Structured Finance & Securitisation

Contributing editor
Patrick D Dolan

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Cayman Islands

James Burch and Shamar Ennis
Walkers

General
1. What legislation governs securitisation in your jurisdiction? Has your jurisdiction enacted a specific securitisation law?
The Cayman Islands is a major participant in the global securitisation market and while there is little by way of domestic securitisation in the Cayman Islands, a vast number of securitisation transactions have a Cayman Islands exempted company as the issuer. Cayman Islands legislation evolves continually to ensure that it is in step with the demands of the securitisation market and that a Cayman Islands exempted company is the securitisation vehicle of choice. A good example of this is the statutory recognition of non-petition clauses, which is one of the pillars of securitisation structuring, within section 95(2) of the Companies Law. The Cayman Islands has also enhanced the section of the Companies Law dealing with mergers to allow for a foreign entity to merge with a Cayman Islands company, which has been used to great effect in the collateralised loan obligation (CLO) space.

2. Does your jurisdiction define which types of transactions constitute securitisations?
No, there is no such definition under Cayman Islands law.

3. How large is the market for securitisations in your jurisdiction?
While there are no securitisations of domestic assets in the Cayman Islands, the securitisation of non-Cayman Islands assets through use of Cayman Islands vehicles is considerable.

Regulation
4. Which body has responsibility for the regulation of securitisation?
There is no regulatory body responsible for the regulation of securitisation in the Cayman Islands.

5. Must originators, servicers or issuers be licensed?
Provided that the originators and servicers are not carrying on business from within the Cayman Islands and that the issuer will not be making an invitation to the public in the Cayman Islands to subscribe for any of its securities, there is no requirement under Cayman Islands law for such transaction parties to be licensed.

6. What will the regulator consider before granting, refusing or withdrawing authorisation?
Not applicable. See question 4.

7. What sanctions can the regulator impose?
Not applicable. See question 4.

8. What are the public disclosure requirements for issuance of a securitisation?
Provided the securities are not listed on the Cayman Islands Stock Exchange, there are no public disclosure requirements in the Cayman Islands.

9. What are the ongoing public disclosure requirements following a securitisation issuance?
Provided the securities are not listed on the Cayman Islands Stock Exchange, there are no ongoing public disclosure requirements in the Cayman Islands.

Eligibility
10. Outside licensing considerations, are there any restrictions on which entities can be originators?
No, there are no restrictions under Cayman Islands law.

11. What types of receivables or other assets can be securitised?
It should be noted that almost all securitisations using Cayman Islands vehicles involve assets that were originated offshore. Cayman Islands law does not prescribe particular types of receivables or asset classes that may be securitised. It should be noted that there are no Cayman Islands provisions that would restrict the acquisition of foreign receivables by a Cayman Islands SPV.

12. Are there any limitations on the classes of investors that can participate in an offering in a securitisation transaction?
No, there are no limitations under Cayman Islands law applicable where a Cayman Islands SPV is the issuer, assuming that no invitation to subscribe for the securities is made to the public in the Cayman Islands.

13. Who may act as custodian, account bank and portfolio administrator or servicer for the securitised assets and the securities?
Cayman Islands law does not prescribe who may act as custodian, account bank and portfolio administrator or servicer, and these roles are usually carried out by transaction parties operating and based outside the Cayman Islands. The Cayman Islands Monetary Authority regulates local service providers including banks.

14. Are there any special considerations for securitisations involving receivables with a public-sector element?
No, there are no special considerations.

Transactional issues
15. Which forms can special purpose vehicles take in a securitisation transaction?
In the vast majority of securitisation transactions, the SPV will be incorporated as a Cayman Islands exempted company with limited liability whose shares will be held on trust (ultimately for charitable purposes) by a Cayman Islands licensed trust company as share trustee (the Share Trustee), which assists with insolvency-remoteness requirements. Some transactions (mostly Latin American securitisations) may involve a trust rather than a corporate SPV, in which case a Cayman Islands trust company would declare a trust over the transaction assets and issue debt backed by the trust property. While rare, partnerships have also been formed as special purpose vehicles to participate in securitisation transactions.
16 What is involved in forming the different types of SPVs in your jurisdiction?

Setting up an SPV in the Cayman Islands is flexible and quick. A Cayman Islands SPV can be set up in as little as 24 hours.

Upon the filing with the Registrar of Companies in the Cayman Islands (the 'Registrar') of: the memorandum and articles; the appropriate filing fees; and a declaration from the subscriber to the effect that the operation of the SPV will be conducted mainly outside the Cayman Islands, the SPV shall be deemed to be registered, and the Registrar shall issue a Certificate of Incorporation.

The Cayman Islands remain relatively inexpensive and the set-up costs for SPVs in the Cayman Islands are still low. Fees payable to the Cayman Islands government upon incorporation and annually thereafter are based on the SPV’s authorised share capital. In a typical transaction, the government fees would be US$854 at incorporation and annually thereafter.

17 Is it possible to stipulate which jurisdiction’s law applies to the assignment of receivables to the SPV?

Yes. Provided the choice of laws of the jurisdiction selected to govern the assignment has been made in good faith and will be regarded as a valid and binding selection that will be upheld in the courts of that jurisdiction and all relevant jurisdictions, such law chosen would be upheld as a valid choice of law in any action in respect thereof in the courts of the Cayman Islands. In some cases where the seller of assets (eg, a hedge fund or another securitisation vehicle) and the SPV are both incorporated under Cayman Islands law, the parties may select Cayman Islands law to govern the sale and assignment documentation in order to simplify the true sale analysis and confirm insolvency and recharacterisation issues to one jurisdiction.

18 May an SPV acquire new assets or transfer its assets after issuance of its securities? Under what conditions?

There are no restrictions arising pursuant to Cayman Islands law preventing an SPV from acquiring new assets or from transferring its assets after issuance of its securities.

19 What are the registration requirements for a securitisation?

There are no registration requirements under Cayman Islands law. There may be filings and registrations for the issuing entity pursuant to FATCA and other tax information sharing legislation depending on the classification of the entity.

20 Must obligors be informed of the securitisation? How is notification effected?

Few, if any, domestic assets are securitised, so with no local originators, there are no notification requirements under Cayman Islands law. Where there has been an assignment of a receivable arising under an agreement governed by Cayman Islands law, the assignment would be perfected by giving notice to the obligors (see question 18).

21 What confidentiality and data protection measures are required to protect obligors in a securitisation? Is waiver of confidentiality possible?

Under Cayman Islands common law, which follows the English common law in this regard, a general equitable duty of confidentiality applies to information coming to the knowledge of a person in circumstances where it would be unconscionable for the recipient to disclose it. More important in a Cayman Islands context, however, is the Confidential Relationships (Preservation) Law (2009 Revision) (CRPL). The CRPL makes it a criminal offence, inter alia, to divulge confidential information (being, information concerning any property that the recipient thereof is not, otherwise than in the normal course of business, authorised by the principal to divulge), subject to certain limited exceptions. ‘Confidential information’ is defined in the CRPL and covers confidential information arising in or brought to the Cayman Islands.

Confidential information may be disclosed with the express or implied consent of the principal of the information. It should be noted that parties divulging confidential information in accordance with the Tax Information Authority Law, facilitating the automatic exchange of tax information between the Cayman Islands and other jurisdictions shall not commit an offence.

22 Are there any rules regulating the relationship between credit rating agencies and issuers? What factors do ratings agencies focus on when rating securitised issuances?

There are no rules in the Cayman Islands regulating the relationship between credit rating agencies and issuers. It should be noted that where applicable, Cayman Islands issuers are bound by, and are, where required, complying with, SEC Rule 17g-7.

There are a number of factors that rating agencies consider when determining a particular rating for securitised issuances. The factors that are particularly applicable from a Cayman Islands perspective are true sale, bankruptcy-remoteness and taxation issues.

Standard & Poor’s has evolved specific ratings requirements for Cayman Islands SPVs given that the Cayman Islands is such a prominent jurisdiction for securitisation.

23 What are the chief duties of directors and officers of SPVs? Must they be independent of the originator and owner of the SPV?

As a general matter, the Cayman Islands Companies Law does not specify the general or fiduciary duties of directors. The Cayman Islands Courts have adopted the English common law principles relating to directors’ duties, which can generally be summarised as:

- a duty to act in what the directors bona fide consider to be the best interests of the company;
- a duty to exercise their powers for the purposes for which they are conferred;
- a duty of trust of the company’s assets;
- a duty to avoid conflicts of interest and of duty;
- a duty to disclose personal interest in contracts involving the company;
- a duty not to make secret profits from the directors’ office; and
- a duty to act with skill, care and diligence.

Of these the duties of loyalty, honesty and fidelity are considered to be the core fiduciary duties.

In a typical off-balance sheet securitisation, the SPV will enter into an administration agreement with a corporate services provider (the ‘administrator’), a company that provides administrative or corporate support services to special purpose vehicles. Among the services provided, the administrator will provide the independent directors and officers of the SPV. The directors and officers of the SPV will typically be independent of the originator but may be employees of the Share Trustee (as defined in question 15). Even if they are employed by the share trustee (or by the originator), directors of a Cayman Islands SPV will owe fiduciary duties to the SPV and will need to act in the best interests of the SPV.

24 Are there regulations requiring originators and arrangers to retain some exposure to risk in a securitisation?

There are no such regulations under Cayman Islands law although structures involving Cayman Islands SPVs are structured to comply with US and European risk retention requirements. In addition, Cayman Islands vehicles have been employed in various ways to facilitate compliance with risk-retention requirements in CLO structures.

25 What types of collateral/security are typically granted to investors in a securitisation in your jurisdiction?

In most off-balance sheet securitisations, security is granted over the underlying assets by the SPV in favour of the note trustee or security trustee for the benefit of the secured parties. Such security interests will typically exclude:

- the corporate benefit fee paid to the issuer in respect of the transaction;
26 How is the interest of investors in a securitisation in the underlying security perfected in your jurisdiction?

In general, no filings are required in respect of mortgages, charges or security interests under the laws of the Cayman Islands in order to perfect the same. A Cayman Islands company is, however, required to make entries in its register of mortgages and charges in respect of such security interests although this register is an internal register of the company and is open to inspection by a creditor or member of the company only and not generally by third parties.

The Cayman Islands does have special rules dealing with security over aircraft, ships, land and limited partnership interests where these are registered in the Cayman Islands or constituted under Cayman Islands law. Such assets have not been subject to extensive securitisation to date.

27 How do investors enforce their security interest?

The Cayman Islands are internationally recognised as being a creditor-friendly jurisdiction. Much will depend on the remedies and processes as set out in the relevant security document. Other than the remedy of foreclosure, investors are permitted to enforce their contractual rights under the relevant security documents without making an application to a Cayman Islands court or a liquidator (in the case of an insolvency), pursuant to section 142 of the Cayman Islands Companies Law.

28 Is commingling risk relating to collections an issue in your jurisdiction?

Typically, the subject receivables are not originated by a Cayman Islands originator and are almost never paid into a domestic Cayman Islands account.

29 What are the primary tax considerations for originators in your jurisdiction?

As mentioned previously, there are no domestic originators in the Cayman Islands. Nevertheless, there are no additional taxes imposed by the Cayman Islands should a transaction be structured using, for example, a Cayman Islands SPV. The Cayman Islands provides a tax-neutral platform for originators and institutions who wish to establish the issuing vehicle there.

Stamp duty arises in the Cayman Islands where the relevant instrument is signed in or physically brought into the Cayman Islands after signing. Accordingly documents are typically executed by power of attorney outside the Cayman Islands.

30 What are the primary tax considerations for issuers in your jurisdiction? What structures are used to avoid entity-level taxation of issuers?

See question 29.

In a typical securitisation transaction, the issuer will apply for an undertaking from the Cayman Islands Governor to the effect that, for a period of 20 years, from the date of such undertaking no law enacted in the Islands after such date which imposes taxes on an entity or its shares or debentures will be applicable to the issuer.

31 What are the primary tax considerations for investors?

The Cayman Islands is party to numerous tax information exchange agreements and subject to both the US and the UK FATCA as well as the Common Reporting Standard. Reporting entities incorporated or formed in the Cayman Islands will, therefore, be bound to provide information regarding their investors to the Cayman Islands Tax Information Authority as and when required by law.

Bankruptcy

32 How are SPVs made bankruptcy-remote?

The orphan SPV structure detailed in question 15 would mitigate the consolidation risk as between the SPV and the originator or Share Trustee, or both, on the bankruptcy or insolvency of the originator or the share trustee, or both. Subject to certain assumptions, the holding of the ordinary shares of the SPV by the share trustee would not result, as a matter of Cayman Islands law, in the SPV being regarded as a beneficially owned subsidiary of the share trustee.

In addition to regular orphan structures, a degree of bankruptcy-remoteness can be achieved for SPVs that are wholly or partly owned by transaction parties through a combination of company law and structural arrangements. This has facilitated a number of innovative securitisation transactions.

33 What factors would a court in your jurisdiction consider in making a determination of true sale of the underlying assets to the SPV (e.g., absence of recourse for credit losses, arm’s length)?

In circumstances where the sale agreement is governed by the laws of another jurisdiction, the Cayman Islands courts would respect the characterisation of the transaction under that governing law. In order to make a determination as to whether there has been a ‘true sale’ as a matter of Cayman Islands law, it would be necessary to review the agreement as a whole to determine if it constitutes a sale. The Cayman Islands courts would likely follow the established English law cases (which would be persuasive although not binding in the Cayman Islands) and in particular the criteria set out by Romer C J in Re George Inglefield Ltd [1933] Ch 1 as to the differences between a sale and a charge. These are:

- there is no right held by the vendor allowing it to reacquire the assets by repaying the price received on the sale;
• there is no obligation on the purchaser to account to the vendor for any profit made upon realisation of the assets; and
• the purchaser has no right of recourse against the seller if a particular asset within the pool of assets realises an amount less than the price paid for it.

Any transaction should be on an arm’s-length basis with appropriate separation between the seller or originator and the purchaser or issuer.

Especially this requires that the job of administering the SPV is handled professionally, by competent administrators who understand the commercial rationale and the legal structure of the transaction and that none of the transaction parties attempt to exert an unacceptable level of control over the SPV and its directors.

34 What are the factors that a bankruptcy court would consider in deciding to consolidate the assets and liabilities of the originator and the SPV in your jurisdiction?

There is no established doctrine in the Cayman Islands of ‘substantive consolidation’, by which we mean the principle that the assets and liabilities of two companies may be treated as though such assets and liabilities were owned and incurred by one entity on a bankruptcy, liquidation or other insolvency proceedings (though see further below).

English case law (which would be persuasive in the Cayman Islands) broadly illustrates that it is only in exceptional circumstances that the basic principle of the separate legal personality of a company is ignored and the ‘corporate veil’ is ‘lifted’, for instance where the device of incorporation is used for some illegal or immoral purpose, is a sham, or where the company is otherwise party to some form of fraud or where public interest concerns must prevail.

All three reported Cayman Islands cases have closely followed the English authorities.

In one case, the Grand Court of the Cayman Islands exercised its discretion under the Companies Law (as amended) in approving a pooling arrangement agreed between the liquidators of group companies where there was a substantial and tangible benefit to the liquidation to be derived from entering into such arrangements. In another case, the Grand Court consolidated the parents of a group of companies where there had been systematic fraud by the owners and management of the companies. Such factors are unlikely to be relevant in the context of a securitisation structure.