

Asset-backed finance and securitisation: considerations for originators

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What is securitisation and asset-backed finance?

Asset-backed finance and securitisation, in simple terms, is lending against an asset or portfolio of assets rather than to a broader business. It is an alternative form of funding for any business that is involved in the making of loans or creation of similar payment obligations (“**receivables**”). As an alternative to (or in addition to) the general corporate borrowing of the business, the business (known in this capacity as the “**originator**” or “**seller**” of the receivables) transfers the receivables, whether loans, trade receivables, hire-purchase agreements or leases (essentially anything that is a payment obligation can, in theory, be “securitised”), into a new special purpose vehicle (the “**SPV**”). Rather than lending to the business more generally, a bank or credit provider instead lends to the SPV and the SPV uses the proceeds of that loan to pay the purchase price for its acquisition of the receivables. The primary credit risk of the

lender is to the underlying portfolio rather than the broader business (although in certain deals there may be some dual dependency on the business, for example in the form of a guarantee from and/or certain financial covenants relating to the business), and it is the returns on the underlying portfolio of assets (rather than the revenue of the business more generally) from which the lender is repaid. At the end of the deal any remaining assets and spare cash in the structure will generally flow back to the originator. These types of funding models can be used to finance existing portfolios and/or to fund the growth of a new portfolio over time.

On a pure asset-backed finance transaction, the lender would not have any recourse to the originator from a credit perspective and would look only to the portfolio of receivables to be repaid. However, the approach taken will depend on the credit profile of the underlying

portfolio and it is common for lenders on smaller transactions (especially for newer businesses or those in niche markets) to require support from the originating business as well, in the form of a guarantee.

Key Tips for Originators

1. Promptly collate copies of all documentation relevant to the underlying receivables including key standard terms, policies and procedures so that the lawyers can identify and address any legal concerns at an early stage
2. Early establishment of the SPV for AML, KYC and account opening purposes and engagement with third party service providers including the bank with which the originator’s collection account is held
3. Early engagement with commercial parties on reporting requirements and systems / data collection capabilities



As a result, it is common to see hybrid corporate credit and asset-backed financing deals as originators transition from their corporate facilities into something more structured. Although most financial covenants on an asset-backed financing will relate to the performance of the portfolio (e.g. arrears or default rates), hybrid deals will generally contain additional triggers and covenants on the originator.

Asset-backed financing is usually “private” for newer businesses and smaller portfolios with originators often working with their relationship banks on their first structured transactions. However, if underlying portfolios grow to c. £200 million or more in size then they may become suitable for a “public” securitisation in which the “loans” made to the SPV to fund its purchase of the receivables (typically in note form – see below) are listed and traded on a stock exchange. This opens up the range of investors who are able to fund a transaction considerably. The portfolios on a public securitisation generally have to be homogenous but there is some more flexibility on private deals to fund two or three different types of assets within a single transaction. Although we

generally refer to the debt provided to the SPV being in the form of a “loan” in this article (mainly for ease of reference), very often the debt is in bond form with the SPV being the “issuer” of the bond. The debt will generally need to be in bond form if it is going to be listed or traded and there are often tax or accounting reasons why a lender may require one or the other but it is mainly a difference in form rather than commercial substance.

Why would a business choose to fund itself through asset-backed financing?

For the right type of business asset-backed finance can have many advantages. We have listed three of these below:

- **Credit risk assessment:** the transfer of the portfolio of assets into an SPV will often strengthen the lender’s credit assessment which will be primarily against the assets rather than the originator, with repayment risk depending on the performance of multiple underlying borrowers and loans rather than the originator’s wider business as a whole. The SPV has no other creditors or broader business risk,

and the lender will have priority recourse over the portfolio if something goes wrong. The transaction will also be structured so as to mitigate against any risk of the SPV entering into insolvency. This reduced investor risk will generally mean reduced funding costs for the originator as compared to, for example, unsecured lending.

- **Increased flexibility:** increased focus on the underlying portfolio often means reduced focus on the originator (especially as the portfolio grows and performance can be tracked over time) and fewer constraints on the originator’s business, freeing up the originator to pursue other lines of business. Where originators are generating various different types of receivables, these can be funded through separate asset-backed transactions with terms modified accordingly to reflect the nature of those receivables.
- **Potential for future public securitisation:** if a portfolio being “warehoused” and initially funded through a private transaction reaches sufficient size then a public securitisation may be



possible. A public securitisation further broadens the range of potential investors and the relative ease with which investors can trade the debt increases liquidity – both of which can increase investor demand and reduce funding costs.

Who are the key parties involved in an asset-backed financing?

1. The Special Purpose Vehicle

A key consideration for lenders and originators at the structuring stage is determining whether the SPV that will acquire the receivables and obtain the financing from the lenders will be a subsidiary of the originator (also referred to as being “**on balance sheet**”) or an orphan SPV (being, broadly, an SPV that has no ownership links to the originator). Accounting, legal and tax considerations will be relevant to this discussion but a key difference between the two is that, if an orphan SPV is used, a third party corporate administrator, known as a “corporate service provider” will need to be appointed to provide directors and corporate administration services to the vehicle.

A public securitisation would almost always involve an orphan SPV and rating agencies and many investors prefer a new orphan vehicle to be used if possible so that there is a clear segregation of the assets and vehicle being lent to from the wider originator group. This also limits the risk of contamination should an insolvency event occur in respect of the originator.

2. Ongoing role of the Originator and Servicer

The originator (or a company within the originator’s group) will generally continue to deal with the receivables and will maintain responsibility for communications with the underlying debtors as it did before the asset-backed financing except that it will be appointed by, and will act as, agent of the SPV pursuant to a servicing agreement. Although the receivables will be purchased by and transferred to the SPV this will generally be done initially on an equitable rather than a legal basis meaning that the underlying customers will not be aware of the transfer and will maintain their relationship with and continue to make payments to the originator. This would only change if a

“perfection event” occurs, usually an insolvency event of the originator or a material breach of undertaking by the originator, upon which customers will be notified and the originator would cease to act as servicer, with a third-party servicer replacing it.

The servicing agreement sets out the terms on which the servicer agrees to administer the receivables (which will be in accordance with its servicing policies and procedures and includes how to deal with late or defaulted receivables), any reporting and information requirements and the circumstances in which the appointment of the originator as servicer may be terminated. The servicing fee is typically set at a market rate so that, if it is necessary to replace the originator, a replacement servicer can be found.

Some newer originators may also elect to appoint a delegate servicer to assist (in return for a fee) with its servicing and administration responsibilities. However, the originator as servicer would be expected, for the purposes of the asset-backed financing, to retain responsibility for the servicing of the receivables and the actions of any delegate. If the asset-backed financing is to be rated, some



rating agencies may also require a back-up servicer to be appointed and available to take over from the servicer in future if a perfection event occurs. Back-up servicing can be on a 'cold', 'warm' or 'hot' basis, which signals the back-up servicer's readiness to step in to the servicing role and the degree of advanced preparation required to facilitate that step-in.

We have listed below some additional considerations from an originator perspective in connection with the servicing role:

- **Systems and data:** originators should focus on reviewing their systems so as to provide for the early identification of data with respect to the receivables and ensuring system functionality so as to facilitate the provision of ongoing reporting (as to which see below).
- **Lender controls:** there is a balancing act between the servicer/originator having the flexibility to run its business without being overly constrained by lender consent requirements and the protections sought by lenders in the documentation package

with respect to servicer actions. For example, lenders will usually have approval rights for any material changes to the originator's standard terms, policies and procedures. However, originators will generally seek carve-outs for amendments that are needed to comply with changes in law, to correct a manifest error, or which are of a formal, minor or technical nature.

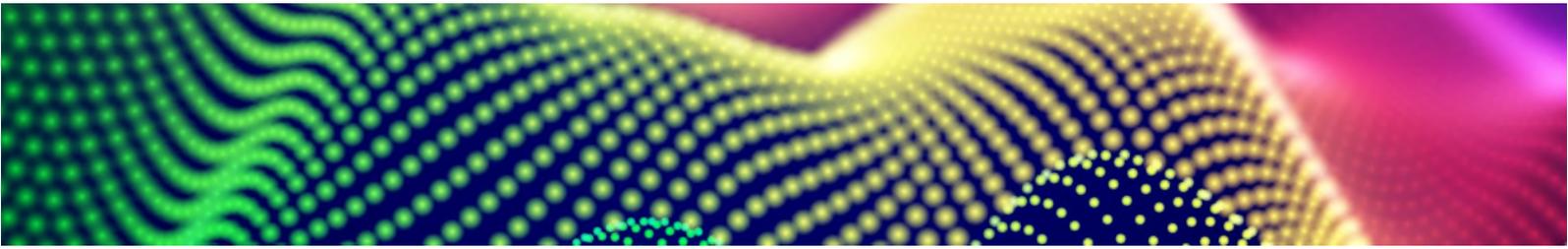
- **Methods of reporting/notification:** the servicer will be required to produce periodic servicer reports for the lenders on certain metrics for the receivables in the portfolio (the form of the report will be agreed in advance with the lenders prior to closing). In addition, if the asset-backed financing is deemed to be a "securitisation" for regulatory purposes under the UK Securitisation Framework or EU Securitisation Regulation (see below for further details), the designated reporting entity (which is often the servicer, acting as agent of the SPV, who retains regulatory responsibility) will be required to make certain

information available to investors following the relevant prescribed template (for example, quarterly loan-level information and monthly/quarterly investor reports containing data on the credit quality and performance of the underlying exposures).

3. Third Party Service Providers

As the SPV will not have any employees of its own, it will need third party service providers to play various roles on the transaction.

- **Trustee/Agent:** the trustee/agent is an agent of the lender. There will typically be a facility agent/bond trustee (depending whether the SPV borrows under a loan or bond) that generally represents the lenders/bondholders and a security trustee that holds the security granted by the SPV. On some transactions these two roles are performed by the same entity or related entities.
- **Account Bank/Cash Manager:** an account bank will be appointed to hold the bank accounts opened in the name of the SPV. A



cash manager will be appointed to operate any ledgers, make payments on behalf of the SPV and prepare the investor reports. If the SPV is “on balance sheet”, the cash management role is sometimes performed by the originator.

Other roles include, as outlined above, a corporate service provider (for an orphan SPV) and the servicer role typically played by the originator. All third parties will be subject to terms that provide for their replacement in certain circumstances, for example, a material contractual breach or rating downgrade.

It is advisable for originators to finalise the cashflow structure and related account structure and controls, and notify their account bank of the proposed changes and, where a different account bank needs to be appointed in respect of the SPV accounts, to commence negotiations with such entities at the earliest possible opportunity in view of the negotiation time that is required to put the necessary arrangements in place and agree the relevant terms.

How is an asset-backed financing structured?

(a) The different phases of the transaction

- Revolving period, availability period and stop purchase events:** where the transaction is designed to support ongoing originations and acquisitions by the SPV over time (rather than just being used to finance an existing portfolio), terms are negotiated that will determine the period during which the SPV can draw funding under the loan and/or apply collections received on the existing portfolio for the purpose of acquiring new receivables from the originator (or, from an originator perspective, the period during which the originator may tap into the funding in order to finance such new originations). Such period is known as the revolving period and/or availability period, and the portfolio and size of the loan to the SPV would generally be expected to grow during this period. At the end of a revolving period, the transaction will go into amortisation.
- Amortisation period:** the amortisation period usually refers to the period during a transaction when no new receivables are being acquired by the SPV and instead collections in respect of the receivables comprising the portfolio are used to gradually repay the loan to investors. The amortisation period could commence right away where the transaction is financing an existing portfolio. However, more commonly, on a deal funding a growing portfolio, the amortisation period will be scheduled to commence after an initial two- to three-year revolving period. The amortisation period may also commence early (and funding will cease) upon the occurrence of certain triggers which, from a credit risk perspective, heighten the risk for the relevant lenders under the loan. These events may either cause a temporary hiatus until cured (also known as “drawstops”) or have a more permanent effect (also referred to as “amortisation triggers”) and may include but are not limited to the occurrence of a change of control, the crystallisation of “key person” risk (e.g. where key



officers or employees are no longer in their roles at the originator) and the occurrence of certain performance triggers in respect of the portfolio (e.g. the percentage of receivables which are in arrears or classified as defaulted exceeding a pre-determined percentage). An amortisation trigger will typically turn off the SPV's ability to acquire new assets and may turn-on cash sweep or cash trap features designed to facilitate quicker repayment of the loan and reduce flexibility for the originator to take cash out of the structure under the subordinated loan or by way of deferred purchase price (as to which see below). However, unlike events of default, amortisation triggers will not usually give the lender any right to enforce the security provided by the SPV in respect of the debt or sell the portfolio and are designed to bite at an earlier stage than the occurrence of an event of default.

- **Events of Default and Enforcement:** if certain events occur, typically non-payment or breach of covenant (including financial covenants) by the SPV or originator, an insolvency event in respect of the SPV or originator, or termination of the

originator as servicer for breach without an appropriate replacement being appointed, then an event of default will occur on the deal and the lender will have the right to accelerate the SPV's debt and enforce security.

(b) The “eligible portfolio” and the “borrowing base” concept

- **Borrowing base:** the borrowing base is a calculation that is used to determine the amount of financing that will be made available by the lender for a particular transaction. Such determination is made by applying a pre-determined percentage, known as the advance rate, to the par value of the portfolio of receivables owned by the SPV which satisfy a pre-agreed list of eligibility criteria (as to which see below). Such receivables are typically referred to as “eligible receivables”. The maximum amount of financing available will be capped at the maximum facility limit. The calculation is designed to create a ‘cushion’ of receivables (and therefore cashflows) that will economically support payments due to the

lender, which is known as ‘overcollateralisation’. Borrowing base calculations are common on all transactions but particularly those that finance ongoing originations; the balance in funding needed by the SPV to acquire the assets (i.e. 100% minus the advance rate) is typically funded by the originator either making a subordinated loan to the SPV or selling the assets at a discount.

- **Concentration limits, eligibility criteria and defaulted receivables:** a lender will seek to negotiate terms in the transaction documentation controlling certain credit features of the receivables portfolio acquired by the SPV. The two main sets of terms that are negotiated are concentration limits, which establish limits for receivables of a certain description as a percentage of the size of the relevant portfolio (e.g. the proportion of the portfolio that can be comprised of lending to borrowers in a particular geographic region or of a particular type or at a particular lending rate), and eligibility criteria, which determine the description



- of receivables that may be offered to be sold to the SPV by the originator. The originator will give legal representations (known as “asset warranties”) that the receivables meet the eligibility criteria. Receivables in excess of the concentration limits or which fail to meet the eligibility criteria will not be taken into account when calculating the borrowing base and/or may be required to be repurchased by the originator. Any receivables that fall into arrears will typically also be excluded from the borrowing base and/or be allocated a reduced advance rate. If the borrowing base decreases during the life of the deal a mandatory prepayment under the loan will usually be required to bring it back in line and prevent the deal going into default.

(c) Other key features of a securitisation transaction

A number of structural features are commonly seen across the range of asset-backed structures. We consider a few, as follows:

- **Collection of payments:** payments of principal and interest in respect of the

receivables purchased by the SPV will form the only or (where there is a guarantee) primary source of funds available to the SPV to repay the indebtedness incurred by it in order to finance the purchase price of such receivables. The transaction documentation thus typically contains tight controls in respect of such payments. Such controls include undertakings by the originator (who will continue to collect the payments from customers in its capacity as servicer) to sweep such payments to dedicated accounts opened in the name of the SPV and secured in favour of the lenders on a regular basis and in the meantime to hold such amounts on trust and (if possible) in a segregated account of the originator.

- **Bank accounts:** it is common for the SPV to operate a small number of accounts sub-divided into a number of ledgers, each serving a different purpose. Such account structure would include a single transaction account dedicated for the receipt of payments in respect of receivables assigned to the SPV (whether such

payments are transferred from the originator accounts in the manner described above or are re-directed to the SPV) and a funding account for the payment of proceeds of the indebtedness entered into by the SPV. Where the transaction documents provide for separate priorities of payment in respect of principal and interest, payments to the account opened in the name of the SPV would be recorded in two separate ledgers, one to record amounts of a revenue nature and another account to record amounts of a principal nature. If a cash reserve is established to collateralise payments of interest or principal in respect of the indebtedness incurred by the SPV, amounts representing such reserve are also recorded in a separate ledger.

- **Payment waterfall:** payments received by an SPV in respect of receivables acquired by it will comprise collections which are applied in accordance with an order of payments, known as a payment waterfall or priority of payments. In some transactions,



collections of a revenue and principal nature are distinguished and applied down separate priorities of payment, with principal collections being applied to acquire more receivables (where this is permitted) and repay principal on the loan, and revenue collections being applied to pay third party costs and interest on the loan, with remaining revenue (being the “excess spread”) paid back to the originator as deferred purchase price for receivables.

- **Security and guarantee support:** the SPV will grant security over all the assets acquired by it, all the bank accounts opened in its name and all its rights under the transaction documents to which it is a party. Where the SPV is an on-balance sheet SPV, it is also typical for the parent company to grant a share charge in respect of its entire shareholding in the SPV. Where required for credit reasons or otherwise to support an analysis that the relevant transaction is not a securitisation for regulatory purposes, and commonly in the case of transactions with an on-

balance sheet SPV, the relevant lender may also require that an entity of substance in the SPV’s group guarantees the obligations of the SPV under the funding documents entered into with the relevant lender.

Due Diligence on the Portfolio

Lenders in asset-backed financings will carry out due diligence on the portfolio of receivables being financed. The legal due diligence generally consists of a review of the standard form documentation to make sure it is suitable for securitisation (in particular, the assignability, confidentiality/disclosure and set-off provisions) and complies with any regulatory requirements (for example, the relevant FCA rules, the Consumer Credit Act or the Unfair Terms in Consumer Contracts Regulations 1999). Lenders will typically also require foreign law legal due diligence to be conducted if the underlying contract is governed by foreign law or if the asset or underlying obligor is based in another jurisdiction.

Completion of the legal due diligence and allowing

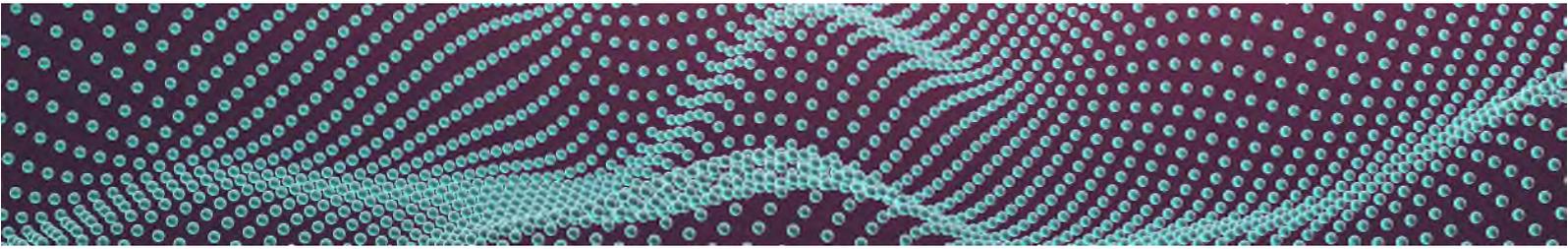
sufficient time for lenders to complete their review of any legal reports is often a key gating item for lenders, and originators should commence the legal due diligence process as early as possible in the transaction and also procure/ensure the prompt identification and availability of the standard form documentation requested by legal counsel. It also goes without saying that all parties need to cooperate in good faith to resolve and correct any issues that may be identified as a result of the legal due diligence process.

Regulatory Requirements

A) The Securitisation Regulations – diligence and reporting requirements

The originator and the investors in any asset-backed financing will need to consider from the outset whether the transaction is a “securitisation” as defined in the UK’s Securitisation Regulations 2024¹ for the purposes of the

¹ SI 2024/102.



UK Securitisation Framework² and/or, if applicable, the EU Securitisation Regulation³ (together, the “**Securitisation Regulations**”). The two regimes are broadly similar, although there is some divergence, and some further divergence is likely, following the introduction of the UK’s new Securitisation Regulations 2024 and related regulatory rules which replaced the EU-derived securitisation regulatory regime in the UK from 1 November 2024⁴. The Securitisation Regulations were introduced to address the risks identified during the global financial crisis of “originate to distribute models”, that is, certain originators being perceived not to have taken sufficient care in the origination of their assets because they would be detaching themselves from the credit risk of the assets by securitising them. Not all asset-backed financings or securitisations in the general sense will be caught – a parent guarantee of 100% of the debt and/or a lack of tranching can both take a transaction outside of these regulatory regimes for securitisations. However, very often the regulations will

apply. The two main obligations on in-scope originators are what is known as the risk retention requirement and certain reporting requirements.

1. Risk Retention Requirement

The Securitisation Regulations require the originator, original lender or sponsor of the transaction to maintain “skin in the game” by retaining an ongoing risk of at least 5%. The risk can be retained in various forms but the most common form of retention is “first loss”, i.e., holding at least 5% of the credit risk of the assets and absorbing the first 5% of loss. This is often held in the form of a subordinated loan provided by the originator to the SPV which is also used to plug the funding gap between the lender’s advance rate and the principal purchase price payable by the SPV for the receivables. However, other forms of risk retention holding can be used, including, for example, originators holding the first loss position by selling the receivables at an initial discount or by holding a

“vertical” (*pari passu*) interest in the loans or notes alongside third-party investors, or through retention by the originator of a random selection of 5% of all assets funded through the transaction.

2. Reporting

The Securitisation Regulations require the originator, original lender, sponsor or SPV to deliver reports on the transaction in a prescribed form including a regular loan level report and regular investor report. Early focus by originators will be required on data collection capabilities and systems required to comply with the reporting requirements imposed by the Securitisation Regulations.

B) The Taxation of Securitisation Companies Regulations

The SPV in an asset-backed financing is often established as a securitisation company for UK tax purposes. This enables the SPV to earn a nominal defined profit each year (typically £1,000 per year). All remaining cash can be paid

² The UK Securitisation Framework comprises the UK’s Securitisation Regulations 2024 (SI 2024/102), the securitisation sourcebook of the FCA Handbook and the Securitisation Part of the PRA Rulebook, together with the relevant provisions of the UK’s Financial Services and Markets Act 2000.

³ Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017.

⁴ As to which see our client briefing: [UK Securitisation: New framework takes effect from 1 November 2024 | Simmons & Simmons](#)



out of the structure without giving rise to deductibility concerns. Whether the SPV is established as a securitisation company or not will have certain repercussions for the legal structure of the transaction, for example, the type of entity that can be used, the form of the debt (whether a loan or a bond) and whether it needs to be limited recourse or not. The tax analysis as well as commercial considerations may also affect whether a rating or listing of the debt is desirable.

If you would like to discuss any of the issues raised in this note, please do not hesitate to contact any of the team listed below.



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