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GLOBAL GUIDE 2016/17
STRUCTURED FINANCE AND SECURITISATION

Structured finance and securitisation in the UK (England and Wales): overview

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MARKET AND LEGAL REGIME

1. Please give a brief overview of the securitisation market in your jurisdiction. In particular:

- **How developed is the market and what notable transactions and new structures have emerged recently?**
- **What impact have central bank programmes (if any) had on the securitisation market in your jurisdiction?**
- **Is securitisation particularly concentrated in certain industry sectors?**

The securitisation market in England and Wales remains one of the (if not the) largest and most developed securitisation markets in Europe. As at the end of Q3 2016, sources estimated the UK to be the most active jurisdiction in Europe (by jurisdiction of collateral securitised) reflecting an estimated EUR36.4 billion of EUR172.2 billion total new asset backed securities (ABS) issuance in Europe. As at end Q3 2016 the UK also accounted for the most active securitisation asset class (UK RMBS) with EUR3.7 billion of placed issuance as at end Q3 2016. The UK also has by far the largest amount of outstanding securitised product (by country of collateral) with about EUR302 billion outstanding as at Q3 2016.

While the securitisation market in England and Wales is therefore well established and one of the largest (if not the largest) in Europe, the overall issuance of securitised products in Europe remains depressed both on a year-on-year basis, as well as when compared to historic (pre-crisis) levels, with a correspondingly negative effect on the UK market and issuance. In Q3 2016 it has been estimated that EUR40.2 billion of securitised product was issued in Europe, a decline of 46.5% from the preceding quarter, and a decline of 30.3% from the same quarter in the preceding year (Q3 2015). The percentage placed of that new issuance was around 40%, a slight increase both on preceding quarters as well as on the same period in 2015.

In light of the lack of appetite in the market and the burden of changing and intensifying regulations affecting the securitisation industry, securitised issuances in the public market in 2016 have continued to focus on existing and well-established structures and asset classes, predominantly UK, Dutch and French residential mortgage backed securities (RMBS) and Pan-European CLOs (which two asset classes together accounted for about 67% of placed issuance in Europe in Q3 2016) although auto-securitisations (predominantly from French and German originators), credit card securitisations, CMBS transactions (especially in France) and consumer finance loans have also seen sizeable issuances.

Where new structures have been developed, it has often been as a result of market participants adapting securitisation techniques around new regulation brought in following the financial crisis, such as the further development of risk retention driven structures seeking compliance with risk retention rules in Europe and, from December 2016, the US.

2016 also saw the first European securitisation backed by loans made through an online marketplace established in the UK. Although this is a new asset class for public European securitisations, and while such "marketplace loan securitisations" have become common in the US, for a number of reasons it seems likely that it will be difficult to reach a comparable scale for this asset class quickly. Despite this, any new asset class should be treated with cautious optimism.

At the end of 2014, the European Central Bank (ECB) announced that it would start purchasing securitisation bonds through an ABS purchase programme (ABSPP), at least in part to stimulate a perceived lack of growth in the European ABS market and to increase liquidity. Market participants had hoped that the entry of the ECB into the ABS market would result in an increase in prime ABS issuance. Although the ECB originally stated that they estimated the amount of purchasable ABS to be around EUR400 billion, as at the middle of December 2016, the ECB had only acquired just over EUR23 billion of ABS (about 37% bought in primary and about 63% bought in secondary). This participation is low when compared to equivalent cumulative purchases of EUR204 billion under the ECB's covered bond purchase programme and EUR1.2 trillion under the ECB's public sector purchase programme as at the same dates. For this and other reasons, many people therefore consider that the ABSPP has not yet had the impact on the ABS market for which many had originally hoped.

At the end of June 2016, the UK voted to leave the EU, giving rise to a likely Brexit in the future. The effect of this process on the UK securitisation market (and participants in securitisations based in the UK) is currently uncertain, although this is discussed in more detail in *Question 29*.

2. Is there a specific legislative regime within which securitisations in your jurisdiction are carried out? In particular:

- **What are the main laws governing securitisations?**
- **What is the name of the regulatory authority charged with overseeing securitisation practices and participants in your jurisdiction?**

Other than certain tax laws (*see Question 26*), there are no laws in England and Wales specifically providing for securitisation transactions. The transaction documents relating to securitisations in England and Wales are most frequently governed by the law of England and Wales.

In the absence of a specific securitisation law for England and Wales, the market is regulated by:

- EU directives and regulations that affect all securitisation activity in Europe, including the requirements for the recognition of significant risk transfers prescribed under the Capital Requirements Regulation (Regulation (EU) No 575/2013) and the EU risk retention regime. In September 2015 the European Commission published a legislative proposal for a regulation laying down common rules on securitisation and creating a simple, transparent and standardised (STS) securitisation (Securitisation Regulation).
- Domestic legislation such as The Financial Services and Markets Act 2000 (FSMA).
- Rules of financial regulators in the UK such as the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA), such as the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules.
- Guidelines, codes of conduct and other rules issued by market bodies that are relevant to, or aimed at, securitisation market participants, such as:
  - those issued by the International Organization of Securities Commission (IOSCO) and the Basel Committee on Banking Supervision (BCBS) such as those on identifying simple, transparent and comparable (STC) securitisation structures;
  - market-led initiatives such as the Prime Collateralised Securities (PCS) label for high quality securitisations, launched by the Association for Financial Markets in Europe (AFME); and
  - industry-led guidelines such as the CMBS 2.0 guidelines published in November 2012 by the Commercial Real Estate Finance Council.

For more information on the regulation of the Securitisation industry, including in the UK, see*Practice note: Securitisation: regulatory framework and reforms*)

The FCA and the Prudential Regulation Authority (PRA) have performed the regulatory functions of the UK's financial services regulator since April 2013. The FCA Handbook and the PRA Handbook set out rules, guidance and other provisions made under powers given to them by the FSMA. Of particular relevance for securitisations are the rules contained in the following parts of the FCA Handbook:

- Chapter 9 (Securitisation) of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU).
- Chapter 4.12 (Securitisation) of the Prudential sourcebook for Investment Firms (IFPRU).
- Where the securitised assets include regulated mortgage and/or regulated contracts or consumer credit or consumer hire agreements, the Mortgages and Home Finance Conduct of Business sourcebook (MCOB) and the Consumer Credit sourcebook (CONC), respectively.
- The Listing, Prospectus and Disclosure Rules of the FCA Handbook.

REASONS FOR DOING A SECURITISATION

3. What are the main reasons for doing a securitisation in your jurisdiction? How are the reasons for doing a securitisation in your jurisdiction affected by:

- **Accounting practices in your jurisdiction, such as application of the International Financial Reporting Standards (IFRS)?**
- **National or supra-national rules concerning capital adequacy?**
- **Risk retention requirements?**
- **Implementation of the Basel III framework in your jurisdiction?**

Accounting practices and treatment of securitisations are outside of the scope of this guide, although it is worth noting that, while securitisation has traditionally been used as a means for de-recognition of assets from the balance sheet of an originator, achieving off-balance sheet treatment is increasingly difficult in all jurisdictions, including in England and Wales.

In terms of regulatory capital and capital adequacy rules, UK financial institutions must 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) (although under the capital adequacy regime for UK (re)insurers there is no such concept of risk weighting; rather, capital requirements are calculated by reference to specified "instantaneous decrease" in the value of the relevant assets).

For more details on capital adequacy requirements and Basel III as they apply to securitisations in the UK, see *Practice note: Securitisation: regulatory framework and reforms*.

The European-wide regime for risk retention is currently set out in:

- Articles 404 to 410 of the CRR, the associated regulatory technical standards (RTS) and implementing technical standards (ITS).
- Corresponding provisions in Directive 2011/61/EU on Alternative Investment Fund Managers (as implemented in the UK through The Alternative Investment Fund Managers Regulations 2013), as supplemented by Articles 50 to 56 of the Level 2 Regulation 231/2013 (AIFMD); and
- Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance as amended, including most recently by Directive 2014/51/EU, as supplemented by Articles 254 to 257 of Commission Delegated Regulation (EU) No 2015/35 (Solvency II).

Although there are differences between the risk retention rules promulgated by the CRR, AIFMD and Solvency II, the rules generally require that an investor does not invest in a securitisation unless the originator, sponsor or original lender has retained a material net economic interest of at least 5% in the securitisation and the investor has undertaken certain due diligence in respect of, among other things, the securities it has acquired and the underlying exposures, and has established procedures for monitoring the performance of the underlying exposures on an ongoing basis.

The onus is currently, under the existing risk retention rules outlined above, on the investors to ensure that the securitisations in which they invest are compliant. Failure to comply with the risk retention and due diligence requirements will result in investors receiving capital penalties for non-compliant investments or the imposition of other regulatory sanctions.

On 30 September 2015, the European Commission published a proposed Securitisation Regulation as part of its capital markets union (CMU) action plan. The proposed Securitisation Regulation aims to introduce a uniform securitisation regulatory framework and to provide clear requirements as to what constitutes an STS securitisation. It also makes certain changes to the risk retention requirements as they apply under the existing European-wide risk retention regime outlined above.

For more details on European risk retention requirements, see *Practice note: Securitisation: regulatory framework and reforms*.

THE SPECIAL PURPOSE VEHICLE (SPV)

Establishing the SPV

4. How is an SPV established in your jurisdiction? Please explain:

- **What form does the SPV usually take and how is it set up?**
- **What is the legal status of the SPV?**
- **How the SPV is usually owned?**
- **Are there any particular regulatory requirements that apply to the SPVs?**

An SPV incorporated in England or Wales usually takes the form of a public or private company limited by shares, or a limited liability partnership (LLP). Both limited companies and LLPs are treated as body corporates with a separate legal personality where the liability of a shareholder/member is limited. An SPV incorporated under the laws of England and Wales is subject to English laws that affect corporate entities generally, including the Companies Act 1985 and 2006 (Companies Acts), the Limited Liability Partnerships Act 2000 and the Insolvency Act 1986 (Insolvency Act) (in each case as amended).

In securitisation transactions an SPV is normally (but not always) established as an orphan entity which is not part of the same corporate group as any other transaction party. The most common method for achieving this orphan status is to have the membership interests held by an entity on trust for discretionary charitable purposes.

Other than certain laws relating to the taxation of securitisation companies (*see Question 26*) and English laws applicable to corporate entities generally, there are no specific rules or regulations applying to SPVs under English law. However, various EU directives and regulations, certain domestic legislation and various guidelines, codes of conduct and other rules issued by other market bodies may apply to the SPV, depending on its particular role in a securitisation (*see Question 2*).

5. Is the SPV usually established in your jurisdiction or offshore? If established offshore, in what jurisdiction(s) are SPVs usually established and why? Are there any particular circumstances when it is advantageous to establish the SPV in your jurisdiction?

For securitisations of assets or businesses located in England and Wales, the SPV will often be incorporated in England because investors and market participants are familiar with the established and respected legal framework applicable to English corporate entities, as well as for various tax reasons relating to underlying assets based in the UK.

An SPV can be incorporated outside England and Wales for specific commercial, regulatory, tax, administrative, structural and/or legal reasons. Popular jurisdictions include Ireland, Luxembourg, The Netherlands, Jersey and the Cayman Islands, with the choice of jurisdiction often guided by factors including:

- The timing/cost of establishing and maintaining an SPV.
- Minimum capitalisation requirements for an SPV.
- Initial/ongoing disclosure or regulatory requirements (such as requirements for audited accounts).
- Taxation of the issuer and its assets in that jurisdiction, including corporate tax on any minimum required retained profits and issues relating to withholding tax (including availability of tax treaty relief in relation to interest and other payments on underlying assets), VAT or other taxes.
- Licensing and authorisation requirements.
- Insolvency law considerations.

Ensuring the SPV is insolvency remote

6. What steps can be taken to make the SPV as insolvency remote as possible in your jurisdiction? In particular:

- **Has the ability to achieve insolvency remoteness been eroded to any extent in recent years?**
- **Will the courts in your jurisdiction give effect to limited recourse and non-petition clauses?**

Typical measures taken to make the SPV as insolvency remote as possible include:

- Establishing a new entity with no operating history and a limited number of known (or potential) creditors.
- Ensuring the SPV will operate as a distinct entity with a separate legal personality to other transaction parties (*see Question 7*).
- Restricting the purpose and activities of the SPV in constitutional and transaction documentation, to reduce the risk of liabilities being created outside the securitisation.
- Limiting the ability of the SPV (or its members) to voluntarily file for insolvency proceedings.
- Ensuring the transfer of assets from the originator to the SPV is on a true-sale basis, so that there is limited risk of the assets being held to be interests of the originator in its insolvency.
- Including non-petition language in any agreement between the SPV and a third party and restricting such third party's ability to initiate insolvency proceedings against the SPV.
- Including limited recourse language in agreements between the SPV and a third party and restricting the SPV's liability to a creditor to the secured assets of the SPV.

Despite the above measures, an SPV will never be fully insolvency-proof as there is no restriction on a third-party creditor not bound by the above contractual provisions (for example a tax authority) taking insolvency action against the SPV.

It has generally been accepted under English law that contractual limited recourse language, providing that creditors have their recourse limited to specific assets of the debtor, is a relevant factor in achieving insolvency remoteness. Despite this, an English court has held that it would be just and equitable to wind up a company (and that it was insolvent on a balance sheet and cash flow basis) despite a contractual limited recourse provision which provided that the company was not liable to pay its bondholders more than its available funds, although the relevant judgment is capable of being limited to its context on a number of factual and legal grounds and, as a result, it is submitted that it is unlikely that an English court would come to a similar conclusion on an opposed and fully argued application.

Ensuring the SPV is treated separately from the originator

7. Is there a risk that the courts can treat the assets of the SPV as those of the originator if the originator becomes subject to insolvency proceedings (substantive consolidation)? If so, can this be avoided or minimised?

The equitable remedy of substantive consolidation, which permits the court to treat the assets and liabilities of one entity as though they were those of another, is not recognised by the English courts. Only in circumstances where the assets and liabilities of two companies are indistinguishably amalgamated together and where to do so would be in the interests of both companies' creditors, may a court sanction an arrangement reached by the insolvency official and those creditors.

The separate legal personality of a company will only be ignored in very limited circumstances, such as:

- Fraud.
- Illegality or improper purpose.
- A company being formed to evade contractual obligations or defeat creditors' claims.
- An agency or nominee relationship being found to exist.

Securitisation transactions habitually attempt to minimise the risk of a court treating the assets of an SPV as those of an originator or other third party, or of a creditor or liquidator of a third party company being found to have a claim on the SPV's assets, by ensuring (either structurally or contractually) that some or all of the following apply:

- There are no grounds for setting aside any transaction entered into between the SPV and another company under the Insolvency Act.
- The SPV has not given any surety or security for the obligations of another company.
- There are no grounds for holding that one company is a shadow director of the other and could be held to be liable for wrongful or fraudulent trading if the other company is in liquidation.
- No financial support direction or contribution notice could be issued under UK pensions legislation and the SPV is not jointly and severally liable with any other company under any relevant tax legislation.
- Corporate activities of the SPV are kept separate from those of other transaction parties and constitutional and other decision-making formalities of the SPV (such as board minutes) are accurately kept and filed separately from those of any other party.
- There is limited or no pooling or intermingling of assets (with the SPV having segregated and/or ring-fenced bank accounts).
- The corporate veil is not used for improper or dishonest purposes (such as to conceal criminal activities, deception or evasion of certain SPV obligations).
- The SPV has, and holds itself out as having, a distinct, independent existence and can acquire and hold assets and carry on business in a manner separate to any other party (achieved, among other things, by the SPV conducting its business in its own name, paying debts out of its own funds and maintaining arm's length relationships with other parties).
- The SPV has independent directors or other management and produces separate (non-consolidated) accounts.

THE SECURITIES

Issuing the securities

8. What factors will determine whether to issue the SPV's securities publicly or privately?

Public offerings and private placements are the two main methods for issuing securities. A combination of the two may be used as part of the same transaction. Factors determining whether the SPV's securities are offered publicly or placed privately include:

- The intended market/investors for the securities.
- Timing requirements for completing the issuance.
- Compliance with any increased regulatory and disclosure requirements of a public offering.
- Potential tax implications of issuing securities listed on a regulated exchange.

9. If the securities are publicly issued:

- **Are the securities usually listed on a regulated exchange in your jurisdiction or in another jurisdiction?**
- **If in your jurisdiction, please identify the main documents required to make an application to list debt securities on the main regulated exchange in your jurisdiction. Are there any share capital requirements?**
- **If a particular exchange (domestic or foreign) is usually chosen for listing the securities, please briefly summarise the main reasons for this.**

The following exchanges are the most commonly chosen for listing ABS:

- London Stock Exchange (LSE).
- Irish Stock Exchange.
- Luxembourg Stock Exchange.
- Cayman Islands Stock Exchange.
- Channel Islands Securities Exchange (formerly the Channel Islands Stock Exchange).

Listing debt securities in London is a two-stage process, requiring securities to be admitted to the official list of the UK Listing Authority (UKLA) and to trading on one of the UK's regulated markets.

An application for admission to the official list currently requires the following documents to be submitted to the UKLA:

- Prospectus (or Listing Particulars in the case of admission to trading on the Professional Securities Market (PSM)).
- Supporting documents:
  - Form A (application for the approval of a prospectus only and not required for listing particulars submitted to the PSM);
  - SPV contact details form;
  - document publication form (specifying how the prospectus has been published and where it can be obtained); and
  - checklists (corresponding to the relevant type of debt security).

The UKLA also requires a fee to be paid in connection with an admission to listing and has discretion to request additional documents. The approval process undertaken by the UKLA is the same, regardless of the regulated market on which the securities are to be admitted to trading.

The LSE has several markets on which securities can be traded, but there are only two main markets on which debt securities are traded, namely:

- The Gilt-Edged and Fixed Interest Market (Main Market) (a European Economic Area (EEA)-regulated market, subject to Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive) and other EU directives).

- The PSM, an exchange-regulated market subject to the rules of the LSE but outside the requirements of the Prospectus Directive).

The practical difference between the two markets for issuers is the level of disclosure required, with the PSM having a lower level of disclosure. The PSM is governed by the rules of the LSE and UKLA, rather than EU directives and is therefore outside the scope of the Prospectus Directive.

In respect of the Main Market (as opposed to the PSM), the level of disclosure required in the prospectus also depends on the denomination of the securities.

On 30 November 2015, the European Commission adopted a legislative proposal for a new Prospectus Regulation intended to repeal and replace the Prospectus Directive along with its corresponding implementing measures (including the current Prospectus Regulation). For further background, see *Legal update: Prospectus Directive: Commission proposal for a new Prospectus Regulation*.

For an overview of the particular rules and procedures for listing debt securities in London, see *Practice note: Listing debt securities in London*.

In terms of share capital requirements, an SPV incorporated in England and Wales must generally be in the form of a public limited company in order to offer securities to the public and, as such, must have a minimum authorised share capital of GB£50,000.

The most frequently chosen exchanges for listing ABS are set out above. In choosing which market on which to list securities, market participants, originators and/or securitisation structurers may be influenced by a number of factors, including:

- Whether the exchange is a recognised stock exchange for the purposes of UK (or other applicable) tax legislation.
- Whether the applicable market has experience in, or a developed market or reputation for, the particular type of securities being issued, as well as the liquidity and depth of the market for such securities on that exchange.
- The rules and regulations of the competent authority in the applicable jurisdiction that governs and oversees listings on that exchange (with some exchanges or authorities being perceived as having greater flexibility, speed of approval or responsiveness or more onerous disclosure or ongoing listing requirements).
- The reputation of the relevant exchange in the minds of potential investors (with some exchanges being perceived to be unstable, unreliable or located in a jurisdiction which is less reputable than others).

Constituting the securities

10. If the trust concept is not recognised in your jurisdiction, what document constitutes the securities issued by the SPV and how are the rights in them held?

The concept of a trust is widely regarded as being a creation of English law and is therefore recognised under the laws of England and Wales.

The rights of a securitisation bondholder in relation to securities held by it are usually constituted by a note trust deed, pursuant to which the issuer appoints a trustee as trustee of the rights of the holders of the issued securities.

Usually, the trust deed will contain covenants and other contractual obligations binding on the issuer of the securities. They are given by the issuer to noteholders directly or, more usually, to the note trustee to hold the benefit of such rights on trust for the noteholders.

There may also be a physical note certificate (certificated or uncertificated, registered or bearer) which constitutes a contract between the issuer and the holder of the securities, with rights to be enforceable or exercisable as set out in the trust deed.

TRANSFERRING THE RECEIVABLES

Classes of receivables

11. What classes of receivables are usually securitised in your jurisdiction? Are there any new asset classes to have emerged recently or that are expected to emerge in the foreseeable future?

A broad range of assets originated or located in the UK have been and habitually are securitised (with the key characteristics of a securitisable asset being its predictable credit and cash flow), including:

- Residential mortgages.
- Commercial mortgages.
- Credit card and other consumer asset receivables.
- Infrastructure assets and whole businesses.
- Vehicle rental fleets.
- Receivables from public utilities.
- Insurance receivables.
- Healthcare receivables.
- Student, auto, home shopping or other personal loans.
- SME, social housing and other corporate loans.
- Lease and rental receivables including shipping and rail leasing contracts.
- Alternative investment funds.
- Trade finance loan receivables.
- IP and music royalty receivables.
- Ticket and gate receipt receivables.
- Online marketplace or peer-to-peer lending loans.

Despite the fact that most European securitisations performed well throughout the financial downturn, in the immediate aftermath of the credit crisis the breadth and volume of new securitisations declined substantially in England and Wales, as elsewhere. As the economy started to recover, many new ABS issuances were either retained by the originator or deposited as collateral with central banks to gain access to central bank liquidity schemes and public issuance still remains low compared to pre-crisis levels.

With limited exceptions there has in recent years therefore been a move away from new, esoteric asset classes and structures, in favour of familiar and well understood assets and structures, such as RMBS, CLOs, credit cards and auto receivables (and in certain jurisdictions, limited number of new CMBS), due to:

- The availability of government subsidised wholesale funding.
- Increasingly penal regulatory capital charges for holding ABS investments.
- Uncertainty around the impact of future, tighter regulatory measures affecting the securitisation market.

Transferring the receivables from the originator to the SPV

12. How are receivables usually transferred from the originator to the SPV? Is perfection of the transfer subject to giving notice of sale to the obligor or subject to any other steps?

The most common method of transferring receivables is by way of assignment (equitable or legal). To perfect an assignment of receivables express notice in writing is required to be given to the obligor.

The giving of such notice will not in itself result in the assignment becoming a legal rather than equitable assignment and certain other formalities are also required under section 136 of the Law of Property Act 1925 (LPA), namely the assignment has to be:

- In writing and signed by the assignor.
- Of the whole of the debt.
- Absolute and not purporting to be by way of charge only.

Where the sale of a receivable falls short of these requirements it will take effect as an equitable assignment and any subsequent assignment effected by the seller and notified to the obligor before the date on which the original assignment is notified to the obligor will take priority.

Alternative methods to transfer receivables include:

- A novation (which transfers the rights and obligations in respect of the receivables and requires written consent from each of the obligor, transferor and transferee).
- A declaration of trust over the receivables, or over the proceeds of the receivables (coupled with a power of attorney).
- A sub-participation (essentially a limited recourse loan to the seller in exchange for an economic interest in the receivables).

Specific statutory requirements may also apply for assignments of certain receivables, such as intellectual property rights and certain policies of insurance.

13. Are there any types of receivables that it is not possible or not practical to securitise in your jurisdiction (for example, future receivables)?

Subject to certain exceptional categories of receivables differentiated mainly on public policy grounds (*see Question 15*), it is possible to transfer any type of receivable, including future receivables arising out of an existing contract, provided that the receivables can be described with sufficient specificity to be distinguished from the remainder of the seller's estate at the moment of transfer.

It is possible to securitise future receivables. An assignment for value of an identifiable receivable, which does not exist at the time of the receivables purchase agreement but which will be clearly ascertainable in the future, is treated as an agreement to assign which gives rise to an equitable assignment of the receivable as soon as it comes into existence.

Where a receivables purchase agreement provides that no further action is required by the seller for the receivables (including receivables arising in the future) to be transferred, the agreement will generally continue to be effective to transfer the receivables even after the initiation of insolvency proceedings. However, either party could exercise a contractual right to terminate and, in certain circumstances, a liquidator may pursuant to the Insolvency Act 1986, be able to disclaim (and thereby terminate) an ongoing receivables purchase agreement if it is considered to be a transaction at an undervalue, a preference, an extortionate credit transaction or a transaction defrauding creditors.

Where the agreement requires further action from the seller, the insolvency official may choose not to take that action and, in that situation, the buyer's remedy is likely to be limited to an unsecured claim in any insolvency proceedings.

It is also possible to restrict a specific assignment of receivables of any asset class by imposing contractual restrictions on their transfer (*see Question 15*).

14. How is any security attached to the receivables transferred to the SPV? What are the perfection requirements?

Security for a receivable can typically be assigned in the same manner as the receivable itself, but it will depend on how the security is constituted. The perfection of a transfer of some types of security may require additional formalities such as registration or payment of a fee. For example, with respect to mortgages over real property in England and Wales, as well as giving notice, certain other formalities (such as registration of the transfer at HM Land Registry) must be complied with to effect a legal assignment.

Prohibitions or restrictions on transfer

15. Are there any prohibitions or restrictions on transferring the receivables, for example, in relation to consumer data?

Contractual restrictions

The most commonly encountered prohibition or restriction on transferring receivables is contractual. If a contract is silent on assignability, the contract and the receivables under it are freely assignable. However, contractual restrictions on transfer by one method (such as assignment) may permit transfer by another (such as novation or trust). Whether a transfer is effectively restricted by contract will be a question of contractual construction.

Restrictions on assignments or transfers are generally enforceable. In very limited circumstances, such as on the death of an individual or in certain limited statutory transfers, assignment may take place by operation of law, overriding an express contractual provision prohibiting assignment.

If an assignment is effected in breach of a contractual prohibition on assignment, although ineffective between the obligor and the seller (to whom the obligor can still look for performance of the contract), the assignment may still be effective between the seller and buyer, if it complies with the governing law and explicit terms of the receivables purchase agreement.

If the seller can establish that the obligor has accepted the assignment through its conduct or by waiver (for example, by course of dealing) the obligor may be estopped from denying the assignment, even where there is a contractual prohibition on assignment.

Legislative restrictions

Although the LPA imposes conditions on effecting a legal assignment (*see Question 12*), there is no legislation that restricts the assignment of receivables in general. In fact, recent legislative attempts in the UK have been intended to tackle barriers to the ability of businesses to access invoice finance and other forms of receivables financing by targeting restrictions that may be included in business contracts preventing the assignment of debts (see *Practice note: Receivables finance: prohibiting restrictions on the assignment of receivables*.

However, the transfer of certain exceptional categories of receivables has been prohibited outright or further regulated by statute (for example, a purported assignment of certain benefits is void under the Social Security Administration Act 1992 (as amended)). As in most such cases these statutory restrictions are imposed on public policy grounds or because the receivables are deemed to be of a very personal nature, they are rarely relevant for commercial securitisations.

In addition to limited and exceptional statutory restrictions on transfer, the transfer of certain types of receivables may subject the buyer or seller to additional requirements such as:

- A transferee of regulated consumer receivables (including consumer credit loans and residential mortgage loans) may require an authorisation under the FSMA, where an exemption cannot be applied.
- A third party servicer of regulated consumer receivables such as consumer credit loans and residential mortgage loans will require FCA authorisation under the FSMA for (as appropriate) debt administration, debt collection and mortgage administration activities.
- The handling and processing of information on living individuals is currently regulated by the Data Protection Act 1998 as amended, but from 25 May 2018 it is expected to be governed by the EU General Data Protection Regulation. If the buyer is considered a data controller, it must be registered with the UK Information Commissioner's Office and comply with the relevant requirements, unless limited exemptions apply.

Avoiding the transfer being re-characterised

16. Is there a risk that a transfer of title to the receivables will be re-characterised as a secured loan? If so, can this risk be avoided or minimised? Are true sale legal opinions typically delivered in your jurisdiction or does it depend on the asset type and/or provenance of the securitised asset?

A transaction expressed to be a sale may be re-characterised as a secured loan if it is found to be a sham such as where the documents do not reflect the actual agreement between the parties. Irrespective of the label given to a transaction by the parties, an English court will look at the substance of the transaction and examine whether it creates rights and obligations consistent with a sale. As such, the re-characterisation risk in relation to a transfer of title to receivables depends on the facts of a specific transfer of receivables.

English case law has established a number of key questions to be considered when concluding that a transaction is a true sale rather than a secured financing:

- Do the transaction documents accurately reflect the intention of the parties, and are the terms of the transaction documents consistent with a sale as opposed to a secured financing?
- Does the seller have the right to repurchase the receivables sold?
- Does the buyer have to account to the seller for any profit made on any disposition by it of the receivables?
- Is the seller required to compensate the buyer if it ultimately realises the acquired receivables for an amount less than the amount paid?

A transaction may still be upheld as a sale despite the presence of one or more of these factors. The intention of the parties, their conduct after the original contract and the express terms of the contract are all factors when a court decides, as a whole, whether a contract is inconsistent with that of a sale.

The following are not, in each case, generally considered to be inherently inconsistent with a sale treatment:

- The seller remaining the servicer/collection agent of the receivables post-sale.
- The seller entering into arm's length hedging with the buyer.
- The seller assuming some degree of credit risk by assuming a first loss position (including pursuant to risk retention regulations).
- The right of a seller (or the option of the buyer to require the seller) to repurchase receivables in certain limited circumstances (such as breach of warranty).

However, the seller retaining an equity of redemption in respect of a transfer of receivables may lead a court to conclude that the transaction is a security arrangement and not an outright transfer.

True sale legal opinions are typically delivered in relation to securitisations involving a transfer of assets under English law where there is a requirement for comfort on the transfer.

Ensuring the transfer cannot be unwound if the originator becomes insolvent

17. Can the originator (or a liquidator or other insolvency officer of the originator) unwind the transaction at a later date? If yes, on what grounds can this be done and what is the timescale for doing so? Can this risk be avoided or minimised?

An insolvency official would need a court order to reverse a transaction made prior to an insolvency, except for a disposition of property made after a winding-up petition has been presented (assuming a winding-up order is subsequently made). Such dispositions are void and any receivables purportedly transferred during that period would remain the property of the seller.

Otherwise, the court may set aside a transaction made at an undervalue in the two years ending with the commencement of an administration or liquidation if the company was at that time, or as a result of the transaction became, unable to pay its debts as they fell due. A transaction is made at an undervalue where the company receives no consideration or consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.

There is a defence if the court is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business with reasonable grounds for believing that it would benefit the company. If a transaction at an undervalue is done with the purpose of putting assets beyond the reach of creditors, there is no requirement to prove contemporaneous insolvency and no time limit for bringing court proceedings.

A transaction which puts a creditor or guarantor of the seller into a better position (in a winding-up) than it would otherwise have been in had that transaction not occurred can be set aside by the court if such preference is made either:

- In the two years ending with the onset of insolvency (in the case of a preference to a person connected with the company).
- In the six months ending with the onset of insolvency (in the case of any other person).

It is necessary to show that a preference was influenced by a desire to prefer the creditor or guarantor, though this need not be the dominant intention, at the time the decision was made to make a payment. There is a rebuttable presumption of a desire to prefer where the creditor or guarantor is a connected party or associate. A transaction which is a preference is voidable. An order may be sought to set aside the transaction and a restorative order may be sought.

Other transactions which can be challenged by liquidators or administrators are voidable floating charges and transactions to defraud creditors.

Establishing the applicable law

18. Are choice of law clauses in contracts usually recognised and enforced in your jurisdiction? If yes, is a particular law usually chosen to govern the transaction documents? Are there any circumstances when local law will override a choice of law?

Choice of law clauses in contracts are usually recognised and enforced in England and Wales under the following:

- For contracts entered into between 1 April 1991 and 16 December 2009, the Contracts (Applicable Law) Act 1990. This enacted the Rome Convention on the law applicable to contractual obligations (80/934/EEC) (Rome Convention).
- For contracts entered into on or after 17 December 2009, Regulation 593/2008/EC of 17 June 2008 (Rome I).

The Rome Convention provides that, without an express choice of law, the applicable law of a contract will be that of the country with which it has the closest connection. There is a presumption that this will be the country where the party who is to effect the performance of the contract has his habitual residence (if an individual) or its central administration (if a corporate entity). The position under Rome I is equivalent, save that the presumption in favour of the habitual residence/central administration (as applicable) is a fixed rule, which may be displaced in certain circumstances. Rome I allows provisions of European law which cannot be derogated from by contract to apply, provided that all of the relevant elements of the contract are located in the EU, despite the fact that the parties chose the law of a non-EU member state as the applicable law.

Both the Rome Convention and Rome I allow for modification of the parties' choice only:

- Where all elements of a contract are connected to a country other than the country whose law has been chosen by the parties, and that country has rules which cannot be disapplied by contract (in which case, the court will apply those rules).
- To the extent that the law chosen conflicts with overriding mandatory rules of English law (as the law of the forum).
- Where the applicable foreign law is manifestly incompatible with English public policy.

Additionally, under Rome I, the English courts will modify the parties' choice of law where the overriding mandatory rules of the place of performance render performance of the contract unlawful, although it is important to recognise that Rome I stresses the importance of the parties' freedom to choose the law of their contract.

For contracts not within the scope of the Rome Convention or Rome I, the applicable law will be decided by reference to English common law principles. English common law is also highly supportive of the parties' choice of a foreign law, and will only modify such a choice in exceptional circumstances, such as to the extent that it conflicted with mandatory principles of English law (such as English insolvency law) or where the choice was manifestly incompatible with public policy.

Common law principles seek first to determine which law the parties intended to govern the contract. If no such intention can be established, the applicable law of the contract is that with which the contract has its closest and most real connection, in light of all the material circumstances. In deciding this, the English courts will consider which law the ordinary businessman would have intended to apply.

English law is usually chosen to govern securitisation transaction documents in an English securitisation although the law governing the receivable itself is often chosen as the law governing the transfer of the receivable and the *lex situs* (the law applicable in the jurisdiction where the object is located) may be chosen as the governing law for creation of any security over an asset (either of which may not be English law). English law will often be chosen to govern the transaction documents for any public capital markets securities issuance (whether or not the assets or counterparties are based in England and Wales) because of commercial parties' familiarity with such law, and the perception of English law as sound and robust and well developed for complex financial concepts of the type underpinning securitisations.

SECURITY AND RISK

Creating security

19. Please briefly list the main types of security that can be taken over the various assets of the SPV in your jurisdiction, and the requirements to perfect such security.

Security interests

English law recognises four types of security:

- A mortgage (which can be legal or equitable). This involves the transfer of title to an asset by way of security for particular obligations, on the express or implied condition that it will be re-transferred when the secured obligations are discharged (such as an assignment by way of security).
- A charge (which can be fixed or floating). This is an agreement under which an asset is appropriated to the satisfaction of a liability or obligation. Unlike a mortgage, it does not technically transfer title, possession or a legal or equitable interest in the asset to the chargee, but merely creates an encumbrance in its favour. Whether a charge will be held to be fixed or floating can be a complex factual analysis but will ultimately depend on the degree of control exercised by the secured creditor over the asset.
- A pledge, which is the actual or constructive delivery of possession of an asset by way of security. The pledgee will have the power to sell the secured asset and to use the proceeds of the sale to discharge the secured obligation.
- A lien (which can be created by contract or can arise by operation of law). This is a right to retain possession of an asset, until discharge of an obligation owed by the owner of that asset.

The type of English law security taken over the various assets of an SPV depends on the particular intentions and requirements of the parties to a transaction. Relevant considerations may include:

- The identity of the owner of the relevant asset.
- The form of the asset (for example, whether tangible or intangible).
- Whether the assets are listed, cleared or settled (in the case of assets such as shares or debt securities).
- The nature of the rights available to a holder of the assets, and whether the security provider requires the right to deal with the assets while subject to the security interest.
- Whether the security taker requires the most secure form of security interest, or will accept a lesser level of security (which may relate to the importance of that particular asset in the context of the entire security package).
- How complicated it will be to create, administer, perfect and enforce the security interest proposed.

For further information, see *Practice note: Taking security*.

Perfection requirements

The manner in which English law security is perfected depends on the type of security taken, the type of asset secured and the identity of the security provider.

Perfection of security under English law is achieved in different circumstances by possession, transfer of title, the formalities of creation (such as writing and signing) or by notice. However, the most common method of perfection is by registration.

Security interests (including mortgages and charges) over assets located in England and Wales or abroad created on or after 6 April 2013 by a company or LLP registered in England and Wales may (subject to limited exceptions) be registered at Companies House by the company creating, or any person interested in, the charge, within 21 days (beginning with the day after the date of creation of the charge). This is a voluntary rather than mandatory regime. However because of the sanctions for non-registration, in practice charge holders usually deliver a statement of particulars to the Registrar for registration (by either paper or electronic method). Sanctions for non-registration are that the security will be void against a liquidator, administrator or (secured) creditor of the company, and the money secured by it immediately becomes payable.

A correctly registered charge is valid against the liquidator, administrator and any (secured) creditor of the company that created the charge (although a charge could still be challenged on other grounds, for example, as a preference or transaction at an undervalue). Registration may also give notice of the existence of the charge to third parties and so assist in establishing the priority of the charge.

A charge created by an overseas company on or after 1 October 2011 does not have to be registered at Companies House. However, for a charge created by an overseas company before 1 October 2011, there was a different registration regime and certain charges created by an overseas company were registrable. For further information, see *Practice note: Registration of charges created by companies and limited liability partnerships on or after 6 April 2013*.

The Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003/3226), as amended by the Financial Collateral Arrangements (No 2) Regulations 2003 (Amendment) Regulations 2009 (SI 2009/2462) and the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993)) (FCR) applies to security which is a financial collateral arrangement involving financial collateral. It removes certain requirements in relation to the creation and registration of security and disapplies certain rules of insolvency law. Where certain security arrangements exist over financial collateral (cash, financial instruments and credit claims) between two non-natural persons, the FCR disapplies certain statutory requirements in relation to that security arrangement (such as the requirement to register security at Companies House under the Companies Act or overseas companies registration requirements noted above, as well as certain provisions of English insolvency law). Where a security interest falls within the FCR, perfection can be by possession or control rather than by registration at Companies House, however in practice, security documents creating the types of security interests referenced above are commonly still registered for a variety of reasons. For more information, see *Practice note: Financial collateral arrangements*.

Other specific assets (such as land, IP rights, ships and aircraft and/or certain agricultural assets) may require registration to perfect security created over them.

For more information on perfection of English law security, see *Practice note: Perfection and priority of security*.

20. How is the security granted by the SPV held for the investors? If the trust concept is recognised, are there any particular requirements for setting up a trust (for example, the security trustee providing some form of consideration)? Are foreign trusts recognised in your jurisdiction?

Security is typically granted by the SPV in favour of a security trustee who holds the security expressly on trust for the benefit of itself (as security trustee), the noteholders and the other secured parties in the transaction. Typically a single document (a security trust deed) is used to vest the security in the security trustee and constitute the trust in favour of the investors.

English law requires the following three certainties to create a valid trust:

- Certainty of intention to create a trust: this is usually clearly demonstrated by the use of express trust language in the security trust deed.
- Certainty of subject matter: the trust property (the security and the associated rights under the transaction documents) must be sufficiently identified.
- Certainty of objects: the objects, or beneficiaries of the trust (that is, the noteholders and other secured parties), must be clearly identified. If drafted properly, the fact that this may be a changing class of beneficiaries should not be problematic.

The trust must also be for a lawful purpose and must be created by a person (here, the SPV) competent to create a trust. The trust property must also consist of rights which can be subject to a trust. As the benefit of contractual rights can be the subject of a trust under English law, rights under security documents and other transaction documents satisfy this requirement.

For more information see *Practice note: Security trusts in finance transactions: overview*.

Under the Recognition of Trusts Act 1987, which ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985, English law recognises that foreign trusts are governed by whichever law is identified expressly by the settlor to govern the trust (or in the absence of such express choice, the law with which the trust is most closely connected).

Credit enhancement

21. What methods of credit enhancement are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the credit enhancement techniques set out in the Guide to a standard securitisation (Guide) ?

The various methods of credit enhancement outlined in the *Guide* are commonly used in England and Wales.

Following the implementation of the EU and US risk retention regimes (*see Question 3*), the method of credit enhancement chosen may also be influenced by the need to meet one of the methods prescribed by the risk retention rules for the relevant retention holder to retain economic risk.

Risk management and liquidity support

22. What methods of liquidity support or cash reservation are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the provision of liquidity support as set out in the Guide?

Third party liquidity facilities are less common in securitisations in England and Wales than they were before the credit crisis, due to:

- A lack of liquidity in the market.
- The reduction in some financial institutions' ratings.
- The introduction of tighter capital rules in relation to the provision of liquidity facilities as a result of post-crisis regulation.

Cash reserve funds (whereby excess cash in the securitisation is held to cover liquidity issues) are commonly used in England and Wales (see *Guide*).

CASH FLOW IN THE STRUCTURE

Distribution of funds

23. Please explain any variations to the cash flow index accompanying Diagram 9 of the Guide that apply in your jurisdiction. In particular, will the courts in your jurisdiction give effect to flip clauses (that is, clauses that allow for termination payments to swap counterparties who are in default under the swap agreement, to be paid further down the cash flow waterfall than would otherwise have been the case)?

The cash flow and payment mechanics in a securitisation are usually governed by a priority of payments (also known as a cash flow waterfall), which will be set out in the transaction documentation. The cash flow index accompanying Diagram 9 of the Guide sets out a template priority of payments. Ultimately however, the payment priorities for a given securitisation transaction will be negotiated on a case-by-case basis, with the order of payment being influenced by various factors, including:

- Tax considerations.
- Rating agency requirements and expectations of investors.
- The relevant negotiating position of the various transaction parties.

Generic variations may include:

- Separate payment priorities governing interest and principal proceeds, as well as for payments before and following enforcement.
- Prior to enforcement of security, the order of payment items in the payment priorities (for example, whether different classes or sub-classes of secured creditors are paid pro rata or sequentially) may depend on the occurrence (or non-occurrence) of trigger events other than enforcement related events (such as certain bespoke performance requirements in relation to the underlying assets).
- Various methods of profit extraction may apply at different levels of the payment priorities, for example an originator may extract fee income (often capped or fixed) near the top of the payment priorities for acting in the capacity of servicer or manager to the SPV, and/or it may receive a subordinated (fixed or equity-like) return towards the bottom of the payment priorities (*see Question 24*), the rights to which, in certain circumstances may be represented by a tradable certificate or security.
- An item in the payment priorities may be used to pay liquidity support providers or to fund (or top-up) one or more cash reserves (*see Question 22*).

A flip clause is a contractual provision that provides for the priority of certain payment rights of a creditor to be dependent on whether certain specified events (including the commencement of insolvency or bankruptcy proceedings) have occurred with respect to that creditor. The effectiveness of flip clauses has been the subject of judicial decisions in both the English and US courts and for the current status of these decisions and lines of cases, see *Legal update: LBSF v Bank of America: Lehman Court diverges from Prior Flip-Clause Rulings*).

Profit extraction

24. What methods of profit extraction are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the profit extraction techniques set out in the *Guide*?

In the UK all of the methods of profit extraction specified in the *Guide* are commonly used. The type of profit extraction used in any given securitisation transaction will depend on a number of factors, including:

- The nature of the assets in the pool.
- The type of credit enhancement used.
- Rating agency and timing considerations.
- Accounting and regulatory capital treatment which may be applied.
- The tax consequences of the proposed method of profit extraction.

THE ROLE OF THE RATING AGENCIES

25. What is the sovereign rating of your jurisdiction? What factors impact on this and are there any specific factors in your jurisdiction that affect the rating of the securities issued by the SPV (for example, legal certainty or political issues)? How are such risks usually managed?

At the time of writing, based on its government bond rating, the sovereign rating of the UK is Aa1 (negative outlook) by Moody's, AA+ (negative outlook) by Fitch and AA (negative outlook) by Standard & Poor's.

Factors impacting the sovereign rating of the UK differ between rating agencies, but have a grounding in the financial, political and macroeconomic strengths of the sovereign nation. Examples of relevant factors include:

- The presence of risk mitigants (in terms of risks facing the financial sector, political risk and macro-economic risk).
- Credibility, effectiveness and coherence of policies and prospects.
- Political stability.
- Gross domestic product.
- Economic growth forecasts.
- The level and structure of government borrowing.
- The structure and sustainability of fiscal financing.
- Performance relative to budgets.
- The current account balance.
- The external liquidity and investment position.

In relation to specific securitisations having a connection with England and Wales, rating agencies are concerned about a variety of risks associated with the structure of the securities issued by the SPV, including:

- Asset isolation: whether, and to what extent, the SPV's assets have been legally isolated by a true sale, so that the credit risk of a specific pool of assets has been effectively de-linked from the credit risk of the originator.

- Asset quality: the pool of assets will be modelled to give an expected loss/impairment, which will then be stress tested under different scenarios. The quality of asset modelling will be affected by matters such as the availability and quality of historic performance data on the pool of assets.
- Credit enhancement: whether the securitisation benefits from sufficient credit enhancement to withstand default and protect bondholders from losses under various stress tested scenarios.
- Counterparty analysis: the level of dependence on, and credit quality of, entities providing services to the SPV, as this represents credit risk outside the securitised assets.
- Originator/servicer/manager quality: the ability of the servicer or manager of the pool of assets.
- Legal structure and documentation: the ability of the parties to enforce the transaction documents related to the securities issuance without any material restrictions, and the effect of insolvency on such rights of enforcement.

These generic concerns (the emphasis on which differs between different rating agencies) may be augmented by more specific asset class or structure/product considerations (which also differ between different rating agencies).

To achieve the desired rating for securities issued by the SPV in a securitisation transaction, any risks identified by the rating agencies appointed to provide a rating for such securities are usually managed by structuring the securitisation in a manner which complies with the applicable rating criteria and methodology of each such rating agency. As part of this structuring process, the rating agencies involved in rating the transaction will conduct their own diligence and review of:

- The legal and commercial structure of the transaction.
- The data underlying the assets to be securitised.
- The transaction parties (such as hedge counterparties and liquidity or other providers of credit or services to the SPV, including the administrative and other operations of any manager/originator and/or servicer).
- The specific legal documentation.

It is usual for legal comfort to be given by way of (among other things):

- Reasoned legal opinions or memoranda covering the main perceived legal risks in the structure under each relevant jurisdiction.
- Representations, warranties, covenants and undertakings of the various transaction parties (including most particularly the SPV) in the transaction documents.

In relation to the regulation of rating agencies in the context of securitisations, see *Practice note: CRAs and credit ratings: EU Regulation* and *Practice note: Overview: Regulation of credit rating agencies: overview.*

TAX ISSUES

26. What tax issues arise in securitisations in your jurisdiction? In particular:

- **What transfer taxes may apply to the transfer of the receivables? Please give the applicable tax rates and explain how transfer taxes are usually dealt with.**
- **Is withholding tax payable in certain circumstances? Please give the applicable tax rates and explain how withholding taxes are usually dealt with.**
- **Are there any other tax issues that apply to securitisations in your jurisdiction?**
- **Does your jurisdiction's government have an inter-governmental agreement in place with the US in relation to FATCA compliance, and will this benefit locally-domiciled SPVs?**

Transfer taxes

Transfer taxes are normally considered in connection with two distinct components of a securitisation transaction, namely the extent to which transfer (or other similar documentary) taxes:

- Are payable in connection with the transfer of securitised assets into a securitisation SPV.
- Arise in connection with the issue and transfer of the SPV's securities, or in connection with the funding and transfer of any subordinated interests or profit extraction instruments issued by the SPV.

In the UK the scope of documentary and transfer taxes has been progressively limited over time, so that in the modern context they are of limited relevance to any securitisation transaction. Generally the UK transfer taxes (stamp duty, stamp duty reserve tax (SDRT) and stamp duty land tax (SDLT)) are levied only on transfers of shares, land and non-standard loans carrying characteristics which the UK legislation has deemed equivalent to equity. As a result, most assets which would normally be transferred into a securitisation SPV, such as commercial loans, auto receivables, trade receivables, RMBS and CMBS assets and credit card receivables, are generally free from transfer taxes.

The treatment of securities issued by an SPV is slightly more complex. In commercial terms securitisation SPV securities do not usually contain characteristics which the UK assimilates to equity, so that in principle such securities should be free of stamp duty on transfer. However securities which are of a limited recourse nature could prima facie be caught by the UK Stamp Duty and SDRT charging provisions.

This matter needs consideration in connection with each transaction, but generally can be managed so as not to cause a problem in practice. Many limited recourse securities are protected by a specific exemption for capital markets securitisation debt. Generally where a non-UK issuer is used, provided the securities which it issues are not registered in a register kept in the UK there should be no charge to UK SDRT (and no need to pay UK stamp duty in practical terms) in any event. Accordingly, where a non-UK securitisation SPV issuer is used, a non-UK register is always recommended.

Profit extraction instruments, such as residual certificates, DACS and super interest notes always need special consideration in relation to their treatment for the purposes of stamp duty and SDRT.

Withholding tax

The UK is a jurisdiction where in many cases withholding tax (at the time of writing, at the rate of 20%) applies to payments of interest. It is always important where a securitisation structure is used to ensure that appropriate UK withholding exemptions apply to all payments made in connection with it.

Generally payments of interest with a UK source may be paid without withholding of UK tax where the recipient is either:

- A UK resident company.
- A non-resident carrying on business in the UK through a branch or agency to which the payment of interest is attributable.

Therefore, where UK resident securitisation vehicles are used, there is generally no UK withholding on underlying assets.

Where payments of interest that arise in the UK are made to a non-UK resident company, including a securitisation SPV, these payments are usually subject to withholding, so that the SPV will generally have to apply for relief under an applicable double tax treaty. Non-UK resident SPVs which purchase UK loans are generally located in Luxembourg, The Netherlands or Ireland, each of which have double tax treaties with the UK.

Various administrative procedures have to be completed before a double tax treaty exemption is actually granted by the UK tax authority (HMRC). Care needs to be taken in connection with the timing of these procedures to ensure that the initial stages of a transaction relying on treaty relief are not adversely affected by temporary withholding tax.

Where UK mortgages are securitised, UK vehicles are normally used to avoid the complexity of multiple treaty claims. However, increasingly foreign treaty based SPVs are used, relying on more recent procedures accepted by HMRC for processing bulk treaty applications.

Following the 2006 decision in the *Indofood* case, care also needs to be taken in situations where an SPV claiming treaty relief could be taken by HMRC to be effectively a conduit arrangement, as relief may be unavailable in such situations.

Payments of interest made by a UK resident securitisation SPV can generally (and subject to certain exceptions) only be paid without withholding of UK tax where the SPV's securities are listed on a "recognised" stock exchange and are therefore entitled to the UK "quoted Eurobond" exemption.

Value added tax (VAT)

In the UK VAT is charged on supplies of goods and services made in the course of an economic activity. Supplies of goods or services are generally standard rated (at the time of writing, at the rate of 20%), zero-rated, exempt, or outside the scope of VAT.

Financial asset securitisations are treated for VAT purposes in accordance with the economic reality, similar to secured borrowings. Generally, although the matter is quite complex, transfers of receivables to SPVs do not therefore mostly constitute supplies in their own right, but usually are treated as merely pre-requisites for the supply of VAT exempt securitisation services by the SPV to the borrowing group. The raising of funds by SPVs is considered to be a non-supply for UK VAT purposes or UK VAT exempt.

Corporation tax: UK SPVs

Since 1 January 2007, a specific corporation tax regime for securitisation companies has been brought into force which effectively taxes securitisation SPVs not on the basis of their deemed accounting profits, but on only the cash surplus retained in the SPV under the transaction cash flow waterfall. Certain tests have to be satisfied for the regime to apply. Among other things:

- The assets securitised have to be financial assets for accounting purposes.
- The SPV broadly has to distribute all the cash that it receives within an 18 month time period (except where reserves of cash are required to be retained, for example for credit enhancement purposes).
- The SPV generally has to satisfy certain requirements in relation to the issuance of securities and their status under UK insolvency law.

Generally, however, most typical UK securitisations will fall within the scope of the regime.

Corporation tax: non-UK SPVs

UK persons who manage and acquire loan assets on behalf of non-UK resident SPV issuers, such as in particular CLO investment managers located in the UK, will need to be satisfied in connection with any transaction undertaken that they are not, for UK corporation tax purposes, treated as carrying on a "trade" in the UK. Were this treatment to apply, the SPV could become liable to UK tax by reference to the profits made by the UK investment manager in the transactions undertaken on its behalf.

Various exemptions exist under UK domestic law and any applicable double tax treaty, so that generally it is possible for CLO investment managers to conduct their affairs in such a way as these charges do not apply.

FATCA and other information exchange compliance

The UK was the first jurisdiction to enter into an Inter-Governmental Agreement with the US relating to FATCA compliance, in September 2012. Under this agreement, UK financial institutions are treated as complying with Section 1471 of the US Internal Revenue Code, provided certain basic requirements are met. As a result, the potential negative effect of FATCA withholding on transactions involving UK entities has been significantly reduced. Under the International Tax Compliance (USA) Regulations 2013, UK reporting financial institutions must report various information, including information relevant to FATCA, to HMRC.

Similarly, under the International Tax Compliance Regulations 2015 (SI 2015/878) (as amended), which includes requirements in relation to the UK's other information exchange agreements, certain UK financial institutions will also be required to report to HMRC similar information to that required under FATCA above. See *Practice note: CRS, EU administrative co-operation and FATCA: UK implementing regulations*.

RECENT DEVELOPMENTS AFFECTING SECURITISATIONS

27. Please give brief details of any legal developments in your jurisdiction (arising from case law, statute or otherwise) that have had, or are likely to have, a significant impact on securitisation practices, structures or participants.

The legal developments arising from statute and regulation affecting the securitisation market generally (*see Practice note: Securitisation: regulatory framework and reforms*) are all relevant to securitisations in England and Wales.

In addition, a number of cases have been heard by the English courts in 2016 which may be of interest to those involved in securitisation (note that cases in relation to pure derivatives matters have been excluded from this chapter, but in relation to publicly reported English law cases of general interest to finance lawyers, see *CaseTracker: Practical Law Finance reported cases*.

In January 2016, in *Canary Wharf Finance II Plc v Deutsche Trustee Company Ltd and others [2016] EWHC 100 (Comm)*, the High Court considered whether a "spens clause" (in broad summary, a clause in many capital markets/bond issuance documentation of certain vintages which is designed to provide protection to a fixed rate investor, by ensuring that on an early termination of a bond or early redemption of notes the investor receives compensation in an amount that will allow it to obtain the same cash flows by re-investing in low-risk gilts) was triggered in the context of a securitisation. See *Legal update: case report: High Court considers whether spens clause was triggered by securitisation note redemption*.

In April 2016 in *Hayfin Opal Luxco 3 SARL & another v Windermere VII CMBS plc and others [2016] EWHC 782 (Ch)*, the High Court considered the interpretation of whether an interest rate provision was void as a penalty in the context of the Windermere VII CMBS transaction. See *Legal update: Case report: Clause may be penalty despite limited impact on contract breaker (High Court)*.

In December 2016 in *Credit Suisse Asset Management LLC v. Titan Europe and others [2016] EWCA Civ 1293*, the Court of Appeal considered an appeal by the Class X Noteholders in a series of CMBS transactions, as to whether Class X Notes should include in their interest rate additional interest due under underlying loans backing the securities issued following a default.

OTHER SECURITISATION STRUCTURES

28. What other structures, including synthetic securitisations, are sometimes used in your jurisdiction?

Other securitisation structures detailed in the *Guide* (such as master trusts and programmatic securitisation structures) are used in the UK. However, following the financial crisis there has been a move (driven by investor demand and increased regulation of the securitisation industry) towards the adoption of simpler, more transparent securitisation structures.

Synthetic securitisations have traditionally been common in England and Wales. However, along with securitisation issuance in general, synthetic securitisations have suffered from a stigma attached to these types of securitisation, due to:

- High default rates on transactions referencing low quality assets.
- A perception from regulators that synthetic structures tend to be more opaque than cash structures.

It is also now difficult to achieve the highest rating agency ratings for synthetic deals, due to the tightening and greater granularity of the ratings criteria applicable to them. In addition, at the time of writing in Q4 2016, the approach of the European regulators to synthetic securitisations (and the relationship of such securitisations to the STS and other regulatory drivers) is still not finalised. For further information, see: *Practice note: Securitisation: regulatory framework and reforms – Branches of reform – Proposals for synthetic securitisations*.

REFORM

29. Please summarise any reform proposals and state whether they are likely to come into force and, if so, when. For example, what structuring trends do you foresee and will they be driven mainly by regulatory changes, risk management, new credit rating methodology, economic necessity, tax or other factors?

Structuring trends and reform proposals that affect securitisations in England and Wales include predominantly the same reforms and regulatory proposals that affect the European market more generally, namely:

- The reforms and regulatory developments and proposals affecting the European securitisation market generally (see *Practice note: Securitisation: regulatory framework and reforms*).
- Reform proposals arising from US legislation, such as the Dodd-Frank Act (see *Practice note: Summary of the Dodd-Frank Act: The Volcker Rule* and Practice note: Summary of the Dodd-Frank Act: Securitization).

The work done by market bodies such as the PCS initiative (which assigns labels denoting certain standards for quality, transparency, simplicity and standardisation throughout the ABS market) and the securitisation division of AFME continues to try to:

- Gain recognition of the strong performance of high quality securitisations throughout the financial crisis.
- Rehabilitate the public image of securitisations with regulators and investors.

These market-led calls for support for the rehabilitation of the European ABS market have been reflected in a growing number of reform proposals from European regulators from late 2014 onwards, including throughout 2016, which ultimately affect the securitisation market. These reform and legislative proposals reflect the continuance of the various post-crisis initiatives to ensure a safer and more transparent securitisation market in the EU (including, at the time of writing, England and Wales).

For further information, see *Practice note: Securitisation: regulatory framework and reforms*.

Following the vote by the UK to leave the EU in June 2016, securitisation professionals have been considering the potential ramifications for the securitisation market in England and Wales as a result of Brexit. It is, regrettably, difficult to be definitive at this stage as to the likely effect of Brexit on the securitisation market in Europe generally or England and Wales more specifically, not least because the existing regulatory proposals governing securitisations (predominantly the draft Securitisation Regulation) are themselves in the process of being negotiated between the European Council, European Commission and the European Parliament, and the manner of any exit from the EU by the UK is not as yet finalised or clear. For further information on resources covering the legal implications of Brexit, see: *http://uk.practicallaw.com/country/eu-referendum*.

30. Has the nature and extent of global, regional and domestic reforms had a positive or negative affect on revitalising securitisation in your jurisdiction?

In the immediate aftermath of the financial crisis an almost unprecedented programme of financial reforms affecting the securitisation market (globally, regionally as well as in domestic markets such as England and Wales) were proposed which have now been, or are still in the process of being, implemented.

The European Commission and the ECB (and, in England and Wales specifically, the Bank of England) have each, at various times in the last few years, acknowledged that an effect of this aggressive post-crisis reform agenda has been to penalise higher quality and safer securitised products when compared to other similar forms of financing, with a correspondingly negative effect on the securitisation industry in Europe generally, including in England and Wales (see for example the overview of the securitisation market outlined in *Question 1*).

There have continued to be positive developments for the securitisation industry in 2016, with a number of central banks, regulators and policy makers acknowledging that securitisation can play a key role in unlocking capital resources and financing economic growth and a variety of proposals for regulations covering (or affecting) the European securitisation industry, culminating most recently in the various initiatives aimed at identifying, categorising and applying beneficial results to (variously) simple, standardised, transparent and/or comparable securitisation structures which look likely to come to fruition in the form of the Securitisation Regulation during 2017.

While the overarching intention behind the majority of these initiatives can be seen as broadly positive for the securitisation industry, in most instances the resulting regulation has been at best poorly drafted and at worst myopic, with the result the industry seems, to many participants, to remain unfairly stigmatised and over-regulated.

ONLINE RESOURCES

legislation.gov.uk

W www.legislation.gov.uk

Description. Contains original versions of all legislation since 1988, as well as revised versions of legislation that have been in force since 1991.

Practical Law Contributor profile

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Professional qualifications. England and Wales.

Areas of practice. Advising arrangers, originators and investors on all aspects of securitisation, structured finance and derivatives including the structuring and restructuring of securitisation transactions across a wide range of asset classes (including trade receivables, credit-card receivables, auto and other loans and leases, vehicle rental fleets and residential and commercial mortgage loans) and a wide range of structures (including CLO/CDOs, RMBS, CMBS, ABCP conduits, covered bonds and whole business securitisations) as well as general capital markets issuances, asset backed and leveraged finance transactions, and portfolio sales.

Publications

- Recognised in legal directories as "one of the brightest young partners in the market", and as "responsive and commercially minded" with "considerable experience and talent".
- Recognised as a "Leading Individual" for securitisation and recommended for derivatives and structured products in Legal 500 UK, as "Up & Coming" for Capital Markets: Structured Finance & Derivatives in Chambers UK and for Securitisation in IFLR 1000.
- Author of a number of academic and commercial guides to securitisation.