Update of the Luxembourg Securitisation Law: Increased Flexibility and Legal Certainty

Executive Summary

- On 9 February 2022, the Luxembourg Parliament has approved a new law amending the law of 22 March 2004 on securitisation. The new law will enter into force after publication in the official journal, which should occur in the course of February.
- The revised legal framework broadens the means of financing securitisation transactions, which now include also the possibility to finance through loans on an exclusive basis.
- The update opens up new possibilities for the active management of CDOs/CLOs and clarifies the ways in which securitised assets may be acquired.
- The scope of possible collateral arrangements has been widened by allowing a securitisation undertaking to grant collateral in favour of all parties involved in the securitisation transaction.
- Amendments also include adjustments to the corporate governance of securitisation vehicles, notably a definition of criteria for authorisation requirements, additional corporate forms, a registration obligation for securitisation funds and rules on legal subordination.
- Legal certainty has been increased, as the new legislation addresses explicitly questions that were previously only covered in FAQs issued by the Luxembourg supervisory authority.

The Luxembourg Parliament has increased the flexibility and legal certainty of the securitisation framework by updating the national legal regime to match the needs of the securitisation market but at the same time focusing on investor protection. Luxembourg's dedicated securitisation law, which ensures both innovation and legal certainty in securitisation structures, is one of the main reasons why Luxembourg has been able to become one of Europe's leading centres for securitisation and structured finance transactions. Over the coming years, Luxembourg is expected to make an important contribution in the redevelopment of the European securitisation market in line with the European Commission's Capital Markets Union Action Plan and its goal to scale-up the securitisation market in the EU.

The Luxembourg law of 22 March 2004 on securitisation, as last amended by the law approved by the Parliament on 9 February 2022 (the "**Securitisation Law**") remains both robust and flexible at the same time, while adding new tools that can be used in securitisation structures, in line with both European legislation and market practice in other EU jurisdictions.

This GSK Update outlines the main new features introduced in the latest amendments and their practical implications for the Luxembourg securitisation market.

I. Broader means of financing securitisation transactions

The new Securitisation Law both broadens and clarifies the means in which securitisation transactions can be financed. Under the previous regime, securitisation vehicles were only allowed to issue *securities*, being typically notes, but including also the possibility to issue shares or warrants. However, the term securities was not clearly defined and it was debatable whether certain types of, especially foreign law governed, instruments would qualify as such. Moreover, the means of financing were in practice limited by the frequently asked questions on securitisation published in 2013 by the Luxembourg supervisory authority, *Commission de Surveillance du Secteur Financier*, (the "**CSSF FAQs**"). The CSSF FAQs excluded the possibility to finance securitisation transac-

tions by loans in most cases – financing by loans was possible only on a transitional or ancillary basis for liquidity or warehousing purposes.

In the new Securitisation Law, the options for funding the securitisation transaction have been broadened by replacing the general reference of issuance of securities with the options to (i) issue *financial instruments* or (ii) enter into *any form of borrowing*.

Firstly, by replacing the term *securities* with *financial instruments*, the new Securitisation Law also increases legal certainty, as the latter is now explicitly defined by making cross-reference to a list of instruments outlined in the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended. The term *financial instrument* is defined to have the broadest possible meaning, including specifically e.g. loan notes, payment instruments and all other instruments evidencing ownership rights, claim rights or securities. By way of example, a securitisation undertaking could now finance the transaction by way of issuing German law governed debt instruments such as *Schuldscheine*, which do not qualify as transferable securities under German law. So far, the issue of a *Schuldschein* by a securitisation undertaking was only possible against the background of the CSSF's administrative practice.

Secondly, a securitisation undertaking can now finance its activities through loans or any other form of borrowing, either on an exclusive basis or in addition to the issuance of financial instruments. According to the parliamentary works of the new Securitisation Law, in this context the concept of borrowing should be interpreted broadly and it should include any form of indebtedness which gives rise to a repayment obligation of the securitisation undertaking. This would include for example indebtedness where the repayable amount depends on the performance of the underlying assets.

These changes mean that the new Securitisation Law is in line with the Regulation (EU) 2017/2402 (the "**EU Securitisation Regulation**"), which does not require securitisation transactions to be financed by issuing securities. Accordingly, the new Securitisation Law ensures that any securitisation subject to the EU Securitisation Regulation can also be carried out by a Luxembourg securitisation vehicle.

II. Additional flexibility for active management and acquisition of securitised assets

Although the previous legal framework was silent on the topic of active management of the securitised assets, the activities of a securitisation vehicle were in practice limited by the CSSF FAQs. The position of the CSSF was that the management should be limited to the administration of the financial flows linked to the securitisation transaction and to a *prudent-man* management of the securitised risks.

Now, the new Securitisation Law explicitly allows active management of the securitised assets in certain types of transactions, as long as the transactions are not financed by way of offering financial instruments to the public. Luxembourg securitisation undertakings may now securitise a pool of risks consisting of debt securities, financial debt instruments or receivables which are actively managed, either by the undertaking itself, or by a third party. In practice, the new legal framework allows for securitisation of actively managed CDOs (Collateralised Debt Obligations) and CLOs (Collateralised Loan Obligations) in private placements.

This new provision is in line with the European Central Bank's interpretation of securitisation, and provides legal certainty to set up such structures also in Luxembourg, while previously the European market of CDOs and CLOs was more focused in other jurisdictions. However, the scope of active management remains rather limited in order to ensure sufficient investor protection and not to enable circumvention of rules applicable to alternative investment funds.

In addition to easing the limitations of active management, the revised legal framework also clarifies the ways in which the securitised risks can be acquired. The new Securitisation Law confirms that a securitisation undertaking may assume the securitised risks by either directly or indirectly acquiring the assets, in particular through a wholly or partly owned entity. The explicit addition that acquisition can be made in both ways clarifies previous

ambiguity which related notably to the securitisation of immovable assets.

III. Wider scope of collateral arrangements

Previously, the possibility of a securitisation undertaking to provide collateral to other parties was limited to secure the claims of direct creditors and investors. The new Securitisation Law has explicitly increased the flexibility of the entering of the securitisation undertaking into collateral arrangements by enlarging the scope of parties who can benefit from such security interest. Currently, a securitisation undertaking can grant a security or pledge its assets to cover all commitments relating to the securitisation transaction.

By way of example, in a securitisation transaction where a bank ("**Bank**") provides financing to the company acquiring the securities ("**TopCo**") issued by the securitisation vehicle ("**SeCo**"), previously the SeCo could not directly grant a security interest over the underlying assets in favour of the Bank. Instead, the SeCo would have granted a security interest over the underlying assets in favour of the TopCo, who then in turn would have granted a security interest over the securities issued by the SeCo in favour of the Bank. Under the current regime, the SeCo could also directly grant a security interest over the underlying assets in favour of the Bank, who ultimately financed the securitisation transaction. Thus, an unnecessary level of complexity has been eliminated from the collateral arrangement, and the parties have more flexibility to structure the collateral arrangements in the most suitable way.

IV. Increased clarity on corporate governance of securitisation undertakings

In addition to the more substantial changes described above, the new Securitisation Law also provides a number of more technical updates relating to the corporate governance of the securitisation vehicle.

Criteria for authorisation from the CSSF

Securitisation vehicles may be either unregulated, as currently a majority of securitisation vehicles are, or authorised and supervised by the CSSF. The new Securitisation Law clarifies the specific criteria pursuant to which a securitisation undertaking needs to be authorised by the CSSF, whereas the matter was previously only addressed in the CSSF FAQs.

The new provisions, which are notably in line with the previous administrative practice of the CSSF, require that a securitisation undertaking which issues financial instruments offered to the public on a continuous basis, i.e. more than three issues per year, must be authorised by the CSSF. Financial instruments are deemed to be offered to the public if all the following conditions are met: (i) such issue is not directed at professional clients, (ii) the financial instrument has a denomination of less than EUR 100,000 and (iii) it is not distributed by means of a private placement.

In addition to the clarification of when an authorisation is necessary, the new Securitisation Law introduces a possibility for the CSSF to exercise its supervisory powers also to vehicles which should have been authorised in accordance with the aforementioned criteria. In case such vehicle is in breach of the new Securitisation Law, its constitutional documents or the issue documents, the CSSF may impose sanctions.

Additional corporate forms

The new Securitisation Law has added to the list of possible corporate forms a securitisation vehicle can take, introducing the possibility to use partnership structures for securitisation. Currently, also an unlimited company (*société en nom collectif*), a common limited partnership (*société en commandite simple*), a special limited partnership (*société en commandite spéciale*), and a simplified joint stock company (*société par actions simplifiée*) can be used as a securitisation vehicle.

By adding the possibility to use these limited partnership structures, which are already frequently used in other

types of financial transactions, also in the context of securitisation, the legislator has updated the Luxembourg toolbox to match the ones available in other European jurisdictions.

Duty to register securitisation funds with the RCSL

While previously only the management companies of securitisation funds needed to be registered with the Luxembourg Trade and Companies Register (the "RCSL"), following the adoption of the new Securitisation Law, also securitisation funds will need to be registered. This allows the funds to obtain an RCSL identification number, which is sometimes required for administrative purposes or public disclosure purposes and is also in line with the requirements for investment funds. Securitisation funds which have been established before the new Securitiation Law entered into force will need to be registered within the following six months.

Legal subordination of different types of financial instruments

In addition to broadening the means in which a securitisation transaction may be financed, the new Securitisation Law also provides for rules governing the legal ranking of different instruments. By way of example, shares/fund units rank junior to beneficiary shares, which in turn rank junior to debt securities issued by the securitisation vehicle. The new subordination rules are aligned with general rules applicable to commercial companies and mutual funds and incorporate the subordination principles in accordance with current market practice. However, parties can also agree to derogate from these principles, as the securitisation vehicle's articles of incorporation, management regulations or the relevant issue documents may contain provisions providing for a different ranking of the claims.

V. Conclusions

The changes to the Luxembourg securitisation framework have been made by taking into account market developments since the early 2000's when the law was originally introduced. The new legislation has successfully implemented the feedback from market participants while at the same time ensuring that investor protection remains an indispensable element. Although the Luxembourg legal framework has proven so far to be sound and well functioning, the new framework can even further diversify and increase the number of securitisation transactions using Luxembourg vehicles.

Moreover, the Luxembourg market is now fully prepared to see securitisation transactions used as a means to promote sustainable finance and the development of FinTech structures via the issue of security tokens.

The revised Luxembourg legal framework, together with the EU Securitisation Regulation provides a comprehensive toolkit for the European securitisation market and ensures that the regulatory framework enables securitisation to play its part in the European Capital Markets Union.

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