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Law modernising the Luxembourg 2004 securitisation law

March 2022

The law amending the Luxembourg law of 22 March 2004 on securitisation (the "**2004 Law**") (the "**Law**") has been voted by the Luxembourg Parliament on 9 February 2022 and has been published on 4 March 2022. It will enter into force on 8 March 2022. The Law contains some targeted adaptations to the securitisation regime under the 2004 Law with the aim to clarify certain elements to enhance legal certainty and to ensure continuing flexibility of the Luxembourg securitisation regime adequate for the market's needs.

Below we focus on the major changes contained in the Law.

1 Additional sources of financing allowed for securitisation entities

The Law broadens the ways how securitisation entities can finance themselves.

Whilst previously a securitisation entity needed to issue securities (*valeurs mobilières*), the value or return of which depended on the securitised risks, under the Law, a securitisation entity can be financed through two types of instruments:

(i) either by issuing financial instruments, of which a definition is contained in the Law and which has a much broader meaning than the previously used concept of securities (*valeurs mobilières*);

(ii) or via loans in a broad sense, being any form of indebtedness that creates a reimbursement obligation for the securitisation entity, including indebtedness whose reimbursable amount depends on the performance of the underlying assets or on the financial standing of the issuer. This will allow securitisations in loan format set up under the European securitisation regime set out in 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 or simple, transparent and standardised securitisation to use the advantageous framework of the 2004 Law.

This change notably takes away doubts around the possibility to use certain foreign law governed instruments such as the German Schuldscheine.

2 Active management of assets by a securitisation entity: opportunities for Collateralised Loan Obligations (CLOs)

Whilst the 2004 Law was mute on the possibility for a securitisation entity to actively manage the assets comprised in its securitised portfolio, the Law specifically clarifies that active management of a pool of securitised risks is allowed where the following conditions are met:

(i) the pool of securitised risks is made up of debt securities, claims or debt financial instruments; and

(ii) the securitisation entity is not financed by issues to the public.

These clarifications confirm that the Luxembourg securitisation framework whit its flexible and robust legal regime (see compartments, statutory limited recourse and non-petition, …) is an appropriate legal framework to set up actively managed Collateralised Loan Obligations (CLOs).

3 Clarifications for securitisation entities that offer securities on a continuous basis to the public

The 2004 Law previously provided that a securitisation entity issuing securities to the public on a continuous basis must obtain an authorisation from the *Commission de Surveillance du Secteur Financier* (the "**CSSF**") to carry on its activities. The 2004 Law did previously not, however, specify what should be understood by (i) issuing to the public nor by (ii) issuing on a continuous basis.

The Law, building on the guidance given by the CSSF, sets up a clear legal framework which clarifies that:

(i) issuing on a continuous basis means issuing three or more times in the course of a financial year (across all compartments of a securitisation entity); and

(ii) issuing to the public, in this context, means an issuance that fulfils cumulatively the three following criteria:

(a) it is not meant for professional clients as defined in the Luxembourg law of 5 April 1993 on the financial sector, as amended; and

(b) the nominal amount of the issued financial instruments is less than EUR 100,000 (now matching the amount specified in the legislation on prospectuses); and

(c) it is not distributed by way of private placement.

To be noted that criminal sanctions now apply to those that have carried out or caused to be carried out issues to the public on a continuous basis without the relevant securitisation entity being authorised by the CSSF.

4 Additional forms of commercial companies allowed for securitisation entities

In addition to the current forms 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 Law allows securitisation entities to also be established in forms that, in some cases, did not exist when the 2004 Law was first adopted: unlimited companies (*sociétés en nom collectif*), common limited partnerships (*sociétés en commandite simple*), special limited partnerships (*sociétés en commandite spéciale*) and simplified public limited liability companies (*sociétés par actions simplifiées*).

5 Holding of securitised assets

The 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, i.e. via a company held entirely or in part by the securitisation entity.

As previously, such possibility should not be viewed as entailing the possibility for the securitisation entity to carry on a commercial or entrepreneurial activity: the purpose of the securitisation transaction remains rendering a physical asset, which may be a movable asset or real estate, liquid.

6 Increased flexibility and legal certainty for security interests granted by a securitisation vehicle

The 2004 Law previously restricted a securitisation vehicle to grant security interests over its assets only to secure the obligations it had assumed for their securitisation or in favour of its investors, their

fiduciary-representative or the issuing vehicle participating in the securitisation; security interests given outside of these limited scenarios being null and void.

To allow for further flexibility without however jeopardising the protection of investors and creditors, the Law has extended the wording slightly and now allows securitisation entities to grant security interests over their assets to secure the obligations relating to the securitisation transaction they are involved in; the new text also deleted the null and void sanction for security interests granted outside of this scenario.

7 Rules governing the creation and operation of compartments

The Law introduces a novelty in the accounting treatment of compartments; where compartment are financed by shares or other equity-like instruments, 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 and the legally required reserve according to the Luxembourg law of 10 August 1915 on commercial companies shall also be determined by reference to each compartment without regard to the global situation of the securitisation entity.

8 Rules governing ranking of investors' rights

The Law specifies a statutory default waterfall of payments/order of priority, applicable to securitisation entities (established as both funds and securitisation companies) as follows:

(i) The units of a securitisation fund are subordinated to the other financial instruments issued by such securitisation fund;

(ii) The shares or interest units of a securitisation company are subordinated to other financial instruments issued by such securitisation company;

(iii) The shares or interest shares of a securitisation company are subordinated to the profit shares (*parts bénéficiaires*) issued by such securitisation company;

(iv) 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

(v) Non-fixed yield debt financial instruments issued by a securitisation vehicle are subordinated to fixed yield debt financial instruments issued by that securitisation entity.

The Law clarifies that constitutional documents of a securitisation entity or contractual documents concluded by the securitisation entity may derogate from those default provisions and contain a different waterfall of payments/order of priority.

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