Global Transportation Finance Newsletter

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In This Issue

Global Sanctions Against Russia Present Potential Challenges to Aviation Finance & Leasing Companies

In 2014, the United States, Canada, and the European Union, among others, implemented individual sanctions against Russia in response to Russia's military incursion into Ukraine. Each of these sanctions may have significant ramifications for financiers, lessors and sellers in the aviation finance and leasing industry that seek to do business in Russia. It is important for these industry participants to recognize the purpose and scope of these sanctions in order to take the steps necessary to minimizing both risk of non-compliance and contractual risk. The discussion below provides a general overview of the sanctions against Russia, and a discussion of the potential impact these sanctions could have on aviation finance and leasing industry participants as well as steps these industry participants should take to minimize risk associated with business operations in Russia and Crimea and with Russian and Crimean individuals.

Prohibited Activities

The United States Treasury Department's Office of Foreign Assets Control (OFAC) has enacted several provisions restricting access to the U.S. debt and equity markets by major Russian banks, energy companies, and defense companies. These sanctions prohibit U.S. persons, including their foreign branches or subsidiaries owned or controlled by U.S. entities, from providing financial services or assistance in new debt and equity that has a maturity date exceeding a relatively short period of time (e.g., 30-days) to certain Russian companies identified in the Sectoral Sanctions Identification List (the SSI).[1] The U.S. also restricts the export of certain goods and technology to certain Russian companies on the SSI. Late last year, OFAC widened these Russian related Ukrainian sanctions when it promulgated restrictions specific to the Crimea region of Ukraine.[2] These provisions prohibit new investments in Crimea by U.S. persons, imports (direct or indirect) from Crimea into the U.S., exports or re-exports from the U.S. (or a U.S. person), and the provision of any assistance to a foreign person in a transaction prohibited by these sanctions. OFAC has also enacted blocking provisions for the property of certain Crimean persons.

Similarly, Canada, through its Special Economic Measures Act, has also placed restrictions on certain Russian banks and other targeted industries within Russia. The Canadian regulations restrict access to Canadian debt and equity markets for transactions with a maturity date exceeding 30 days. Finally, the European Union also has enacted restrictions similar to those enacted in the United States and Canada. The EU restrictions prohibit citizens of EU member states and corporations

Recent Accolades

Vedder Price Named "Law Firm of the Year" at Airline Economics–Aviation 100 Awards

At the Aviation 100 Awards in Dublin, Vedder Price was named "Law Firm of the Year," an honor voted on by thousands of industry participants. The firm was also recognized for "Overall Deal of the Year" for our role as counsel to Castlelake, L.P. in the private securitization of a portfolio of 79 aircraft subject to operating leases that were initially leased to 26 lessees in 17 countries.

Top UK Asset Finance Firm

Ranked In CHAMBERS UK - 2015 - Vedder Price

Vedder Price's London team was recently recognized as a top Asset Finance firm by *Chambers UK*. Among the strengths noted by clients during the selection process, our team was recognized as "execution-oriented and commercially sensible."

"Law Firm of the Year" for Equipment Finance

For the second year in a row, *U.S. News-Best Lawyers* has named Vedder Price "Law Firm of the Year" for Equipment Finance in its annual "Best Law Firms" rankings.

New Thought Leadership

Dean N. Gerber has written an article titled "De-Registration and Export Remedies under the Cape Town Convention" for the *Cape Town Convention Journal*. This article provides a critical analysis of the key provisions of the Convention and Protocol detailing with de-registration and export remedies and also identifies some of the key areas where the Convention and Protocol may need a broader interpretation in order to give effect to their desired goals.

Read the full article.

John E. Bradley has written an article titled "Ship Lease Finance: The Jurisdictional Challenge" for publication in the Fourth Quarter 2014 edition of *Benedict's Maritime Bulletin*. In this article, Mr. Bradley discusses the critical importance of choosing the appropriate judicial forum when a shipping loan goes into default, particularly in the United States, where state and federal courts operate in parallel.

Read the full article.

domiciled in EU member states from dealing with financial instruments having a maturity of greater than 30-days with certain Russian entities and also restrict the exporting of goods or technology that can be used by the Russian military.[3] The EU also has enacted comprehensive sanctions targeting trade and investment against Crimea and Sevastopol.[4]

Besides restricting targeted Russian companies from access to financial services and certain goods and technologies, the United States, Canada, and the EU also specifically blocked or froze the property and assets belonging to specifically enumerated persons (as well as those believed to be controlled by, or acting on behalf of such blocked persons). Although the restrictions of all three sanctions are similar, the Russian entities and individuals targeted vary in the United States, Canada, and the EU regulations. As a result of these variations, companies therefore, are wise to conduct jurisdiction specific due diligence prior to consummating a transaction in Russia or with Russian individuals or entities.

Impact of Sanctions on the Aviation Finance and Leasing Industry

Penalties for violating the Russian sanctions can be substantial. However, the sanctions are by design targeted to reach specific individuals and entities believed to be engaged in actions (or those closely associated with them) contributing to Russia's current activities in the Ukraine. In other words, the sanctions in no way serve as a complete bar to doing business in Russia.

What does this mean for the aviation finance and leasing industry? Generally, the burden of compliance with these sanctions rests on the industry participants seeking to do business. For example, if a U.S. aircraft lessor wants to execute a lease in Russia today, the lessor should be mindful of the U.S. regulations both prohibiting U.S. "persons" from transacting in new debt (and equity) for certain Russian entities and blocking the property and assets of certain Russian individuals. To maximize compliance with the sanctions, U.S. companies should:

- Obtain the name (and if an individual, the date and place of birth) of each Russian purchaser seeking to enter into a lease agreement with the U.S. company for an aircraft. Check the names (and if individuals, the dates and places of birth) of the Russian purchasers against the Russian companies listed on the SSI, and for Russian individuals, the names of individuals listed on the Specially Designated Nationals List (SDN).
- Ensure that technology or equipment that the U.S. aviation company sells or finances for a company in Russia is restricted from being put to military use.
- Ensure that no debt financing is provided to Russian financial institutions or defense companies exceeding 30-days maturity, and no new equity financing of persons determined to be subject to the Directive, *i.e.*, the Russian financial institutions identified in the SSI.
- Confirm that the purchaser, lessee or finance counterparty in any aircraft transaction is not an entity identified in the SSI or the SDN.

In addition to the steps above, it is imperative for companies to keep apprised of changes to the various lists of covered Russian entities and individuals sanctioned by the U.S., Canada, and EU since the sanctions tend to operate independently of one another.[5]

How could the interplay of the U.S., Canadian, and EU sanctions impact aviation finance and leasing industry participants? There is no per se reciprocity between the jurisdictions imposing the sanctions discussed above, and the overlap between the U.S., Canadian, and EU sanctions is a source of confusion. A recent example is illustrative. On August 4, 2014, Dobrolyot Airlines, a Russian subsidiary of Aeroflot (also a Russian company), had its lease agreement for two Boeing aircraft annulled due to the enactment of Canadian sanctions. As a result, Dobrolyot was forced to suspend various flights. Interestingly, Dobrolyot is not restricted by U.S. sanctions; in fact, Dobrolyot signed a contract with Boeing a few days later for the purchase of 16 new commercial aircraft. Why was the lease of U.S. manufactured aircraft annulled by the EU sanctions but the contract for the sale of the aircraft by the U.S. manufacturer permitted?

With regard to the annulled lease agreement, Dobrolyot was leasing its two Boeing 737-800s from BBAM, an aviation leasing firm. BBAM is 50% owned by Onex Corp., based in Toronto, Canada. In early August 2014, Canada expanded its list of sanctioned entities to include Dobrolyot. BBAM's lease agreement with Dobrolyot appears to have contained an "illegality clause." Typically, inclusion of an illegality clause in a lease agreement either results in the immediate right of the lessor to terminate the lease, or to a period of mitigation where the parties may attempt to restructure the transaction in a fashion that is not illegal. If such attempts are unsuccessful, the lessor then has the right to terminate the lease. Since the Canadian sanctions prohibited dealings with Dobrolyot, BBAM, probably at the direction of Onex Corp., annulled the lease agreement with Dobrolyot.[6] In contrast, the sale of the 16 commercial aircraft by Boeing to Dobrolyot, which was announced shortly thereafter, was permitted because Dobrolyot is not restricted by the U.S. sanctions.

This example illustrates the caution aviation finance and leasing industry participants must use in transactions involving Russian entities or individuals. As the BBAM scenario showed, the economic sanctions may have the effect of annulling or cancelling existing agreements. The devil, as always, is in the detail. Nonetheless, there are several things industry participants can do to minimize their contractual risk in the event that the enactment of sanctions result in it being illegal for a financier or lessor to fulfill a contractual obligation.

First, if a financier or lessor is a party to an arrangement that is rendered illegal as a result of the enactment of sanctions, the financier or lessor should formally notify its Russian counterparty of the circumstance and expressly reserve any rights the financier or lessor has under the agreement to terminate it, pending further investigation of the impact of the sanctions. Second, companies should be certain to include an "illegality" clause in their agreements to guard against the risk that new economic sanctions prohibit the continuation of a sale, lease or financing arrangement. For maximum protection, this clause should be accompanied with a clause providing indemnity for all losses the seller or financier may sustain as a result of the termination. Finally, financiers should consider including a negative covenant prohibiting an aircraft subject to a sale or financing from being operated in a way that would violate applicable sanctions. A case-by-case analysis will be required to determine the coverage of the sanctions against Russian entities and individuals. Rightly, many within the aviation finance and leasing industry have recognized that the recently imposed Russian sanctions make doing business in Russia a risky proposition. However, keeping abreast of them and following the aforementioned guidelines will minimize the risks of conducting business that touches Russia and Crimea or Russian and Crimean individuals.

Violations of OFAC sanctions can lead to severe civil and criminal penalties, including jail terms of individual executives. Given the complexity of these business transactions, the number of parties involved, and the continuous adjustments to the sanctions, aviation finance and leasing industry participants should seek legal guidance prior to engaging in transactions that may pose a high degree of legal risk.[7] To this end, should questions arise about the impact of the sanctions discussed above, or any of the sanctions the OFAC administers, OFAC attorneys will provide non-binding general and informal guidance telephonically, in writing, or through face-to-face meetings. Where the transaction details merit explicit U.S. approval, industry participants can formally apply for a "license" from OFAC to engage in the transaction. These licenses can be obtained through a formal written request to OFAC stating in detail the proposed transaction.[8]

If you have questions about this update, please contact Marques O. Peterson.

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1 The U.S. Ukraine-related sanctions and the SSI list can be found online at http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx (last visited January 7, 2015).

2 These sanctions are also available online at http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20141219.aspx (last visited January 7, 2015).

3 The Canadian and EU Ukraine-related sanctions programs can be found online at http://www.international.gc.ca/sanctions/countries-pays/ukraine.aspx?lang=eng and http://europeansanctions.com/eu-sanctions-in-force/russia/ (last visited January 8, 2015).

4 The EU related sanctions against Crimea and Sevastopol can be found online at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.365.01.0046.01.ENG (last visited January 8, 2015).

5 For example, shortly before this publication, the European Council, on November 17, 2014, asked the European External Services and the European Commission to identify further separatists in Ukraine for designation on the EU Russian sanctions lists. *See* http://www.consilium.europa.eu/press/council-meetings (November 17, 2014 Foreign Affairs Press Release). Similarly, on December 19, 2014, Canada added several individuals to the list of designated persons on two of its schedules and also imposed new export restrictions on goods used in Russia's oil exploration and extractive sector. *See* http://www.international.gc.ca/sanctions/countries-pays/russia_regulations-russie_reglements.

aspx?lang=eng and http://www.international.gc.ca/sanctions/countries-pays/ukraine_regulations-ukraine_reglements.aspx?lang=eng (unofficial versions of the amendments to the Russia Regulations and to the Special Economic Measures (Ukraine) Regulations) (last visited January 7, 2015).

6 No consultation with the Canadian government on the part of Onex Corp. or BBAM was necessary because compliance with the sanctions is required by Canadian persons.

7 The recent loosening by the U.S. of the Cuban sanctions, for example, is illustrative of the need for industry participants to stay abreast of the OFAC sanctions. On January 16, 2015, OFAC significantly amended the Cuban sanctions in a manner that will impact the U.S. aviation industry. Specifically, the regulations now permit airlines and travel agents to provide services to Cuba; however, the immediate impact will likely be minimal as the Cuban embargo remains in effect and tourist travel to the country remains restricted with permitted travel being limited to 12 specifically enumerated groups stated in the regulations. The OFAC amendments to the Cuban Assets Control Regulations can be found at: http://federalregister.gov/articles/2015/01/16/2015-00632/cuban-assets-control-regulations (last visited January 20, 2015).

8 For guidance on OFAC's licensing policy, *see* http://www.treasury.gov/resource-center/sanctions/Programs/Pages/ukraine.aspx (last visited January 8, 2015).

Aircraft Securitizations and the EU Risk Retention Rules

European institutions that invest in securitization transactions, whether in the United States or elsewhere, should be mindful of the risk retention rules that are part of the European capital requirements regulation (the CRR).[1] The CRR contemplates that European institutions will invest in a securitization transaction only if the sponsor, originator or original lender in the transaction retains part of the credit risk of the assets that are being securitized. The CRR reflects a belief that risk retention rules will induce the applicable parties "to conduct quality screenings properly, improve underwriting standards and monitor for credit risk" in securitization transactions.[2]

The CRR applies to securitization transactions in which the investors include European credit institutions[3] or investment firms.[4] In order for a transaction to comply with the CRR, the sponsor of the transaction (or the originator or original lender) must disclose that it will retain at least 5% of the economic risk with respect to the transaction. The CRR applies to various types of securitization transactions; this article will focus on the application of the CRR to aircraft securitization transactions.

What Type of Transaction Is Covered by the CRR?

In order to be covered by the CRR, a transaction must have the following characteristics: (i) the credit risk associated with one or more "exposures" (such as loans or leases) is tranched; (ii) payments in the transaction depend on the performance of the exposures; and (iii) losses on the underlying exposures are distributed based on the subordination of the tranches. For purposes of the CRR, a "tranche" is defined by reference to the contractual segmentation of credit risk, in which the holder of a position in the transaction takes a risk of credit loss that is greater than or less than the holder of another position in the transaction.

For example, in the context of a typical securitization of aircraft leases, immediately prior to the securitization a leasing company owns and/or manages a group of special purpose entities that are the lessors of the applicable aircraft. In connection with the securitization transaction, the leasing company transfers ownership of the special purpose leasing companies to an issuing entity and the issuing entity may issue a senior class of notes and a subordinated class of notes to third party lenders. That transaction would be subject to the CRR: (i) the portfolio of leases transferred into the transaction constitute the underlying "exposures" in the transaction; (ii) payments on the notes issued by the issuing entity depend on rent payments on the underlying aircraft leases; and (iii) the holders of the subordinated class of notes take more risk of credit loss than do the holders of the senior class of notes.

Who Must Retain the Credit Risk?

The CRR's risk retention requirements can be satisfied if the applicable portion of the economic risk of a securitization transaction is retained by any of the originator, the sponsor or the original lender in respect of the transaction.

For purposes of the CRR, an "originator" is an entity that either (a) by itself, or through related entities, was involved in the original agreements that created the obligations of the debtors that give rise to the exposures being securitized, or (b) buys a third party's exposures for its own account and then securitizes those exposures. In a typical aircraft lease securitization, the originator would be the applicable aircraft leasing company.

Under the CRR, the "sponsor" is an "institution" (other than an originator) that establishes and manages a securitization scheme that acquires exposures from third-party entities.[5] In the context of an aircraft lease securitization, a sponsor could include an investment bank that establishes a special purpose entity to purchase aircraft leases from third parties.

For purposes of the CRR, the "original lender" is an entity (other than the originator) "which, either itself or through related entities, directly or indirectly, originally created the obligations or potential obligations" that are being securitized.[6] In the context of an aircraft securitization, the original lender could be a bank or an investment fund that made a series of aircraft loans and

London Shipping Finance Reception

In October, our Shipping Finance team hosted industry professionals at a cocktail reception in London at the Coq d'Argent. Many of our clients and friends attended the event along with lawyers from our London, New York and Chicago offices.

that is selling the aircraft loans directly or indirectly to a securitization transaction.

The CRR does not require multiple applications of the risk retention requirement for a single securitization transaction. If the originator takes the risk retention for a transaction, the sponsor and the original lender will not be subject to additional risk retention for the same transaction.[7] If the securitization transaction involves multiple originators (or multiple original lenders), then the risk retention requirement may be satisfied either (i) by allocating the risk retention among such originators (or such original lenders) on a pro rata basis, or (ii) if certain conditions are satisfied, by allocating all of the risk retention to a single originator (or to a single original lender).[8]

How Much Risk Must Be Retained, and What Are Permissible Forms for Holding the Required Amount of Risk Retention?

Pursuant to the CRR, a compliant securitization is one in which the originator, the sponsor or the original lender has agreed to retain, during the life of the transaction, "a material net economic interest" of not less than 5%. The CRR specifies various methods for holding the required amount of risk retention.

Retention of Economic Risk in Each Tranche

An originator, sponsor or original lender may elect to satisfy the CRR's 5% risk retention requirement by holding 5% of the nominal value of each of the tranches issued to investors in the securitization transaction.[9] For example, in a securitization of aircraft leases, if the issuing entity issued a senior class of notes and a subordinated class of notes, a sponsor using this risk retention approach would retain at least 5% of the face amount of each such class of notes.

As an alternative to holding 5% of the nominal value of each tranche, the originator, sponsor or original lender may satisfy the CRR's risk retention requirement by holding a separate "vertical tranche" that has a nominal value of at least 5% of the total nominal value of all of the other tranches issued in the securitization transaction.[10] The vertical tranche could be a separate class of notes (Class V) issued by the issuing entity, and would be required to expose the holder of such class to the credit risk of the other classes of notes on a pro rata basis.[11] For example, if $200 million of senior notes and $100 million of subordinated notes were issued in an aircraft lease securitization transaction, the vertical tranche could take the form of a Class V note in the face amount of $15 million ($300 million x 5%).

Retention of Economic Interest in Randomly Selected Exposures

The CRR's risk retention requirement may be satisfied through the holding of "randomly selected exposures" in an amount equal to at least 5% of the nominal value of the securitized exposures.[12] This option is available only for larger pools of loans or leases, since there must be at least one hundred loans or leases for this option to apply. If there are at least one hundred loans or leases, then the originator or sponsor could satisfy the CRR's risk retention requirement by retaining an economic interest in at least 5% of those loans or leases selected at random from the total pool of loans or leases.[13]

Retention of First-Loss Tranche

Another option for satisfying the CRR's risk retention requirement is the retention of a first-loss tranche equal at least 5% of the nominal value of the entire pool of securitized exposures.[14] The CRR permits this option to be satisfied by a combination of a first-loss tranche and other tranches that (i) have a risk profile that is the same (or more severe) than the risk profiles of the tranches issued to investors and (ii) do not mature earlier than the tranches issued to investors.

First-loss tranches are not unusual in aircraft securitization transactions. For example, securitizations of aircraft loans, aircraft leases and aircraft engine leases have featured the issuance of equity tranches in the form of E certificates that will be the first to bear losses arising from the pool of securitized assets.

The first-loss form of risk retention may also be satisfied by overcollateralization, if the overcollateralization is sized to be at least 5% of the nominal value of the tranches issued in the securitization transaction.[15] For example, in connection with a securitization of a portfolio of $420 million of aircraft loans, the issuing entity might issue $250 million of senior notes and $150 million of subordinated notes. The overcollateralization in this example would be $20 million (which is the difference between the size of the loan portfolio and the face amount of the notes), and would equal 5% of the $400 million of notes issued in the transaction.

Retention of First-Loss Exposure to Every Securitized Exposure

Another way to comply with the CRR is through the retention of a first-loss exposure equal to 5% of every securitized exposure in the transaction.[16] In a securitization of aircraft leases, this would require that the losses on each lease be tracked separately, and that any loss on a lease would be allocated first to the applicable holder of the risk retention until the total loss borne by the holder of the risk retention equaled 5% of the amount due on such lease at origination. This method of risk retention may be accomplished by selling assets (such as leases) to the securitization issuer at a discount of at least 5% of the nominal value of the applicable asset.[17]

Synthetic and Contingent Forms of Risk Retention

The CRR's risk retention requirements may be fulfilled through a synthetic form of retention or a contingent form of retention.[18] A "synthetic form of retention" is defined as retention of an economic interest by means of a derivative instrument. This would appear to include a total return swap or similar arrangement. A "contingent form of retention" is defined as retention of an economic interest by means of a guarantee, a letter of credit or "other similar forms of credit support ensuring an immediate enforcement of the retention". If the party providing the synthetic or contingent form of retention is not a "credit institution" as defined in the CRR, then the synthetic or contingent risk retention must be 100% cash collateralized.

Other Types of Risk Retention

Certain types of risk retention may satisfy the CRR even though such types of risk retention are not expressly mentioned in the CRR. The Committee of European Banking Supervisors published guidelines (the CEBS Guidelines) relating to various types of risk retention in connection with the European risk retention rules that existed prior to the adoption of the CRR.[19] The European Banking Authority has indicated that all methods of risk retention included in the CEBS Guidelines will remain available for purposes of satisfying the risk retention requirements of the CRR.[20] For example, the CEBS Guidelines allowed a first loss tranche to consist of, among other things, the funded portion of a reserve account.[21] Thus, a cash reserve of 5% should satisfy the CRR's risk retention requirements.

Transfer of Risk Retention

The CRR provides that the risk retention in a securitization "shall not be subject to any credit risk mitigation or any short positions or any other hedge and shall not be sold."[22] This is designed to ensure that the originator, sponsor or original lender, as applicable, continues to have "skin in the game" after the closing of the securitization transaction. Certain hedges are permitted under the CRR so long as they do not have the effect of hedging against the retained credit risk.[23] A hedge against foreign currency risk could be a permitted hedge, since that hedge would protect against fluctuations in the value of a particular currency rather than protecting against the failure of a lessee to pay rent.

What Is the Consequence of Failing to Comply with the CRR?

If a European institution becomes exposed to a securitization transaction (other than as the originator, original lender or sponsor), and the securitization transaction fails to conform to one of the permitted risk retention models under the CRR, the European institution will face an additional capital charge on its exposure to the securitization transaction.[24] By penalizing the investment of funds in non-compliant securitizations, the CRR incentivizes European institutions to require that the securitizations in which they invest comply with the risk retention requirements of the CRR.

Due Diligence Requirements

The CRR imposes due diligence requirements on European institutions that invest in a securitization. Both before and after investing in a securitization, an investor subject to the CRR must "have a comprehensive and thorough understanding" of various types of information relating to the securitization, including: (i) the net economic interest retained by the applicable sponsor, originator or original lender; (ii) the risk characteristics of the applicable class of securities in which the investor is investing; (iii) the risk characteristics of the loans or leases that are being securitized; (iv) the reputation and loss experience of previous securitizations completed by the applicable sponsor or originator; and (v) the structural features of the securitization that could have a material impact on the performance of the securities in which the investor is investing, such as the payment waterfalls, the liquidity and credit enhancements applicable to the transaction, and the events of default applicable to the transaction.[25] An investor subject to the CRR must review its compliance with the CRR at least annually (and more frequently upon becoming aware of certain developments that could adversely affect the investor, including a material change in the structural features of the transaction).[26]

Conclusion

In transactions involving the securitization of aircraft loans and leases, it is not unusual for the party establishing the securitization to retain some economic risk in the transaction. This economic risk has taken various forms in the past, including the retention of subordinated securities, overcollateralization and the funding of reserve accounts. The CRR imposes a 5% threshold for the retention of risk in securitizations that qualify for the CRR. That 5% test should not prevent the successful completion of securitizations of aircraft assets.

If you have questions about this update, please contact Marc L. Klyman.

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1 *See* Articles 404-410 of Regulation (EU) No. 575/2013. The CRR became effective on 1 January 2014. The CRR replaced the previous European rules for risk retention that were known as "Article 122a".

2 European Banking Authority, Final Draft Regulatory Technical Standards and Final Draft Implementing Technical Standards, EBA/RTS/2013/12 and EBA/ITS/2013/08 (17 December 2013) ("EBA Final Draft"), p. 4.

3 For purposes of the CRR, a "credit institution" is an entity "the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account".

4 Subject to certain exclusions, an "investment firm" is defined for purposes of the CRR by reference to Article 4(1) of Directive 2004/39/EC. Under that Directive, an investment firm is "any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis."

5 For purposes of the CRR, an "institution" is defined as a credit institution or an investment firm. For definitions of those terms, see footnotes 3 and 4 above.

6 *See* EBA Final Draft, pp. 8-9.

7 Recital (58) of Regulation (EU) No. 575/2013.

8 Article 3 of Commission Delegated Regulation (EU) No. 625/2014 of 13 March 2014 supplementing Regulation (EU) No. 575/2013 of the European Parliament and of the Council by way of regulatory technical standards specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk ("Regulatory Technical Standards").

9 CRR, Article 405(1)(a).

10 Regulatory Technical Standards, Article 5(1)(c).

11 Regulatory Technical Standards, Article 1(d).

12 CRR, Article 405(1)(c).

13 To ensure that the selected exposures are random, the selection should take into account, to the extent applicable, "factors such as vintage, product, geography, origination date, maturity date, loan to value ratio, property type, industry sector and outstanding loan balance". Regulatory Technical Standards, Article 7(1).

14 CRR, Article 405(1)(d).

15 Regulatory Technical Standards, Article 8(1)(b).

16 CRR, Article 405(1)(e).

17 Regulatory Technical Standards, Article 9(2).

18 Regulatory Technical Standards, Article 4.

19 *See* Guidelines to Article 122a of the Capital Requirements Directive, 31 December 2010 (Committee of European Banking Supervisors).

20 *See* EBA Final Draft, Response to Question 8, p. 51.

21 CEBS Guidelines, clauses (55) and (58).

22 CRR, Article 405.

23 Regulatory Technical Standards, Article 12(1).

24 CRR, Article 407.

25 CRR, Article 406(1).

26 Regulatory Technical Standards, Article 17.

The Cape Town Convention and Entry Points

AEPs and DEPs

The Cape Town Convention allows for any state to designate an entity within its territory as the entry point (EP) through which information shall or may be transmitted to the International Registry (IR). Where a Contracting State has so designated such an entity, any registration made which seeks to circumvent the applicable entry point will be invalid, provided that as discussed below, there is an important exception to this rule.

The current version of the Regulations promulgated in connection with the Cape Town Convention (the Regulations) currently allows for two categories of designated entry points. One is an "authorizing entry point" (or AEP), which authorizes transmission of information required for registration under the Cape Town Convention to the IR. In this case, the entity designated as the AEP would provide the party seeking to effect a registration with a unique authorization code (UAC), which is required to be included with the information submitted to the IR in order to properly effect the registration of an interest. The other type of entry point is a "direct entry point" (or DEP), and in this scenario the information related to an applicable interest is directly transmitted to the IR by the DEP as opposed to the registry user seeking to effect such registration. Designated AEPs and DEPs are not part of the IR, and their operations are governed exclusively by national law.

As there exists a system of nationality of registration for airframes and helicopters, the declaration to utilize an EP made by the applicable Contracting State of registration is the relevant EP for purposes of determining compliance with the aforementioned rules. As there is no system of nationality registration in respect of aircraft engines, the use of EPs cannot be made compulsory.

The countries that currently have an AEP regime are Albania, Brazil, China, Mexico, Ukraine, the United Arab Emirates (which initially adopted the DEP regime), the United States of America and Vietnam (the AEP Contracting States). There is currently no country utilizing the DEP approach.

In practice, local counsel in the applicable AEP Contracting State will usually obtain the UACs – partly because they have a direct and established working relationship with the national aviation authority (as the AEP) and partly because they will be providing any required Cape Town legal opinion (and, as a result, will want to know that the AEP procedure has been followed properly).

Experience in Brazil

A good example of some of the potential issues that could arise in connection with the designation of an AEP comes from the experiences in Brazil. When Brazil first ratified the Cape Town Convention, it made a declaration authorizing the use of an AEP for filing interests in respect of airframes and helicopters. Brazil designated the Brazilian Aeronautical Registry as its AEP for purposes of issuing UACs. Nothing, however, prohibits a Contracting State from imposing its own requirements, and restrictions to its EP and Brazil's rules may be the most restrictive in this regard. Brazil's regulations promulgated in connection with the issuance of UACs require a potential registry user seeking to obtain a UAC to (i) provide personal information to the local registry authorities, (ii) provide a written undertaking to not only comply with applicable Brazilian authority rules and regulations but also to comply generally with applicable law, and (iii) submit to criminal and civil liability for the misuse of any UAC.

UACs in Brazil were first made available in April 2014; however, Brazil's ratification of the Cape Town Convention predated that date by several years. So what is the impact of having made a declaration to have an AEP but not making UACs available for a considerable period after that? Would any registration made without such a code during the period in which such codes were not made available be nonetheless invalid? Fortunately, the Cape Town Convention regulations provide some guidance here in that they explicitly provide that a registration is not invalid if, in the case of an AEP, an authorization code is not obtainable under its procedures based on the facts of the transaction to which it relates (which was clearly the case in Brazil).

Transaction context

Experience on a recent transaction serves as a further reminder as to the potential pitfalls involved in the AEP process and the importance of effective management of that process.

The transaction in question involved the refinancing of a Mexican-registered aircraft that was (and still is) owned by a European lessor; and required closing to happen on a fixed date – being the date upon which the original financing was due to be repaid in full (primarily via a new bank loan) at maturity. One of the conditions to the new financing was a requirement for the registration of prospective international interests in relation to the aircraft, which of course pre-supposed the availability of UACs.

All parties were aware of the need to obtain UACs and of the need to obtain them on time because of the hard-stop refinancing date. As such, an early request was made to Mexican counsel to obtain the UACs from the Dirección General de Aeronáutica Civil (the Mexican aviation authority), but despite this the UACs were not produced by the refinancing date (and for purposes of this article, we assume that the regulation referred to above in connection with the Brazilian experience would be inapplicable here in that the UACs were available under the existing procedures). This caused significant stress and uncertainty on the transaction, closing delays and additional costs.

Conclusion

It is critical to consider the implications of any involvement of an EP on a transaction as their involvement could give rise to delays which may impede on the parties' ability to successfully close the subject transaction. Transaction parties need to plan carefully for this process, including by:

- clearly communicating any hard deadlines to all parties, including local counsel;
- instructing local counsel that have experience of the EP process and who know how to work successfully with the applicable authority;
- instructing local counsel early enough;
- communicating well with local counsel; and
- asking local counsel to advise of any applicable minimum time requirements for registration and/or production of the UACs; and of any applicable local or national public holidays that might affect timing.

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