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FORTHCOMING CHANGES IN THE LUXEMBOURG LEGISLATION GOVERNING SECURITISATION VEHICLES

This article is part of a series that will be published in our "Structured Debt in a New World" publication launching early 2022. The publication will cover hot topics in the structured debt market such as this one.

Over recent years, the Luxembourg law dated 22 March 2004 on securitisation (the "**Securitisation Law**") has proven a successful framework for a wide variety of securitisation, repackaging and financing transactions. On 12 May 2021, a bill (the "**Bill**") was introduced with a view to making small, but important adjustments to the Securitisation Law and clarifying certain questions in the interest of legal certainty. The main proposed innovations are a significant broadening of the financing techniques available to Luxembourg securitisation companies and a welcome clarification that the Securitisation Law can be used as a legal framework for structuring managed CLOs. In this article, we set out more detail on the Bill's proposed changes and their market impact.

As a preliminary note, it is worth remembering that the Securitisation Law and the EU Securitisation Regulation are two completely distinct legal regimes and it is perfectly possible for a transaction to come within the ambit of one, the other, neither or both. The Securitisation Law is an "opt-in" regime whereas the EU Securitisation Regulation applies mandatorily where the transaction meets the definition of a "securitisation", meaning that a vehicle which elects to be subject to the Securitisation Law may or may not be a securitisation special purpose entity for EU Securitisation Regulation purposes.

The innovations that will be introduced by the Bill can be grouped into 3 categories:

i. Increased flexibility on the financing side

ii. Rules regulating the assets held by a securitisation vehicle

iii. Corporate governance rules

We examine each in turn below.

Increased flexibility on the financing side

Types of funding

The Securitisation Law currently requires a securitisation vehicle to issue securities, the value of or return on which depends on the securitised assets. This requirement has led to lengthy discussions about what counts as a "security" for these purposes, particularly in situations where the financing instruments issued were governed by foreign laws. It has also led to significant complexity and uncertainty around the use of loan funding for leverage or liquidity management purposes, or during any warehousing phase.

The Bill proposes to allow a securitisation vehicle not only to fund itself using any form of financial instruments (as opposed to the narrower concept of securities), but also using loans. In each case the value of or return on the relevant financial instruments or loans must depend on the underlying assets. This can easily be achieved by, e.g. making the loan limited recourse to the securitised assets, or ensuring that its value or return otherwise tracks those of the underlying. This change will bring welcome simplicity to the discussion around the characterisation of the funding instruments which can be used and allows securitisation vehicles to be funded via loans such as e.g. asset-backed or profit participating loans.

Issuance to the public

Any securitisation vehicle issuing securities on a continuous basis to the public needs to be licensed by the CSSF. The Securitisation Law does not, however, define the concept of "on a continuous basis to the public", although the concept has been clarified by the CSSF in its *Frequently Asked Questions*.

The Bill now proposes to have a statutory definition of this concept, thus increasing the legal certainty. The Bill proposes that any vehicle issuing financial instruments to the public more than 3 times per financial year would be considered to be issuing "on a continuous basis" and therefore would require a licence. Moreover, the Bill provides that an issuance will not be made "to the public" if it meets any of the following three conditions:

i. The issuance is solely made to professional clients as defined in the financial sector law.

ii. The denomination of the financial instruments offered exceeds EUR 100,000.

iii. The financial instruments are distributed by way of a private placement.

These conditions are broadly based on the guidance provided by the CSSF except that it lowers the minimum wholesale denomination from EUR 125,000 to EUR 100,000. This is a welcome alignment between the Securitisation Law and the EU Prospectus Regulation (though worth noting a slight difference in that the EU Prospectus Regulation terms, the equivalent concept would be an exempt offer to the public, rather than saying it is not an offer to the public at all).

Rules regulating the assets held by a securitisation vehicle

Active management

The Securitisation Law is currently silent on the question of whether a securitisation vehicle can actively manage its assets. The Bill proposes to address this by specifying that a securitisation vehicle would only be permitted to securitise a debt portfolio that is actively managed if the financial instruments issued for the purposes of such securitisation are not offered to the public.

This confirms that active management of a debt portfolio is possible unless the relevant securitisation is offered to the public, which would not normally be the case, given securitisations almost invariably have minimum denominations of at least EUR 100,000.

This clarification is very welcome as it removes any uncertainty as to whether active management of debt portfolios was permitted. With this clarification, Luxembourg looks set to offer an efficient legal framework for managed CLOs. That said, the proposed amendments, do not per se permit any conclusion on securitisations of other asset classes and does not prejudice any arguments supporting the possibility for Luxembourg securitisation entities to actively manage their portfolio as the Securitisation Law will remain silent on this point (bar the above express prohibition).

Acquisition of real assets

Under the Bill, a securitisation vehicle would be allowed to acquire the assets it securitises either directly or indirectly. Besides allowing the securitisation vehicle to directly own the assets generating the cash flows that are securitised (such as the assets subject to a lease if the lease receivables are securitised), this provision also confirms that a securitisation vehicle can acquire the assets or risks to be securitised indirectly, either through a fully owned subsidiary, or via the acquisition of an entity holding these assets or risks. This is helpful against the existing regulatory position against allowing securitisation vehicles to own anything other than financial assets.

Granting of third party security interests

The Securitisation Law currently provides that a securitisation vehicle may only grant security over its assets (i) for the purpose of securing its own obligations in connection with the securitisation of those assets, or (ii) in favour of its investors. As a result, any security for the obligations of a third party may be null and void. The Bill would adjust this to permit a securitisation vehicle to give security for obligations relating to the securitisation transaction and does not exclude giving security for the obligations of third parties. This will, for example, allow a securitisation vehicle that acquires a junior loan to provide security over that loan in favour of the senior lenders, as is occasionally required. Until now, this has been a barrier to securitisation vehicles to acquiring such loans. Similarly, where the securitisation vehicle holds assets via one or more wholly-owned subsidiaries, it will now be possible to have the securitisation vehicle grant security, or give guarantees, for the indebtedness of its subsidiaries. The Bill furthermore proposes to drop the sanction that any security granted in violation of this rule is null and void, which increases the legal certainty around transaction structuring considerably.

Corporate governance rules

New corporate forms available

Under the original Securitisation Law, securitisation vehicles were either established as a securitisation fund or as a company. In the latter case, only *société anonyme*, *société en commandite par action or société à responsabilité limitée* were permitted.

The Bill will also allow the use of tax transparent partnerships such as a s*ociété en nom collectif*, or a *société en commandite spéciale*.

The Bill specifies that partnerships subject to the Securitisation Law will need to prepare and publish annual accounts on the basis of the provisions of the law of 2002 on the register of commerce and on financial statements. They will not benefit from available exemptions in that respect.

Annual accounts and distributions

Where a compartment is financed by way of equity, the Bill provides that the financial accounts relating to such compartment should be approved by the shareholders of the relevant compartment only. Similarly, in these cases, the determination of the distributable assets and reserves, as well as of the legal reserve, is made on a compartment by compartment basis.

Ranking of securities

Finally, the Bill provides a framework governing the ranking of different classes of funding and, in particular, confirms that any form of debt ranks senior to shares, units and beneficiary units (unless otherwise agreed) and that fixed income debt ranks senior to participating debt.

Conclusion

The above changes will not fundamentally alter the Luxembourg securitisation regime, which is already very versatile and adaptable. The changes do, however, remove certain obstacles that may have rendered the structuring of some Luxembourg securitisation transactions more cumbersome. It remains to be seen how quickly the Bill will be adopted by the Luxembourg Parliament. While any forecast in that regard is difficult, we would hope and expect that these changes will become law in the course of 2022.

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