industry factors affecting their business or the use of the land.  
Also, see above, Residential mortgage-backed securities (RMBS). |
| Commercial mortgage-backed securities (CMBS) | Credit cards. Credit card repayments and interest payments.  
Auto loans. Interest payments and principal repayments on loans in respect of motor vehicles.  
Other consumer lending. For example, interest and principal payments on consumer loans and overdraft facilities. | The underlying receivables pool has a granular nature. It is made up of a large number of individual and unrelated obligors, and each obligation forms a small percentage of the total.  
These receivables are usually suitable for securitisation because, although it may be hard to predict the default characteristics of an individual credit, the cash flows of the pool as a whole tend to have consistent performance levels that allow statistically reliable assumptions to be made about payment and default characteristics (see above, Reasons for doing a securitisation, Cheaper borrowing and credit arbitrage). |
<table>
<thead>
<tr>
<th>Class</th>
<th>Receivables income usually made up from:</th>
<th>Reasons for using the receivables and any particular risks, benefits or other issues associated with them:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial ABS:</td>
<td>Trade and other receivables. Income from trade and other types of operating company receivables, such as franchise agreements and the receipts from sales of goods and/or services, including gate receipts from theme parks and sporting stadia. Asset finance. Lease payments for large assets, such as aeroplanes, ships and machinery. Also income from related assets, such as flight slots and spare parts. Intangible assets. Income streams from intellectual property rights including music royalties and branding rights.</td>
<td>See above, Consumer ABS. A niche and bespoke market with a long history of securitisation. The sector has not witnessed the same growth as other asset classes due to a range of factors, including the difficulty of valuing cash flows, illiquidity and legal complexities.</td>
</tr>
<tr>
<td>Whole business</td>
<td>Receivables of a whole operating business.</td>
<td>To be securitised, the business must have characteristics that allow for statistically reliable cash flows based on stable revenues, identifiable costs and expenses, and capital outflows over a sufficient period. The legal regime must also allow the investors, as secured creditors, to access the cash flow of receivables without becoming subject to a moratorium or other creditor or shareholder rights if a default occurs. Whole business securitisations are not possible for all businesses in all jurisdictions (see Country Q&amp;A, Questions 11 (<a href="http://www.practicallaw.com/1-500-7835">www.practicallaw.com/1-500-7835</a>) and 13 (<a href="http://www.practicallaw.com/1-500-7835">www.practicallaw.com/1-500-7835</a>)).</td>
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<tr>
<td>Class</td>
<td>Receivables income usually made up from:</td>
<td>Reasons for using the receivables and any particular risks, benefits or other issues associated with them:</td>
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</tbody>
</table>
| Infrastructure         | Payments for services provided under a concession or from consumer payment obligations (for example, tolls or fares). | Infrastructure securitisations use the proceeds from the sale of the receivables to provide the capital required for building and operating the infrastructure project, and in some cases to generate a return. The predictability of the cash flow in infrastructure securitisations relies on the high creditworthiness of the counterparty (governments, in the case of some direct concessions, or monopoly providers, in the case of some public service providers). Infrastructure securitisations are subject to significantly different risks to other securitisations, including:  
> Construction and development risk.  
> Operational risk.  
> Significant exposure to a single asset.  
> Exposure, potentially, to a single underlying debtor (such as a government). |
<p>| Collateralised debt obligations (CDOs) | CDOs In a CDO structure, the receivables transferred to the SPV are a basket of debt obligations (such as loans or bonds) owed to the originator and the receivables from these debt obligations (from interest payments and principal repayments on them) are used to pay and secure the amounts due on the securities issued by the SPV. There are a variety of different CDO structures depending on the type (or, more usually, types) of debt obligation making up the receivables pool (see below). |</p>
<table>
<thead>
<tr>
<th>Class</th>
<th>Receivables income usually made up from:</th>
<th>Reasons for using the receivables and any particular risks, benefits or other issues associated with them:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collateralised loan obligations (CLOs)</td>
<td>CLO structures use receivables from interest and principal payments on a pool of loans. There are various types of loans that can be used.</td>
<td>An originator may carry out a CLO securitisation to:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; Make an arbitrage profit from the returns on the underlying receivables exceeding the costs of payments due on the securities issued (arbitrage CLO).</td>
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<tr>
<td></td>
<td></td>
<td>These are generally done by asset management companies, who repackage the loans or other debt obligations, pool them together and use them as collateral for the tranches of securities.</td>
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<td></td>
<td></td>
<td>&gt; Reduce or manage loan book exposures (balance sheet CLO), for example, to remove concentrations of amounts lent to certain customers or sectors, and to diversify the loan portfolio.</td>
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<tr>
<td></td>
<td></td>
<td>These are generally done by commercial banks wishing to improve their regulatory capital ratios by removing loan assets from their balance sheets.</td>
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<td></td>
<td></td>
<td>For further information on these, see above, <em>Reasons for doing a securitisation</em>.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>There are various types of loans that can be used in CLO structures, and these are subject to different risks.</td>
</tr>
<tr>
<td>Large corporate CLOs. Loans to large companies.</td>
<td></td>
<td>Usually balance sheet CLOs done by originating banks (<em>see above</em>).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Large companies often have relatively good credit ratings so securities issued in large corporate CLOs may be relatively low risk.</td>
</tr>
<tr>
<td>Small to medium-sized enterprise (SME) CLOs. Loans to smaller companies.</td>
<td></td>
<td>Usually balance sheet CLOs done by originating banks (<em>see above</em>).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SME CLOs are generally subject to higher levels of credit risk than large corporate CLOs.</td>
</tr>
<tr>
<td>Class</td>
<td>Receivables income usually made up from</td>
<td>Reasons for using the receivables and any particular risks, benefits or other issues associated with them</td>
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</tr>
<tr>
<td><strong>Leveraged loan CLOs.</strong></td>
<td>Loans that are secured by an asset where the value of the loan is a relatively high percentage of the value of the asset (it has a high loan-to-value (LTV) ratio).</td>
<td>The high LTV ratio means there is an increased risk for the CLO investors that loans forming part of the receivables pool collateralising the CLO may default, and that assets/security of the defaulting company available to pay the loan will not cover the full amount of the loan. This higher risk profile requires greater levels of credit enhancement or the offer of higher returns on the securities (usually through offering a higher interest rate (coupon) on the securities) to attract investors. Leveraged loans are usually only included in a CLO as a small proportion of the total receivables pool and most of the return is guaranteed by more senior assets in the receivables pool. They are generally included to enable the overall securities (or tranches of them) issued by the SPV to achieve desired yield characteristics to attract a wider pool of investors.</td>
</tr>
<tr>
<td><strong>Second lien CLOs.</strong></td>
<td>A type of secured loan where the interest and principal payments usually have the same priority for payment as the senior debt, but the security on the loan is subordinated in certain ways to that senior debt.</td>
<td>Because the security granted for the loan is subordinated, second lien CLOs are subject to similar risks and are used in similar ways to leveraged loan CLOs (see above, Leveraged loan CLOs).</td>
</tr>
<tr>
<td><strong>Emerging market CLOs.</strong></td>
<td>Loans to entities in emerging markets.</td>
<td>Can be arbitrage or balance sheet CLOs. Can be subject to different risks, including: &gt; Differences in approach to borrowing and lending. &gt; Country and political risk. &gt; Legal certainty risks.</td>
</tr>
<tr>
<td><strong>Distressed debt CLOs.</strong></td>
<td>Loans that have passed their due dates and may become subject to enforcement action.</td>
<td>Can be arbitrage or balance sheet CLOs. The main risk in these CLOs is correctly valuing the loans transferred to the SPV. They also require skilful management of the restructuring and enforcement process by the investment manager.</td>
</tr>
<tr>
<td>Class</td>
<td>Receivables income usually made up from:</td>
<td>Reasons for using the receivables and any particular risks, benefits or other issues associated with them:</td>
</tr>
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</tr>
<tr>
<td>Collateralised bond obligations (CBOs)</td>
<td>CBOs use interest and principal payments on a pool of bonds or notes. There are various types of bond that can be used.</td>
<td>For reasons for doing a CBO securitisation, see above, Collateralised loan obligations (CLOs). The different types of bonds are subject to different risks.</td>
</tr>
<tr>
<td><strong>Investment grade corporate CBOs</strong></td>
<td><strong>Bonds or notes with an investment grade rating</strong> (see above, The role of the rating agencies).</td>
<td>An investment grade rating means that the underlying debt obligation is recognised as being of relatively high quality with a low risk of default. Because of this, the cost of issuing investment grade securities is generally lower with less rigid disclosure rules. Borrowing is therefore cheaper, but the return to the investors is reduced.</td>
</tr>
<tr>
<td>High yield bond CBOs.</td>
<td>Bonds or notes that are non-investment grade (junk bonds) and so carry higher returns to investors.</td>
<td>Bonds of this kind are:</td>
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<tr>
<td></td>
<td></td>
<td>&gt; Statistically more likely to default than investment grade securities.</td>
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<td></td>
<td></td>
<td>&gt; Perceived to have a speculative and volatile nature.</td>
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<tr>
<td></td>
<td></td>
<td>&gt; Likely to generate much lower recoveries than on syndicated loans.</td>
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<td>This higher risk profile requires either:</td>
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<td>&gt; Greater levels of credit enhancement to achieve higher credit rated tranches.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; The offer of higher returns to attract investors.</td>
</tr>
<tr>
<td>Emerging market CBOs.</td>
<td>Bonds or notes from entities in emerging market countries.</td>
<td>See above, Emerging market CLOs.</td>
</tr>
<tr>
<td>Distressed securities CBOs.</td>
<td>Bonds or notes already in default.</td>
<td>See above, Distressed debt CLOs.</td>
</tr>
<tr>
<td>Other CDOs</td>
<td>Other CDOs may contain a mixed basket of bonds, loans or other diversified payment rights.</td>
<td>The risks depend on the debt obligations making up the basket. However, by having a mixture of differing obligations, with varying degrees of risk, it is possible to structure the CDO so that different tranches of the securities are backed by different obligations. By doing this, the returns to investors on each different tranche of securities are varied and so the range of investors to whom the securities can be sold is maximised.</td>
</tr>
<tr>
<td>Class</td>
<td>Receivables income usually made up from:</td>
<td>Reasons for using the receivables and any particular risks, benefits or other issues associated with them:</td>
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</tbody>
</table>
| **Re-securitisation CDOs**  
(due to their opaque nature, the additional risks associated with them, the difficulty in assessing the value of the securities issued under them and their deemed part in causing or exacerbating the global financial crisis, the future of some of these structures is in doubt) | These are CDO securitisations of pools of securities bought by an originator from SPVs that issued them in earlier securitisations. There are three main types of re-securitisation CDOs:  
- **CDOs of ABS.** Receivables used from a pool of securities from ABS securitisations.  
- **CDOs of CDOs (CDO squared).** Receivables used from a pool of securities from CDO securitisations.  
- **CDO of ABS and CDOs.** Receivables used from a pool of securities from a mixture of ABS and CDO securitisations. | The further tranching and structuring of the credit profile of ABS and CDO securities in this way produces additional arbitrage opportunities. The rapid growth of ABS in recent years is partly due to demand from CDO managers establishing these structures.  
Re-securitisation transactions can provide good returns to investors. However, they are subject to additional risks. These are:  
- **Concentration risk.** This arises when a high percentage of the portfolio is exposed to a particular credit.  
- **Correlation risk.** This arises when a high percentage of the portfolio reacts in the same, or similar, way to particular circumstances or events, such as the collapse of the US sub-prime home loan sector.  
By combining one structure with other structures, it is possible that exposure to particular credits or circumstances is magnified, undermining the diversification effects of the CDO structure.  
It is possible to further securitise a pool of securities from CDO squared transactions, producing "CDO cubed" securities, which may be followed by further securitisation of these, and so on. CDOs cubed transactions have already taken place. However, the more levels of securitisation that are added, the greater the risk of overlap in exposure. |
Participants

<table>
<thead>
<tr>
<th>Participant</th>
<th>Type of entity</th>
<th>Involvement:</th>
<th>Documents:</th>
</tr>
</thead>
</table>
| **Originator** | Usually large financial institutions, large companies/commercial enterprises, or specialist securitisation entities. Small and medium-sized enterprises (SMEs) are also starting to securitise their assets in some jurisdictions. | > The originator is the entity behind the securitisation. It usually generates the receivables that are sold to the SPV.  
> The originator may want to securitise its assets:  
  - to achieve a lower cost of borrowing;  
  - as an alternative source of borrowing;  
  - to accelerate cash receipts and remove assets from its balance sheet.  
> The originator usually also acts as servicer (see below, Servicer) and may provide a subordinated loan to the SPV for liquidity support. | > Agreement to transfer the receivables.  
> Agreements to provide credit enhancement or liquidity support (if applicable).  
> Servicing agreement (if applicable). |
| **Investors** | Typically, financial institutions, insurance companies, pension funds, hedge funds, companies, high net worth individuals. | > Purchase the securities issued by the SPV.  
> Receive interest and capital payments from the securities. | Securities purchase agreement. |
| **Arranger** | Usually a financial institution. | > Appointed by the originator.  
> Arranges:  
  - the structure of the risk profile of the receivables to create different tranches of securities;  
  - credit arbitrage;  
  - credit enhancement;  
  - liquidity support;  
  - profit extraction methods;  
  - for counterparties to take on risks.  
> Ensures the transaction proceeds through each step to close.  
> Agrees to initially buy the securities. | Subscription agreement.  
Offering circular.  
Agreement among managers. |
<table>
<thead>
<tr>
<th>Participant</th>
<th>Type of entity</th>
<th>Involvement:</th>
<th>Documents:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers</td>
<td>Financial institutions.</td>
<td>▶ Along with the arranger, the managers agree to initially buy the securities. &lt;br&gt; ▶ The managers line up investors to take the securities.</td>
<td>Agreement among managers.</td>
</tr>
<tr>
<td>Trustee</td>
<td>Usually a professional corporate trustee.</td>
<td>▶ Appointed by (but is not the agent of) SPV. &lt;br&gt; ▶ Holds benefit of covenants and rights in the securities on behalf of the investors. &lt;br&gt; ▶ May also act as security trustee (see below, Security trustee).</td>
<td>Trust deed.</td>
</tr>
<tr>
<td>Security trustee</td>
<td>Usually a professional corporate trustee.</td>
<td>▶ Holds the benefit of the security on behalf of the investors and other parties whose interests are secured.</td>
<td>Security trust deed.</td>
</tr>
<tr>
<td>Paying agent</td>
<td>Typically a major bank.</td>
<td>▶ Appointed by SPV. &lt;br&gt; ▶ Pays interest and principal on the securities to the investors as they fall due. &lt;br&gt; ▶ May often be more than one, particularly in a cross-border securitisation. In such cases, one paying agent is appointed as principal paying agent and acts as the main counterparty to the SPV in respect of the paying agency functions.</td>
<td>Agency agreement.</td>
</tr>
<tr>
<td>Servicer</td>
<td>Often, initially, the originator or a company within the originator’s group. Sometimes a third party servicer is appointed. Not applicable to CDO transactions.</td>
<td>▶ Appointed by SPV. &lt;br&gt; ▶ Responsible for ensuring the underlying receivables continue to be collected and administered. &lt;br&gt; ▶ The servicer does this on behalf of the SPV as its agent. &lt;br&gt; ▶ Receives payment for the duties it performs under the servicing agreement.</td>
<td>Servicing agreement.</td>
</tr>
<tr>
<td>Participant</td>
<td>Type of entity</td>
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</table>
| Investment manager, also known as collateral manager | Usually an independent party that is an expert in the type of investments that the SPV holds. Not applicable to non-CDO type transactions. | > Appointed by SPV.  
> If the portfolio of receivables underlying the securitisation is "dynamic" and requires active management (for example, in a managed collateralised debt obligation (CDO) securitisation (see table, Classes of receivables)), an investment manager is appointed to:  
- determine the assets making up the portfolio, both initially and on an ongoing basis;  
- negotiate and enter agreements for the acquisition, management and sale of receivables;  
- deal with hedging arrangements relating to the receivables;  
- deal with valuations of the portfolio required by the SPV;  
- comply with reporting requirements relating to the asset portfolio.  
> Paid a management fee that may be based on a percentage of the average balance of the portfolio of receivables and/or an incentive fee relating to a percentage of receipts from the receivables over a threshold level reflecting the successful management of the portfolio.  
> The investment manager may be required to hold a junior tranche of subordinated securities to act as an incentive for it and give confidence to other investors (this is expected to be a legal requirement by the end of 2010). | Investment management agreement. |
### Participant | Type of entity | Involvement: | Documents:
--- | --- | --- | ---
**Collateral administrator** | Usually a bank, independent of the other participants. | > Appointed by SPV.  
> Agent in relation to administering the portfolio collateralising the securities.  
> Maintains a database detailing the content of the portfolio and uses this database to:  
  - run performance tests;  
  - provide reports on the underlying assets;  
  - obtain valuations of the underlying assets;  
  - calculate payment and receipt requirements;  
  - open and administer bank accounts;  
  - direct payments to be made according to the transaction documents. | 
**Swap counterparty** | Financial institutions with derivatives capabilities. | > Enters contract to take on certain risks in a securitisation, such as the risks of interest rate and currency mismatches between the receivables and the securities. | Swap documents. |
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<thead>
<tr>
<th>Participant</th>
<th>Type of entity</th>
<th>Involvement:</th>
<th>Documents:</th>
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</table>
| **Monoline insurer**         | Large specialist insurance institutions that provide insurance for financial obligations. Monolines – as opposed to multiline insurers – provide just one line of insurance (financial “guaranty” insurance), and are generally licensed under New York state insurance law. The best known monolines are Ambac, MBIA, FGIC and FSA, although a number of other monolines provide this form of specialist insurance cover (for example, CIFG and XL). | > An insurance policy with a monoline may be taken out by the SPV or by the arranger in the SPV’s favour.  
> Usually the monoline unconditionally and irrevocably agrees to pay interest and principal in line with the original payment schedule for the securities issued to the investors if the SPV defaults on its payment obligations.  
> Monoline insurers aim to minimise the risk inherent in these financial guarantees by:  
  - only taking on “investment grade” risk (see above, The role of the rating agencies);  
  - analysing the risk of default in any one transaction and only issuing policies where the risk is considered acceptable;  
  - maintaining a diverse portfolio of underlying exposures. | Insurance policy.                                                                                     |
| **Clearing systems**         | The main securities clearing systems in Europe are Euroclear Bank SA/NV and Clearstream Banking, S.A. In the US, the service is provided by DTC.                                                                                                                                                                                                                   | > Provide clearing and settlement services for the securities.                                                                                               | If issuing global notes in New Global Note form, the SPV must enter into a standard form ICSD agreement and an Effectuation and Disposal Authorisation with Euroclear and Clearstream. |
| **Rating agencies**          | There are three main rating agencies:  
> Standard & Poor’s.  
> Moody’s Investor Services.  
> Fitch Ratings.                                                                                                                                                                                                                                                                         | > Retained by the arranger (on behalf of the SPV).  
> Rates the securities to indicate whether the SPV has a strong or weak capacity to pay interest and principal.  
> The rating is provided after detailed statistical analysis on the probability of default and the effects of such default on the ability of the SPV to comply with its payment obligations in respect of the securities. |                                                                                                             |
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<th>Participant</th>
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<th>Involvement:</th>
<th>Documents:</th>
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</table>
| Accountants | Accountancy firms. | > Used by SPV and originator.  
> Provide confirmation of financial information in relation to the SPV and any guarantors, and the receivables themselves.  
> Involved in the latest audit report and financial statements of the SPV or, if the SPV is newly incorporated, a report on its position immediately following the securitisation.  
> Does due diligence confirming any change in the financial position of the SPV between the date of the financial audit and the date of the due diligence confirmation.  
> Carry out the financial modelling of the cash flows.  
> Does financial analysis of various aspects of the underlying collateral.  
> Consent to inclusion of information provided by them and included in the offering circular (see table, Documents, Offering circular). |            |
<table>
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<tr>
<th>Participant</th>
<th>Type of entity</th>
<th>Involvement:</th>
<th>Documents:</th>
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<tbody>
<tr>
<td>Lawyers</td>
<td>Law firms.</td>
<td>&gt; Used by the originator, investment manager, arranger, trustee, and paying agent(s). Other parties, such as the managers, may also use lawyers.  &gt; Ensure the legal efficacy of the transaction, both in its constituent parts and as a whole. &gt; Responsible for:  - advising on the legal and regulatory aspects of the structure;  - advising on the tax aspects of the structure;  - drafting and negotiating the legal documents;  - establishing the relevant legal entities;  - reviewing the corporate capacity and authority of each party;  - due diligence in respect of the underlying assets and certain parts of the offering circular (usually done by the lawyer appointed by the arranger);  - identifying any concerns about the enforceability of the transaction documents;  - co-ordinating documentary and legal aspects of the transaction, and moving the transaction from term sheet to close (usually done by the lawyer appointed by the arranger). &gt; The arranger’s lawyers, in particular, are responsible for drafting the principal documentation and liaising with the rating agencies in relation to novel or complex issues affecting the transaction’s legal structure.</td>
<td>Retention contract.</td>
</tr>
<tr>
<td>Participant</td>
<td>Type of entity</td>
<td>Involvement:</td>
<td>Documents:</td>
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</table>
| **Special purpose vehicle (SPV)** | The precise legal status of the SPV varies between jurisdictions (see Country Q&A, Question 4 (www.practicallaw.com/1-500-783S)). However, the SPV is usually a separate entity from any other participants in the securitisation. It will often be incorporated in a low-tax or no-tax jurisdiction. It will have no employees and will not conduct business other than set out in the transaction documents. | > Established by the originator or the arranger.  
> Established specifically for the purpose of the securitisation, the SPV is the central character and least substantive entity. Its main purpose is to isolate the receivables that are used to repay the securities from the credit risk of the originator.  
> SPVs generally are intended to be virtually profit-neutral.  
> Issues debt securities to the investors to fund the acquisition of rights. | Party to most documents. |
| **Listing agent**                 | Specialist teams usually forming part of a corporate administration company or law firm based in the jurisdiction of the stock exchange on which the SPV’s debt securities are to be listed. | Usually appointed by the arranger (or its lawyers). The listing agent will submit the draft offering circular to the stock exchange for comments/approval. The Listing Agent will liaise with the relevant stock exchange and see to all formalities required to ensure listing of the securities. | Stock exchange prescribed forms. |
| **Stock exchange**                | A recognised stock exchange. Typically in Ireland, Luxembourg or the UK.       | Once it approves the offering circular, the stock exchange will admit the securities onto its official list for trading. | Stock exchange prescribed forms. |
## Documents

<table>
<thead>
<tr>
<th>Document</th>
<th>Parties</th>
<th>Purpose:</th>
<th>Details included:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offering circular, also known as offering memorandum or prospectus</td>
<td>SPV. Arranger. Managers.</td>
<td>&gt; Key selling document of a securitisation.</td>
<td>&gt; Terms and conditions of the securities.</td>
</tr>
<tr>
<td></td>
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<td>&gt; In the EU, constitutes a prospectus if securities are listed.</td>
<td>&gt; Information about SPV.</td>
</tr>
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<td>&gt; Information on the underlying assets on which the securitisation is based.</td>
<td>&gt; Must comply with legal requirements applicable to securities offerings in each jurisdiction where securities are listed and in the jurisdiction where the SPV is incorporated.</td>
</tr>
<tr>
<td>Trust deed</td>
<td>SPV. Trustee.</td>
<td>&gt; Legal instrument constituting the securities being offered.</td>
<td>&gt; SPV’s covenants to pay which runs parallel with the SPV’s promise to pay in the certificates representing the securities.</td>
</tr>
</tbody>
</table>
|                                                    |                                | > Sets out relationship between SPV and trustee.                         | > SPV’s further covenants, representations and warranties for the benefit of the investors.
<p>|                                                    |                                |                                                                         | &gt; Schedule of terms and conditions set out in the offering circular and the form of certificates representing the securities. |
| Security trust deed                                 | SPV. Security trustee (on behalf of all secured parties, including the investors). | &gt; Constitutes the security created over the assets of the SPV making up the security package in favour of the investors. | &gt; The security interests over the assets making up the security package. |
|                                                    |                                | &gt; Sets out relationship between SPV and security trustee.                | &gt; Security trustees enforcement powers and rights to deal with the assets comprising the security package. |
| Paying agency agreement                             | SPV. Paying agent(s).          | &gt; Mechanical document, setting out agents’ powers and responsibilities.  | &gt; Sets out mechanism for investors to present their securities for payment, exchange/replace damaged/lost certificates and generally to obtain information or exercise rights they have under their securities. |</p>
<table>
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<tr>
<th>Document</th>
<th>Parties</th>
<th>Purpose:</th>
<th>Details included:</th>
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</thead>
</table>
| Subscription agreement    | SPV. Arranger. Managers.     | > Document through which the arranger and manager(s) agree to buy the securities being issued. | > Arrangers agree to pay the initial purchase price for the securities on the issue date, subject to conditions relating to:  
  - the SPV’s legal status;  
  - listing and rating of the securities.  
  > Also provides that the investors do not have to buy the securities if a material adverse event occurs between signing the subscription agreement and closing the securities issue. |
| Servicing agreement       | SPV. Servicer (usually the originator initially (see table, Participants)). | > Sets out terms on which the initial servicer is to administer the receivables or other assets constituting the security, on an ongoing basis. | > Main duty to collect amounts due under the receivables contracts.  
  > Procedures and actions to be taken by the servicer in relation to the receivables, including how to deal with late and defaulted receivables. |
| Sale agreement            | Originator. SPV.             | > To effect the transfer of receivables between the originator and the SPV. | > Must be sufficient to effect a clean transfer.  
  > Contains representations, warranties and any criteria the receivables must satisfy before they can be transferred to the SPV.  
  > The SPV’s recourse (rights) against the originator for breach of representation or warranty by the originator.  
  > Originator’s obligation to repurchase any receivable not eligible at the same price at which it was sold to the SPV. |
| Agreement among managers  | Arranger. Managers. SPV.    | > Contract between SPV, the lead manager (usually the arranger) and the co-managers recording the number of securities each manager has agreed to buy. | > Number and type (that is, tranche) of securities each manager has agreed to buy.  
  > Payment and allocation of the managers’ commission (governed by the International Professional Managers Association (IPMA) rules).  
  > Delegates power to the arranger/lead manager to act on behalf of the other managers in certain circumstances.  
  > Usually is in IPMA standard form. |
<table>
<thead>
<tr>
<th>Document</th>
<th>Parties</th>
<th>Purpose:</th>
<th>Details included:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment management agreement, also known as collateral management agreement</td>
<td>SPV. Investment or collateral manager.</td>
<td>&gt; If active management of a portfolio of receivables is required (as in an actively managed CDO (see table, Participants, Investment manager)), the investment manager appointed by the SPV is responsible for acquiring, maintaining and selling collateral in accordance with the agreement between them.</td>
<td>&gt; Strict eligibility guidelines in respect of the assets that may form part of the portfolio which the investment manager must comply with.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; Circumstances in which the manager can be replaced or the agreement terminated.</td>
<td></td>
</tr>
<tr>
<td>Liquidity agreement(s)</td>
<td>SPV. Liquidity support provider.</td>
<td>&gt; Sets out the details of the liquidity support facility.</td>
<td>&gt; Liquidity support is usually in the form of a loan so will set out standard loan agreement terms and conditions, including the amount of the loan facility and the circumstances when it may be used.</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>&gt; In some jurisdictions, for tax reasons, it is particularly important, from a lending bank’s perspective, that the liquidity support facility is not regarded as a form of credit enhancement.</td>
</tr>
<tr>
<td>Credit enhancement agreement(s)</td>
<td>SPV. Credit enhancement provider (for example, a monoline insurer (see table, Participants)).</td>
<td>&gt; Sets out the finance techniques used to improve the credit worthiness of the issued securities.</td>
<td>&gt; Depends on the receivables and type of credit enhancement used (see above, Credit enhancement).</td>
</tr>
<tr>
<td>Document</td>
<td>Parties</td>
<td>Purpose:</td>
<td>Details included:</td>
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</tr>
<tr>
<td>Swap documents</td>
<td>SPV, Swap counterparty.</td>
<td>&gt; Sets out the particular risks the swap counterparty will take on and the fee it will receive.</td>
<td>&gt; In a standard securitisation, swap documents may be required for interest rate risks, currency risks, basis risks, timing risks, and cash flow-based risks and will set out the details of such risks and the circumstances under which the swap can be carried out.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; In a synthetic transaction, swap documents set out the credit default swap arrangement, including details of the receivables due from the reference assets, the premium payable by the buyer of protection and the events which constitute a credit default and requiring payment by the swap counterparty.</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>&gt; Swap documents are usually based on the International Swap and Derivatives Association (ISDA) standard documents.</td>
<td></td>
</tr>
<tr>
<td>Opinions</td>
<td>Lawyers.</td>
<td>&gt; The arranger and the trustee require lawyers' opinions on certain aspects of the transaction. Lawyers carry out due diligence before issuing their opinions.</td>
<td>Should include opinions on:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; each party's capacity and authority to enter the transaction;</td>
<td>&gt; whether the transaction documents have been duly executed and represent legally binding and enforceable obligations;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; whether requisite consents and authorities have been obtained and registrations made;</td>
<td>&gt; whether all legal formalities for the transfer of receivables have been complied with;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; whether security interests are effective;</td>
<td>&gt; whether choice of law provisions are effective;</td>
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<tr>
<td></td>
<td></td>
<td>&gt; tax treatment.</td>
<td></td>
</tr>
<tr>
<td>Document</td>
<td>Parties</td>
<td>Purpose:</td>
<td>Details included:</td>
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<td>--------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>Comfort letters</td>
<td>Accountants.</td>
<td>&gt; Done by SPV’s auditors, and addressed to managers to reassure them before they buy the securities.</td>
<td>&gt; Confirms that unaudited financial information in the offering document is correct.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; Comfort letters are usually binding on the auditors although they often attempt to limit their liability.</td>
<td>&gt; Usually two comfort letters are sent:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- the first, at the time of the signing of the subscription agreement;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- the second, just before completion.</td>
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</tbody>
</table>