## Legal update

# Modernisation of the Luxembourg securitisation law

On 9 February 2022, the Luxembourg Chamber of Deputies (*Chambre des Députés*), adopted the law modernising the Luxembourg law of 2 March 2004 on securitisation, as amended (the ***New Securitisation Law***). The New Securitisation Law enhances legal certainty and flexibility of the Luxembourg securitisation regime, while ensuring and increasing effective protection for investors.

The New Securitisation Law have modernised the following main aspects.

## New sources of funding

The New Securitisation Law achieved the double objective to clarify on and to broaden the sources by which the Luxembourg securitisation vehicles can finance themselves.

Under the old regime, a securitisation entity needed to issue securities, the value or return of which depended on the securitised risks.

Under the new regime, a securitisation entity can finance itself:

- Either by issuing financial instruments (*instruments financiers*) whose definition contained in the New Securitisation Law refers to the definition of financial instruments under article 1 point 8 (other than letter f) of the law of 5 August 2005 on financial collateral agreements, as amended, and has much broader meaning than the previously used concept of securities (*valeurs mobilières*); or
- Through any form of loans whose yield or reimbursable principal amount depends on the risks acquired.

The replacement of the notion securities with financial instruments enables a broader category of instruments to be issued and takes into account the flexibility required by the market. In fact, this amendment takes away those questions, arisen under the old regime, about the qualification of certain instruments as securities, in particular those not qualified as such by their legal framework under their foreign law (such as the German Schuldscheine).

Furthermore, the New Securitisation Law broadens the funding sources by providing that the securitisation vehicles may exclusively be financed through loans, whose yield or repayable principal depends on the risks acquired.

Under the old securitisation regime, a securitisation undertaking was primarily an issuance entity and the use of borrowings as funding was allowed only in specific circumstances and on an ancillary basis. This restriction has now been lifted and this provides a much more flexible framework and allow certain investors, whose investments are restricted for internal reasons to specific loan products, to also participate in Luxembourg securitisation structures.

Also, this amendment aligns the New Securitisation Law with the European Securitisation Regulation, which does also not require financing solely in the form of securities.

Finally, this amendment will reduce the legal formalities and the cost to set up securitisations in Luxembourg.

## New legal forms

Under the old regime, the securitisation companies could take the form of:

- Public limited liability companies (*sociétés anonymes*);
- Partnerships limited by shares (*sociétés en commandite par actions*);
- Private limited liability companies (*sociétés à responsabilité limitée*) ; and
- Cooperative companies (*sociétés cooperatives*).

The New Securitisation Law increases the number of legal forms that can be used for securitisation companies by extending them to:

- The unlimited company (*société en nom collectif*);
- The common limited partnership (*société en commandite simple*);
- The special limited partnership (*société en commandite spéciale*); and
- The simplified limited company (*société par actions simplifiée*).

Hence, the New Securitisation Law now introduces greater structuring flexibility and the use of tax transparent corporate forms alongside the current use of securitisation funds.

Given the wide use of partnership structures in Luxembourg, this amendment is welcome by the market and will make the Luxembourg fund hub even more attractive to investors.

## New authorisation and supervision requirements

The New Securitisation Law clarifies the question as to when a securitisation undertaking is to be considered to be issuing to the public on a continuous basis and thus requires the authorisation, and is subject to the supervision, of the CSSF (*Commission de Surveillance du Secteur Financier*), the Luxembourg financial regulatory authority.

Under the old regime, the answer to this question was based on the FAQs on Securitisation published by the CSSF which provided that issuances were made to the public continuously if more than three issuances were made to the public per calendar year on an all compartment basis and these issuances were addressed to non-professional investors, had a denomination of less than €125,000 per unit and were not distributed by private placements.

Pursuant to the New Securitisation Law, a security undertaking could be deemed to be issuing on a continuous basis if three issuances are made to the public per calendar year on an all compartment basis and to offer to the public if the financial instruments in question are:

- Not addressed to professional investors as defined in the Luxembourg law of 5 April 1993 on the banking sector;
- Have a denomination of less than €100,000 per unit; and
- Are not distributed by private placements.

All three criteria are cumulative.

## New rules governing the accounting treatment of equity-financed compartments

Whilst the flexibility to create compartments and the choice to have either a securitisation company or a securitisation fund remains an integral part in the New Securitisation Law, it is worth noting that a novelty has now been introduced in the accounting treatment of compartments.

Where compartments are equity-financed, the balance sheet and the profit and loss account prepared for each compartment shall be approved only by the holders of shares or equity instruments linked to that compartment, unless the articles of the securitisation entity provide otherwise.

Likewise, limitations to the distribution of profits and other distributable reserves may be determined by reference to each compartment, without regard to the global situation of the securitisation entity, unless the articles of the securitisation entity provide otherwise.

In the same way, the legally required reserve according to the Luxembourg law of 10 August 1915 on commercial companies, as amended, shall be determined on a compartment basis without regard to the global situation of the securitisation entity, if this is provided for by the articles of the securitisation entity.

The introduction of such accounting segregation pursues the objective of protecting a compartment's investors from other compartments.

## Holding of securitised assets

The New Securitisation Law specifically clarifies that a securitisation entity can assume the risks that it is going to securitise by acquiring the underlying assets to which the risk is linked either directly or indirectly.

Whilst this clarification should not be read as a possibility for the securitisation entity to carry on a commercial or entrepreneurial activity, it is now provided for that:

- Securitisation undertakings can directly own the assets generating the cash flows that are securitised; and

- Securitisation undertakings can acquire such assets or risks to be securitised indirectly, either through a subsidiary or via the acquisition of an entity holding these assets or risks.

## Security interests

Under the old regime, a securitisation vehicle could grant security interests over its assets only for the benefit of its investors or direct creditors, i.e. it was not allowed to grant security over it assets to third parties to the securitisation transaction. In practice, certain transactions were made impossible or difficult to structure because of the restriction. For example, bank financings granted to a parent company of a securitisation entity where the funds were then invested in/down streamed to the securitisation entity could not benefit from security interests granted by the securitisation vehicle.

The New Securitisation Law provides securitisation vehicles with greater flexibility so that they may grant security interests over their assets to parties that are involved in the securitisation transaction and who are not direct creditors of the securitisation vehicle.

Under the regime introduced by the New Securitisation Law, a Luxembourg securitisation undertaking will be able to provide collateral to any third party provided the granting of collateral be linked to the securitisation transaction as a whole (*relatifs à l'opération de titrisation*).

## Active management of securitised risk portfolios

Under the old regime, a securitisation vehicle was not explicitly authorised to actively manage the assets comprised in its securitised portfolio.

The New Securitisation Law specifically clarifies that active management of a pool of securitised risks is allowed where the following conditions are met:

- The pool of securitised risks is made up of debt securities, claims or debt financial instruments; and
- The securitisation entity is not financed by issues to the public.

Hence, it is now allowed for Luxembourg securitisation vehicles to actively manage risks linked to bonds, loans or other debt instruments, except if the financial instruments are issued to the public. This might enable Luxembourg to attract more collateralised debt obligations (CDOs) / collateralised loan obligations (CLOs) structures and to propose its jurisdiction as an appropriate legal framework to set up actively managed CDOs and CLOs.

## Ranking/ Legal subordination

The New Securitisation Law expressly states subordination rules in respect of financial instruments issued by a securitisation vehicle, setting out a default waterfall of payments/order of priority, applicable to securitisation entities, unless otherwise agreed.

Pursuant to the New Securitisation Law:

- The units of a securitisation fund are subordinated to the other financial instruments issued by, and loans contracted by, such securitisation fund;
- The shares (actions) or corporate units (parts sociales) or partnership interests (parts d'intérêt) of a securitisation company are subordinated to other financial instruments issued by, and loans contracted by, such securitisation company;
- The shares (actions), corporate units (parts sociales) or partnership interests (parts d'intérêt) of a securitisation company are subordinated to the profit shares (parts bénéficiaires) issued by such securitisation company;
- The profit shares (parts bénéficiaires) issued by a securitisation company are subordinated to the debt financial instruments issued and to the loans contracted by such securitisation company; and
- Non-fixed yield debt financial instruments issued by a securitisation vehicle are subordinated to fixed yield debt financial instruments issued by that securitisation entity.

## New registration requirements

The New Securitisation Law introduces a legal obligation for existing and future securitisation funds (and their liquidation) to register with the Luxembourg Trade and Companies Register (RCS). Existing securitisation funds will have to register within six months after entering into force of the New Securitisation Law.

It further introduces the obligation for securitisation funds to draw up and publish annual accounts in accordance with the provisions of the law of 19 December 2002 on the register of commerce and companies and the accounting and annual accounts of companies.

These new requirements provide investors with an additional way of identification. The registration results in the allocation of an RCS registration number, and therefore avoids certain administrative issues, including the inability for a securitisation vehicle to list its securities on a stock exchange.