Luxembourg: The new securitisation regime offers more flexibility and new opportunities

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On 9 February 2022, the Luxembourg Parliament voted to adopt a law that brings about long-awaited reform of the Luxembourg's securitisation regime.

The law of 25 February 2022 – which was published in the Luxembourg official gazette on 4 March 2022 and entered into force on 8 March 2022 (the **Amended Law)** – clarified certain aspects of the Luxembourg law dated 22 March 2004 on securitisation (the **2004 Law**) as well as adapted the 2004 Law to the requirements of the current securitisation market. The intention is that the updated securitisation regime will increase the appeal of Luxembourg securitisation vehicles and bring new opportunities for the Luxembourg financial services industry.

This article summarises the main changes that the Amended Law made to the 2004 Law.

Additional financing options

Before the Amended Law was enacted, a Luxembourg securitisation vehicle (**SV**) had to finance the acquisition of the risks that it intended to securitise by issuing securities (*valeurs mobilières*), and in principle[1] the SV could not make use of other sources of financing, such as entering into a traditional loan agreement that was not structured as a debt security.

The Amended Law has introduced changes that allow SVs to finance, partially or totally, their activities by entering into contractual types of borrowing (for example, borrowing by way of a loan agreement).

In addition, the Amended Law replaces the reference to 'securities' (a term that is not defined under Luxembourg law) in the 2004 Law with a reference to 'financial instruments' (*instruments financiers*), a term that is clearly defined in the Luxembourg law dated 5 August 2005 on financial collateral arrangements.[2] The reason for this amendment is to ensure uniform interpretation and more certainty for market participants, especially where the securities issued by the SV are not governed by Luxembourg law.

These changes clarify and extend the means by which SVs can finance their securitisation activities. They also align the Luxembourg securitisation regime with the European Securitisation Regulation[3] by ensuring that any securitisation transaction subject to such EU Regulation can be performed by and through Luxembourg SVs (including securitisations resulting from entering into loan agreements).

1 Except on an ancillary and/or limited basis.
2 Article 1, point 8 of the Luxembourg law dated 5 August 2005 on financial collateral arrangements, with the exception of claims and rights under Article 1, point 8, f.
3 Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent, and standardised securitisation.

Active management of debt portfolios: opening the door to CLOs

While the 2004 Law was silent on this subject, in practice the CSSF's[4] regulatory approach was very restrictive with regards to the SV's management of its securitised assets. The CSSF considered that the SV's *"action must be limited to a "prudent man" passive management"*[5] *and that such management "can under no circumstances consist of either active management of the portfolio aiming to take advantage of short-term fluctuations of market prices and resulting in an ongoing activity of claim acquisition and assignment or (...) a professional credit activity performed by the securitisation undertaking on own account".*[6]

In light of the current debt market practices and the opportunities that a more permissive approach would offer to the Luxembourg financial services industry, the Amended Law allows SVs to actively manage – directly, or through a third-party manager – a portfolio of assets consisting of debt financial instruments or claims, provided that their acquisition is not financed by the issuance of financial instruments to the public.[7]

Such a development will further increase the attractiveness of Luxembourg SVs as standalone investment vehicles as well as core parts of wider investment structures that manage debt portfolios. We anticipate that the Amended Law, that allows SVs to actively manage debt portfolios, will put Luxembourg higher on the list of jurisdictions that CLOs managers consider when establishing their European investment structures.

Clarification of the criteria for SVs to be approved by the CSSF

SVs issuing securities to the public on a continuous basis must be authorised by the CSSF.

While the concept of the *"issue of securities to the public on a continuous basis"* was not legally defined before the reform, the Amended Law now clarifies the conditions under which SVs must be authorized by the CSSF, by adding the following definitions, which reflect current regulatory practice:

- an SV issues financial instruments on a continuous basis when it offers financial instruments to the public more than three times during the course of one financial year, taking into consideration the total number of issuances by all compartments of the SV;

- an issue of financial instruments is *offered to the public* when:

    - it is not reserved to professional clients;[8] and
    - the nominal value of the financial instruments is lower than EUR 100,000; and
    - it is not distributed by means of a private placement.

Increased flexibility to grant security interests

The Amended Law allows SVs to grant security interests over their assets in order to cover obligations *relating* to the securitisation transaction. This broadens the circumstances under which security interests can be granted,[9] addressing direct commercial needs of the market while at the same time maintaining investors' protection. Specifically, the SVs can now grant security to secure obligations of third parties to the extent the security granted by the SV *relates* to the relevant securitised transaction.

4 *The Commission de Surveillance du Secteur Financier*, i.e. the Luxembourg financial supervisory authority.
5 *Frequently Asked Questions, Securitisation* from the CSSF dated 23 October 2013.
6 *Frequently Asked Questions, Securitisation* from the CSSF dated 23 October 2013.
7 See below on the concept of "issue of securities to the public".
8 Under the meaning of article 1 of the Luxembourg law dated 5 April 1993 on the financial sector.
9 Before the reform, SVs could grant security interests over their assets or transfer their assets for guaranteed purposes only in order *"to secure the obligations it has assumed for their securitisation or in favour of its investors, their fiduciary-representative or the issuing vehicle participating in the securitisation"*.

Subordination

The Amended Law includes a set of rules to clarify the ranking between the claims that holders of instruments issued by an SV may have against the SV. Although these rules apply by default, they may be overridden by specific contractual arrangements between the parties to the securitisation transaction.

More flexibility as to the legal form of the SV

Before the securitisation regime was reformed, there were limited legal forms that could be used to set up a Luxembourg securitisation company and, in practice, most securitisation companies have been set up as public companies limited by shares (*sociétés anonymes* or SA) or private limited liability companies (*sociétés à responsabilité limitée* or Sàrl).

The Amended Law offers more flexibility and securitisation companies can now be set up as common limited partnerships (*sociétés en commandite simples* or SCS), special limited partnerships (*sociétés en commandite spéciales* or SCSp), simplified limited liability companies (*sociétés par actions simplifiées* or SAS) or general partnerships (*sociétés en nom collectif* or SNC). The addition of the SCS and the SCSp, in particular, has been welcomed by investors and managers who are already familiar with these tax transparent partnerships.

Accounting requirements

To ensure the same level of accounting transparency to investors no matter the legal form of the SV, the Amended Law now provides that an SV that is set up as an SCS, SCSp or SNC (which are legal forms that are in principle subject to less strict accounting requirements) is subject to the same obligations in terms of accounting preparation and publication as an SV that is set up as an SA or a Sàrl.

Furthermore, to reinforce the effectiveness of the legal segregation between compartments of an SV, the Amended Law provides that when a compartment is financed by the issue of shares, it is possible to have the accounts prepared at the level of the compartment and such accounts only need to be approved by the shareholders of that compartment.

Conclusion

The changes made to Luxembourg's securitisation regime have been welcomed by the Luxembourg financial services industry, with the further opportunities and flexibility for Luxembourg SVs that they bring.

With the Amended Law permitting active management of debt portfolios, CLOs managers may now consider Luxembourg as a jurisdiction of choice and Luxembourg SVs as a serious option for setting up their European investment structures.