Some thoughts on active management in securitisations and the way securitisation vehicles are financed

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The new Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (hereafter the «Securitisation Regulation») will come into force on 1 January 2019.

Many practitioners in Luxembourg are wondering if the coming into force of the Securitisation Regulation should not be used by the Luxembourg legislator to optimise certain points in the current Luxembourg law of 22 March 2004 on securitisations, as amended (the «**2004 Law**»).

Although there are several aspects to be optimised that could be dealt with in this article, we would like to focus here specifically on two aspects: the active management of underlying assets held by a securitisation vehicle and the means of financing of a securitisation undertaking.

1. Active management of underlying assets

a. Current situation

Very soon after the adoption of the 2004 Law, the *Commission de Surveillance du Secteur Financier* («**CSSF**») has, in its annual report of 2007, taken the view that securitisation undertakings may not, through an active management, create new risks in respect of the underlying assets. The regulator took the view that the necessary passive position of a securitisation vehicle is the result of the «specific nature» of a securitisation transaction, in which the vehicle's activity should be limited to acquiring or assuming risks which have been created and transferred to the vehicle by a third party (the originator).

In the CSSF's report of 2007, a specific exemption (from such passive management rule) existed for securitisation transactions involving portfolios composed of «*actively managed*» financial assets. However, when the compilation of all CSSF-requirements in respect of securitisations into the CSSF's *Frequently Asked Questions - Securitisation* (the «***FAQs Securitisation***») took place, the reference to «actively managed» ultimately disappeared, so that many practitioners took the view that it would then be prudent to consider that an active management of any asset (including financial assets) should not be recommended.

The legitimate concern of the CSSF is, of course, to place safeguards against abusive behaviour tending to circumvent by means of a securitisation structure binding prudential and regulatory requirements such as those applying to, for example, fund managers.

The reality in the financial markets is however such that, once the eligibility criteria for the underlying assets have been set, the portfolio is often managed «dynamically» by investment or collateral managers. The risk of the investors (noteholders) exposed to these assets does not really vary since the framework of the quality of the assets to be acquired is fixed initially in the issue documents. Purchases and sales of assets therefore always move within this precisely defined quality framework. Resale and reacquisition of assets (often during an initial ramp-up period or during a reinvestment period) is very often profitable for investors since dynamic management makes it possible to quickly dispose of non-performing assets and replace them with more profitable assets.

In the *FAQs Securitisation*, the CSSF specifically takes into account this reality by describing the conditions for the securitisation of financial assets or instruments. The CSSF specifies that «*when financial assets are securitised, the articles of incorporation or the documents relating to the issue of securities must describe the selection criteria, as well as the composition of the securitised portfolio, where applicable, according to the classes of assets. They must also lay down the conditions and criteria according to which the assets composing this portfolio can be assigned, in accordance with Article 61 of the 2004 Law* […]». The principle of the subsequent disposal of assets is therefore accepted by the CSSF, which is of course fully aware of the practical transactions operated the financial markets.

But then, the *FAQs Securitisation* limit the possibility of making disposals: the CSSF clearly indicates that management activities «*must be such that they do not fall within the scope of the regulations governing the operation and management of undertakings for collective investment in transferable securities and alternative investment funds*». It is therefore clear here that the CSSF, as mentioned above, wishes to avoid circumvention of regulatory requirements for the approval and operation of fund managers.

b. Argumentary in favour of allowing expressly active management for securitisations

First of all, it should be noted that the preparatory works for the 2004 Law did not provide for such a restrictive view of the management of the assets of the securitisation vehicle and that the 2004 Law does not impose any restrictions on the management method. Article 61 of the 2004 Law confines itself to stipulating that «*a securitisation undertaking is authorised to dispose of its assets only in the manner provided for by its articles of incorporation or management regulations*». This provision is designed to protect investors from the diversion of assets, but the spirit of the 2004 Law, in our view, was not in itself to limit the management style to purely passive management.

In addition, the European legislator indirectly takes into account the existence of securitisation with active management. Indeed, by specifically excluding in the Securitisation Regulation discretionary active management for STS securitisations in order to fulfill the simplicity criterion, the European legislator recognises *a contrario* that more sophisticated securitisations involving active management can be achieved for all other securitisations falling under the regime of the Securitisation Regulation (which would then not be STS securitisations). Thus, if the European securitisation regime *ipso facto* integrates securitisations with active and discretionary management (for securitisations other than STS securitisations), Luxembourg should not deprive itself of this possibility.

Moreover, in almost all cases of sophisticated securitisations that can have a significant economic impact, the management is carried out by investment managers or collateral managers with a license in their country of residence. The risk of regulatory circumvention is therefore very low for these important transactions. It should furthermore be emphasised here that for securitisations (active or passive) carried out under the Securitisation Regulation, investment or collateral managers will need an authorisation.

To avoid any risk of circumvention of the regulatory requirements that may be applicable in the management of the underlying asset portfolio, it might be appropriate to clarify the 2004 Law by amending current Article 60 of the 2004 Law, which could, for example, go in the following direction:
- for all the securitisations under Regulation 2017/2402 carried out by Luxembourg SSPEs, the manager of the underlying assets must be authorized in accordance with the UCITS, AIFM or MiFID II directives;
- for all securitisations carried out under the 2004 Law (but outside the scope of Regulation 2017/2402) and involving active and discretionary management, the investment manager of the underlying assets should be authorized in his country of residence to carry out an active management activity;
- for all securitisations carried out under the 2004 Law (but outside the scope of Regulation 2017/2402) and involving purely passive management of a «prudent man», the manager of the underlying assets would not need to be authorised.

2. The means by which the securitisation vehicles are financed

The 2004 Law requires the issue of transferable securities (*valeurs mobilières*) as a means of financing securitisation vehicles. The CSSF has stated very pragmatically in its *FAQs Securitisation* mentioned above that additional loan financing was possible, provided that a substantial part of the financing is done through the issuance of transferable securities. Moreover, certain «structural» exceptions are of course accepted by the CSSF, such as full loan financing in an initial «warehousing phase» or full financing by loan(s) of acquisition vehicles in a double-tier structure involving a vehicle of issuance and an acquisition vehicle. However, the principle of the requirement of issuing securities (dictated by the 2004 Law) remains.

This restrictive condition for the mandatory issue of securities has often been perceived by the markets as too restrictive. The requirement to issue securities seems to be of a rather «semantic» origin because it is linked to the name of the transaction, «securitisation», which implies the - economic - transformation of underlying assets into securities.

Nevertheless, considering the definition of «securitisation» in the new Securitisation Regulation, it appears that the European legislator has established a formal definition of securitisation which is *per se* disconnected from the issue of securities.

Securitisation is indeed defined in the Securitisation Regulation as «*a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranched…*».

Although certain definitions in the Securitisation Regulation (for example, the definition of «traditional securitisation») refer to an issue of securities and recital (1) of the same Securitisation Regulation also refers to a conversion of the underlying assets into securities, the approach of the European legislator shows, clearly in our opinion, that it is possible to move away from the «dogma» of the issuance of securities.

In addition, the need for issuing «transferable securities» (*valeurs mobilières*) is a very specific requirement that securities which are tradeable on capital markets be issued. This extreme precision excludes many securities which, in themselves, are not transferable securities, but which could be perfectly used by investors to expose themselves to underlying risks.

Flexibility at this level would be welcome and could consist in slightly modifying the 2004 Law on this point, so as to allow the financing of the securitisation vehicle by the issuance of all kinds of securities or instruments and to allow *expressis verbis* financing, for a substantial part, through loans or any other means of financing.

Réconcilier patrimoine naturel et patrimoine financier

Orcadia AM lance une sicav responsable « fossil-free »

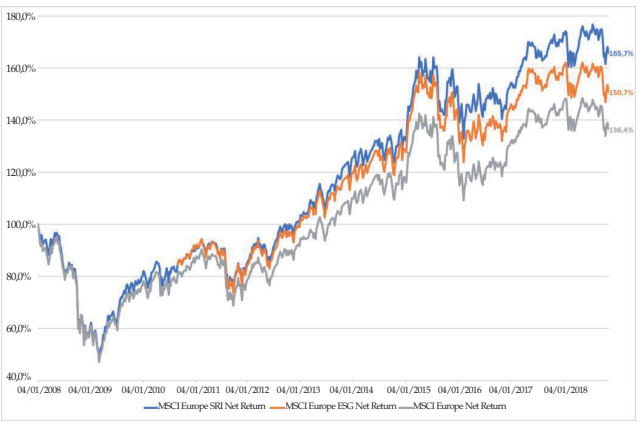
Orcadia AM, la société de gestion patrimoniale créée par Etienne de Callataÿ, Geert De Bruyne, Jacky Goossens et Patrick Keusters, annonce la création d'un nouveau compartiment de sicav à la fois responsable et «fossil free».

Il n'y aura pas d'investissement dans les entreprises du secteur des énergies fossiles (ni dans le nucléaire) et toutes les entreprises dans lesquelles il sera investi répondront à un filtre responsable strict, à savoir faire partie des 25% les meilleures de leur secteur en termes environnementaux, sociaux et de gouvernance (ESG).

Pourquoi ne pas investir dans les énergies fossiles ? Cela peut découler de raisons éthiques ET de motivations financières. Les premières sont évidentes. Pour les secondes, il suffit de reprendre l'observation d'un économiste français, Jean Pisani-Ferry, pour qui, parlant des grands acteurs de l'énergie fossile «la valorisation boursière de ces entreprises est incompatible avec un objectif de limitation du réchauffement planétaire.». Et la baisse récente du prix du pétrole rappelle, si besoin était, la volatilité de celui-ci.

Pourquoi investir dans les entreprises responsables, celles qui ont un meilleur bulletin sur le plan environnemental, social et de la gouvernance ? Ici aussi, cela peut découler de raisons éthiques ET de motivations financières. Et ici encore, les premières sont évidentes. Pour les secondes, il suffit d'observer le graphique ci-dessous.

Il compare l'évolution de trois indices boursiers européens sur les dix dernières années : l'indice global (en noir), le panier limité aux 50% d'entreprises les mieux classées en termes ESG (ligne orange) et le panier limité aux 25% d'entreprises les mieux classées en termes ESG, appelées «SRI» (ligne bleue). Il en ressort une surperformance de l'investissement responsable.



Orcadia AM a décidé de lancer un compartiment qui investit dans le panier d'actions de la zone euro répondant à la norme responsable la plus stricte de 25% les meilleurs en termes ESG par secteur et à l'exclusion intégrale du secteur des énergies fossiles. En outre, il y a d'autres exclusions plus «classiques» (armes, nucléaire, OGM, …). Ce compartiment vient d'être créé avec des capitaux initiaux d'une dizaine de millions, pour partie apportés par les fondateurs d'Orcadia et une ONG environnementale bien connue. Les frais de gestion sont de 0,7% en cas d'apport inférieur à EUR 2,5 millions et 0,35% pour un investissement supérieur à EUR 2,5 millions.

Avec ce compartiment, Orcadia AM offre aux investisseurs qui le souhaitent la possibilité de combiner :
(1) un investissement réellement responsable ;
(2) une très large diversification sectorielle ;
(3) la sortie des énergies fossiles ;

le tout avec les traits distinctifs d'Orcadia AM :
- qualité de gestion et de service ;
- tempérance dans les frais de gestion ;
- évitement des situations de conflit d'intérêt ;
- engagement sociétal marqué.