



GUIDANCE NOTE FOR BOARD MEMBERS

SECURITISATION OF NON-PERFORMING LOANS (“NPLs”)

WORKING GROUP | BEST PRACTICE
MANAGEMENT & CORPORATE GOVERNANCE

DECEMBER 2023

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INTRODUCTION – SECURITISATION OF NON-PERFORMING LOANS (“NPLs”)

In non-performing loan transactions, the securitisation vehicle or financial vehicle corporation (“**FVC**”) securitises a portfolio of non-performing loan receivables (“**NPL**”) which are generally defined as loan receivables in which the borrowers are in default because they have not made the scheduled payments for a specified period.

The NPL portfolio is usually acquired at a significant discount reflecting the fact that the debtor is in financial distress. A distressed / non-performing debt can be defined as debt where there is no reasonable expectation that the holder will recover the full and complete debt instrument’s principal amount and any unpaid interest that accrued before the instrument became distressed.

In a securitisation context, the contemplated situation is where debt receivables purchased at a significant discount are transferred to an FVC, usually by credit institution as original lender.

NPLs can be secured by collateral or unsecured. Personal or commercial loans are the usual types of unsecured NPLs. The most common secured NPLs are mortgage loans, with residential or commercial property as the collateral. The strategy for realising the NPL investment varies with the type of collateral.

In the situation where the NPLs are secured by a collateral, one of the strategies to realise the investment is based on obtaining the collateral, either through an amicable resolution with the debtor or through a court decision in a legal proceeding. The ownership title of the collateral/property is temporarily transferred to the FVC that will further sell it to a property company (“Propco”) that may be set up in the country of origination of the NPL, for this purpose specifically. The collateral/property will further be sold to a third party. The whole process from obtaining the collateral’s ownership title from the original debtor until selling it to a third party is usually managed by a Servicer. In other cases, a revised payment term or restructuring of existing debt, etc. can be negotiated with the borrowers for future cash flow instalments to the FVC.

With regards to the notes, in some transactions they are split into two or more tranches, each characterised by a different risk/return level. For example, the senior tranche usually carries a predefined interest rate and is further up in order of payments in the waterfall. Subordinated or junior notes on the other hand are first to absorb losses and receive the residual amounts left after all other waterfall payments. Since the mechanics involve tranching, these structures then typically fall under the EU **Securitisation Regulation**, and hence the Originator/Seller of the receivable portfolio is required to retain a minimum

interest of 5% in the transaction¹.

In case the notes are admitted for trading on a stock exchange, it is important to be aware of the issuer’s, i.e. the FVC’s, ongoing obligations set by the relevant stock exchange. These may vary significantly depending whether the notes are listed on a regulated or unregulated market, and, in particular, in terms of publication of financial reports under the transparency laws. For example, under the Luxembourg transparency law, issuers who have only debt securities traded on a regulated market and where such debt securities have a denomination of at least EUR 100,000. - (or equivalent in other currency) are exempted from certain requirements regarding annual and half-yearly financial reporting.

For risk management purposes, the FVC may enter into a swap agreement to hedge certain positions in terms of currency and interest exposure as well as cash flows.

On 28 December 2021, the Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU² (also known as the “NPL Directive”) entered into force. The NPL Directive lays down a specific framework and requirements for:

- credit purchasers of (i) the creditor’s rights under a non-performing credit agreement, or (ii) the non-performing credit agreement itself, issued by a credit institution established in the EU; and
- credit servicers of NPLs, who act on behalf of a credit purchaser.

EU Member States have until 29 December 2023 to implement the NPL Directive into national law and must apply those measures from 30 December 2023. In Luxembourg, a draft law No. 8185 implementing Directive (EU) 2021/2167 of 24 November 2021 on credit managers and credit purchasers has been submitted to the Luxembourg Parliament (*Chambre des Députés*) on 24 March 2023.

In this publication, we do not examine how the NPL Directive or the Luxembourg law, once implemented, will affect the obligations of servicers or FVCs based in Luxembourg.³

Terms and abbreviations used in this publication are defined in the “**GLOSSARY AND ABBREVIATIONS**” at the end of the document.

¹ Article 6 of the Regulation (EU) 2017/2402 of the European Parliament and of the Council Regulation of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

² <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021L2167>

³ Following the recent adoption by the European Union of the NPL Directive, LuxCMA has taken the proactive steps to manage its implementation in Luxembourg. A dedicated Task Force entered into force on 5 December 2023 and its main objective will be to thoroughly assess the NPL Directive and related legislation and subsequently develop an actionable roadmap for its implementation by the end of the year.

MAIN PARTIES INVOLVED IN THE SECURITISATION OF NPLs

The key parties and their most important responsibilities in NPL securitisations, are described here below:

ARRANGER

The **Arranger** is involved, among other things, in setting up the transaction, selecting the pool of assets, defining the terms of the securities to be issued and in the overall preparation of the structure.

The Arranger is a party to the main transaction documents, including subscription agreements. Under such agreements the FVC provides the Arranger with several undertakings, representations, and warranties.

The Arranger may perform a variety of other functions in the securitisation transaction combination of which may depend on a transaction setup.

CALCULATION AGENT

The **Calculation Agent** is responsible for calculating and reporting on the distribution of interest, principal repayments, and profit participation (if applicable) due to Noteholders.

CASH MANAGER

The **Cash Manager** acts as agent of the FVC in administrating the transaction account and the funding account in accordance with the applicable terms and conditions. To this extent, the Cash Manager is responsible for making all the administrative arrangements required to facilitate payments or performance as described in the transaction documents.

CLEARING AGENT

The **Clearing Agent** is usually a financial institution that is interposed between the FVC and the Noteholders. It accepts securities as eligible for settlement and is also responsible to properly service those securities. Having a clearing agent may reduce the risk associated with failure to deliver the securities on the settlement date.

DATA TRUSTEE

The role of **Data Trustee** is not materially different from the other transactions discussed in these guidelines (e.g. receivable transactions) hence it is not expanded any further in this document.

LISTING AGENT

In case when FVC intends to list its notes, it may appoint a **Listing Agent** (which is however not mandatory if the notes are listed on the Luxembourg Stock Exchange) to act as an intermediary between the stock exchange and the FVC, Arranger and/or legal advisor. The role of the Listing Agent is to ensure all required listing documentation is approved by the stock exchange and the listing process is successfully completed. Majority of the stock exchanges have a list of approved listing partners that can assist in this process.

MONITORING AGENT

The **Monitoring Agent** has the role of examining and monitoring the servicing and performance of the receivables and properties as defined in the Monitoring Agent Agreement. The Monitoring Agent is usually an accounting firm that is appointed to verify, most of the times, receivables, invoices and costs incurred by the Servicer, real-estate brokers etc., but also reports that are prepared by the Servicer.

The responsibilities of a Monitoring Agent are specific and can be different from one transaction to another, as defined in the Monitoring Agent Agreement.

PAYING AGENT

The **Paying Agent** is usually a credit institution, responsible for the payments of interest and principal to the Noteholders, as authorised and instructed by the FVC, based on a paying agency agreement.

Among the main duties mentioned above, the Paying Agent shall maintain records of all documents received in connection with its duties and shall make such records available for inspection at all reasonable times by the Issuer, the Administrator, the Calculation Agent, the Security Agent and the other Agents.

SECURITY TRUSTEE

The **Security Trustee** is an entity who acts autonomously and independently from the other counterparties involved in the transaction, as it is the entity appointed to protect the rights of the Noteholders, as well as of the other secured parties, as set out in the transaction documents. Whilst not mandatory under the Luxembourg securitisation law,

this role is quite common in receivables transactions.

The approval from the Security Trustee is generally required for all major amendments and waivers that may occur or be required during the life of a securitisation transaction. The Security Trustee may also be called to intervene at the occurrence of specific trigger event, for example events of default, in order to safeguard the assets and mitigate the impact of any negative event to the transaction.

For these reasons, it is always important at FVC level to make sure that the Security Trustee is informed about any event, or possible event, that may affect the performance of the assets or the notes. Details about if and by which deadline the Security Trustee should be informed about events occurring at FVC level are generally provided within the transaction documents.

Often the FVC is required to periodically provide a non-default (or compliance) certificate to the Security Trustee attesting that, up to that moment, no default has occurred and the issuer has complied with all its obligations as set-out in the transaction documents

SERVICER / BACK-UP SERVICER FACILITATOR

The **Servicer** is appointed by the FVC to manage the portfolio on its behalf. This role is therefore fundamental within the transaction. The Servicer’s duties mainly consist of:

- Onboarding of the debtors;
- Storage and maintenance of records and delivery of records to the FVC, upon request;
- Periodical reporting;
- Bank account statements for the collection and expense accounts and bank account reports;
- Audit and tax information;
- Notify the FVC of any breach of the Seller in connection to the NPL purchase agreement;
- Ancillary services (NPL collection services, costs payments services, others);
- Management duties in respect of legal management services (e.g. enforcing the rights of the mortgage liens in the appropriate court of law; arrangements with the debtors to achieve a friendly repossession of the collateral security etc.);
- Realisation and disposition/sale of properties; and
- Appraisal of the properties.

Given the specific context in which the Servicer has to perform its duties, the Servicer is often a third party specialised in the management of NPL portfolios, contrary to a performing loan receivable securitisation, where the Servicer is usually the Seller/Originator of the loan receivables.

The centrality of the Servicer role in this kind of transactions is testified by the fact that, among the transaction parties, often a Back-up Servicer will be appointed, i.e., an entity

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ready to take over the same duties of the original Servicer should the latter be no longer able to perform this function. Alternatively, a Back-up Servicer Facilitator may be appointed: the role of this entity is to quickly find a new Servicer to replace the original Servicer, if needed. It is therefore important for the Back-up Servicer Facilitator to be well positioned and have good knowledge of the market to find suitable replacements.

The appointment of a Back-up Servicer or a Back-up Servicer Facilitator provides additional comfort to all parties, but especially to the Noteholders, about the continuity of monitoring of the assets.

COMMON REPORTING IN NPL SECURITISATIONS

The frequency with which reports must be prepared is generally aligned with the frequency of the interest payment dates (“**IPD**”) scheduled for the notes. Main types of report are:

SERVICER REPORT

This report is prepared by the **Servicer** and serves as starting point for the calculations and preparation of the other reports related to a specific IPD. In fact, it includes information about the NPL portfolio, cash-flows during the period since the previous IPD (collection period), in detail:

- NPL portfolio overview and main characteristics of the NPLs (status, outstanding balance, last payment made by the debtor etc.)
- Properties portfolio overview;
- Collections overview;
- Expenses overview (stamp duty, land registry, judicial etc.);
- Amounts available for payment to the noteholders.

The Board of Directors of the FVC has to monitor the reporting and performance of the NPL portfolio.

The servicer report is often provided to the Noteholders.

BUSINESS PLAN

The **Business Plan** is prepared by the Arranger at inception and it is usually used when making the investment decision, depending on the expected yield. The Business Plan is updated periodically (at least once a year) and most of the times contains data and information about the past performance (up to a cut-off date) of the NPL and properties’ portfolios as well as expected future cash-flows.

This report contains information such as:

- NPL portfolio overview;
- Properties’ portfolio overview;
- Forecasted cash-inflow;
- Forecasted expenses connected to the realisation of the collaterals/properties: legal fees, notary fees, valuation fees, marketing fees, asset servicer fees, etc.
- Forecasted timeline;
- Forecasted strategies to realise the cash-flows; and
- Appraisal of the properties and collaterals.

CASH MANAGER REPORT

The Cash Manager Report means a report prepared by the **Cash Manager** in accordance with the Cash Management Agreement in the form agreed between the Cash Manager, the Issuer (FVC), the Seller, the Facility Agent (acting on the instructions of the instructing party), the Noteholders, the **Calculation Agent** and the hedge counterparty prior to the funding date and such other form as may, from time to time, be agreed between the Cash Manager, the Issuer, the Seller, the Facility Agent (acting on the instructions of the Instructing Party), the Noteholders, the Calculation Agent and the Hedge Counterparty.

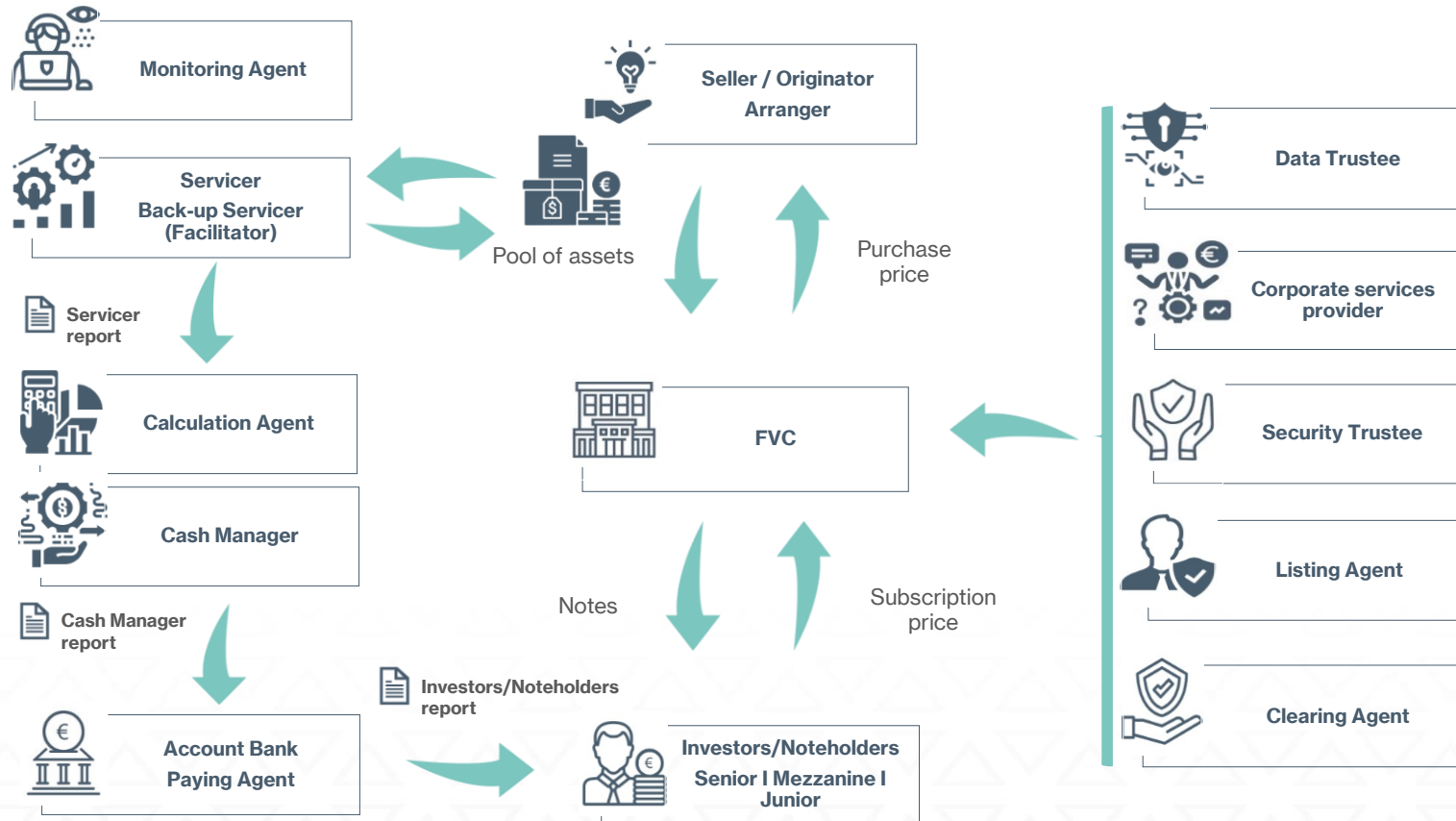
INVESTORS/NOTEHOLDERS REPORT

This report is prepared by the **Paying Agent**, has wide distribution in the format of PDF and usually includes data about:

- Details about relevant transaction parties and related rating;
- Bank accounts – available funds;
- Information about cash reserve and other credit enhancement measures;
- Principal amounts outstanding and interests payable for each note tranche;
- Information about the swap; and
- IPD calculation – waterfall of payments.

In certain transactions also a payment report is prepared, basically including details about all payments to be made by the issuer at the relevant IPD.

TYPICAL NPL STRUCTURE ILLUSTRATION



GLOSSARY AND ABBREVIATIONS

<p>A</p>	<p>Arranger</p>	<p>means the party involved among other things in setting up the Securitisation transaction, the selection of the pool of assets, defining the terms of the securities to be issued and overall, the preparation of the structure. Full definition and roles can be found in the dedicated section in this publication.</p>	
	<p>B</p>	<p>Business Plan</p>	<p>means a comprehensive document that outlines the strategic direction and financial projections of a company whose loan has become non-performing. The business plan is typically developed by the arranger or the prospective buyer of the NPL portfolio to assess the feasibility of rehabilitating the loan and recovering its value.</p>
<p>C</p>		<p>Calculation Agent</p>	<p>means the party responsible for calculating and reporting on the distribution of interest, principal repayments, profit participation (if applicable) due to Noteholders. Full definition and roles can be found in the dedicated section in this publication.</p>
		<p>Cash Manager</p>	<p>means the party acting as agent of the FVC in administrating the transaction account and the funding account in accordance with the applicable terms and conditions. To this extent, the Cash Manager is responsible of making all the administrative arrangements required to facilitate payments or performance as described in the transaction documents. Full definition and roles can be found in the dedicated section in this publication.</p>
	<p>Clearing Agent</p>	<p>means a party, usually a financial institution, that is interposed between the FVC and the Noteholders. It accepts securities as eligible for settlement and is also responsible to properly service those securities. Full definition and roles can be found in the dedicated section in this publication.</p>	

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	Corporate Services Provider	means the party that provides the FVC with services including the provision of a registered address, maintenance of corporate records, and delivery of corporate secretarial services. Additional services might include the provision of directorships and tax services.
D	Data Trustee	means an entity holding the portfolio decryption key allowing for the decryption of personal data which are encrypted and which are necessary for the identification of the names and addresses of the underlying debtors of the receivables. Full definition and roles can be found in the dedicated section in this publication.
F	FVC	means the Financial Vehicle Corporation as per ECB definition laid down in Regulation ECB/2013/40.
I	IPD	means Interest Payment Dates. Dates on which lenders receive interest payment on the debt instrument they hold. Interest payment dates are usually set at the outset and usually correlate closely to rental quarter dates.
L	Listing Agent	means an intermediary between the stock exchange and the FVC, Arranger and/or legal advisor. The role of the Listing Agent is to ensure all required listing documentation is approved by the stock exchange and the listing process is successfully completed. Majority of the stock exchanges have a list of approved listing partners that can assist in this process. Full definition and roles can be found in the dedicated section in this publication.
	LuxCMA	means the Luxembourg Capital Markets Association.

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M	Monitoring Agent	means a third party appointed to oversee and monitor the ongoing performance of the securitised assets. The primary role of the monitoring agent is to ensure that the terms and conditions of the securitisation transaction are complied with by all parties involved and to provide transparency and accountability to investors.
N	NPL	means Non-Performing Loan
O	Originator	means the party assigning assets to the FVC/SSPE in a securitisation transaction.
P	Paying Agent	means a party, usually a credit institution, responsible for the payments of interest and principal to the Noteholders, as authorised and instructed by the FVC, based on a paying agency agreement. Full definition and roles can be found in the dedicated section in this publication.
	Publication	means this document as well as the information contained herein.
S	Securitisation Regulation	means 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.
	Security Trustee	means an entity who acts autonomously and independently from the other counterparties involved in the transaction, as it is the entity appointed to protect the rights of the Noteholders, as well as of the other secured parties, as set out in the transaction documents. Whilst not mandatory under the Luxembourg

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	<p>securitisation law, this role is quite common in receivables transactions. Full definition and roles can be found in the dedicated section in this publication.</p>
	<p>Servicer</p> <p>means a party appointed by the FVC to manage the portfolio of receivables on its behalf. Full definition and roles can be found in the dedicated section in this publication.</p>

Legal disclaimer: This document as well as the information contained herein (collectively the “**Publication**”) was prepared by the Luxembourg Capital Markets Association (LuxCMA).

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About the LuxCMA – Luxembourg Capital Markets Association

Created on 1 March 2019, the LuxCMA is a not-for-profit association (a.s.b.l.), registered at the RCSL (F12205), whose registered office is 6 rue Jean Monnet, L-2180 Luxembourg. The LuxCMA today represents memberships detailed on LuxCMA’s website (www.luxcma.com), which is composed by banks, law firms and services providers, amongst others.

Working Group I Best Practice

The aim of this working group is to find practical solutions (or answers) to practical problems. Capital market participants are often confronted with varying practices among the numerous practitioners active in Luxembourg, including when it comes to compliance, accounting, presentation of the financial statements, clearing, reporting, or general legal questions, and the purpose of the group will be to identify any recurring problems or inconsistencies in such practices and to analyse whether it is possible to work out practical recommendations and good market standards which address such issues.

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