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LUXEMBOURG LAW

Securitisation in Luxembourg

SECURITISATION IN LUXEMBOURG

Luxembourg has implemented a flexible legal framework for securitisations since the adoption of the law of 22 March 2004 on securitisation, as amended (the "**Securitisation Law**"). In 2022 the Securitisation Law has been amended in various respects in order to provide for an even greater flexibility (the "**2022 Amendment**"). Together with the Luxembourg law of 10 August 1915 on commercial companies, as amended (the "**Company Law**"), such laws have enabled investors and asset managers to find a reliable, flexible and investor friendly environment to structure their securitisation transactions.

This brochure offers an overview of the Securitisation Law and its possibilities to structure securitisation undertakings in Luxembourg.

I. FLEXIBILITY IN THE ORGANIZATION OF SECURITISATION UNDERTAKINGS

The Securitisation Law offers the possibility to structure securitisation undertakings in the form of a securitisation company or in the form of a securitisation fund. Securitisation undertakings may submit themselves to the Securitisation Law through an "opt-in" via their constitutive documents, management regulations or issue documents in order to benefit from the possibilities offered by the Securitisation Law.

I.1 Securitisation companies

Securitisation companies must take one of the forms provided by the Securitisation Law.

Since the 2022 Amendment which has expanded the forms of companies that may be used to set up a securitization company the following corporate forms are available for structuring:

- **S**ociété **A**nonyme (**SA**) (public limited company)
- **S**ociété en **C**ommandite par **A**ctions (**SCA**) (corporate partnership limited by shares)
- **S**ociété à **R**esponsabilité **L**imitée (**SARL**) (private limited liability company)
- **S**ociété **C**oopérative organisée comme une société anonyme (**SCoopSA**) (co-operative company organised as a public limited company)
- **S**ociété en **C**ommandite **S**imple (**SCS**) Common limited partnership)
- **S**ociété en **C**ommandite **Sp**éciale (**SCSp**) (special limited partnership)
- **S**ociété en **N**om **C**ollectif (**SNC)** (General corporate partnership)
- **S**ociété par **A**ctions **S**implifiée (**SAS**) (Simplified joint stock company)

The SCS and the SCSp are partnership structures that have been very popular in the fund industry, and allow for great structuring flexibility. Furthermore, SCS and SCSp are tax transparent and therefore add another tool for sponsors alongside securitisation funds. The SCSp is also a corporate form that has no legal personality, contrary to the other available corporate forms.

The SCA, the SCS and SCSp allow asset managers to offer an investment in equity to potential investors, while ensuring that they will be able to retain control through the general partner.

I.2 Securitisation funds

Securitisation undertakings may also be organised as a securitisation fund, which does not have a legal personality and will be managed and represented vis-à-vis third parties by a Luxembourg incorporated management company, which is unregulated. Securitisation funds may consist of one or several co-ownerships or one or several fiduciary estates. The management regulations of the Securitisation fund shall expressly specify whether the fund is subject to the co-ownership rules or to the trust and fiduciary rules.

Unlike investment funds, securitisation funds are not subject to any annual subscription tax.

II. ASSETS, FINANCING AND MANAGEMENT

II.1 Direct or indirect acquisition of all types of assets

The Securitisation Law provides for a broad definition of "securitisation", which allows the securitisation of all types and classes of assets. Securitisation undertakings may acquire assets (whether movable or immovable, tangible or intangible) or assume risks to be securitised, either directly or indirectly, including through a wholly-owned or partially owned subsidiary of the securitisation undertaking.

The Securitisation Law offers flexibility in the assumption of risks as securitisation undertakings may either directly acquire the assets (by a so-called true sale), or may opt for synthetic securitisations

by using credit derivatives. The Securitisation Law expressly clarifies that the use of credit derivatives does not constitute insurance activities that would be subject to the Luxembourg law of 7 December 2015 on the insurance sector, as amended. The Securitisation Law further provides that the assignment by or to a securitisation undertaking of receivables entails the transfer of the guarantees and security interests relating to such receivable.

II.2 Wide array of financing methods

The Securitisation Law provides for a flexible framework with respect to the possibilities to finance the securitization undertaking.

Securitisation undertakings may be financed by issuance of "instruments financiers" (financial instruments), as such term is defined in the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended. This term is very broad and will allow securitisation undertakings to be financed by any type of instruments, including securities governed by either Luxembourg or a foreign law, German *Schuldscheine,* Carbon Credits or warrants, futures, options, etc.

Securitisation undertakings may also be fully financed or partially financed (together with the issuance of financial instruments) by credit loan facilities which no longer need to be ancillary to the issuance of the securities, for warehousing purposes or for short-term liquidity purposes (as it was the case prior to the 22 Amendment). The definition of credit is very broad and understood as any form of debt creating a reimbursement obligation for the securitisation undertaking.

In addition the 2022 Amendment has considerably broadened the scope where security can be granted by a securitisation undertaking. Securitisation undertakings may now generally grant security interests over their securitized assets "in the context of a securitisation transaction".

II.3 Management of assets

Securitisation undertakings are free to appoint an investment manager or a portfolio manager that will manage their assets.

The Securitisation Law allows active management by the securitisation undertaking itself or by a third party, subject to the portfolio of securitised assets being composed only of debt security, loans, debt financial instruments or receivables, and the securitisation undertaking's financial instruments being not offered to the public.

Securitisation undertakings may therefore be an effective tool for sponsors that are looking for a favourable legal framework to set up structures whose strategy is to invest in collateralized loan obligations (CLOs) or collateralised debt obligations (CDOs).

III. COMPARTMENTALISATION OF SECURITISATION UNDERTAKINGS

The Securitisation Law offers the possibility to create ring-fenced compartments within a securitisation undertaking, each representing a distinct part of the assets and liabilities of the securitisation undertaking. This segregation of assets and liabilities will provide protection in case of insolvency of the securitisation vehicule, and the rights of investors and creditors, in case of such a compartment structure, will be limited to the assets and liabilities of a given compartment.

Each compartment corresponds to separate assets and liabilities and is segregated from (i) the other compartments of the securitisation undertaking and (ii) the assets of the securitisation undertaking which are not allocated to any compartment.

Each of the compartments can be liquidated separately without negatively impacting the securitisation undertaking's remaining compartments. There are also no costs to establish separate compartments as it is a decision of the management body, which does not require a minimum share capital, or any formality such as a notary deed (to the extent the articles provided for the creation of compartment right from the outset) or any filing with the Luxembourg trade and companies register (*Registre de Commerce et des Sociétés, Luxembourg*) to the extent financing does not occur via equity instruments.

IV. SUPERVISION

The vast majority of securitisation undertakings in Luxembourg are unregulated and therefore not subject to any regulatory supervision. Notwithstanding any notifications etc. regarding requirements that may apply.

A securitisation undertaking will need to be authorised by the Luxembourg *Commission de Surveillance du Secteur Financier* (the "**CSSF**") in case it fulfils two criteria: the securitisation undertaking issues financial instruments that are offered to the public, and on a continuous basis.

The "continuous basis" criteria will be met in case the securitisation undertaking carries out more than three issuances of financial instruments offered to the public during one financial year. The number of issuances corresponds to the total number of issuances carried out by all compartments of the securitisation undertaking during that period.

The second criteria is the issuance of financial instruments that are offered to the public. An issuance of financial instruments will be deemed to be made "***to the public***", if **all 3** of the following criteria are met:

- the issuance is **not made to professional clients** within the meaning of article 1(5) of the law of 5 April 1993 on the financial sector, as amended, which refers to the definition of professional clients under MiFID II;
- the **denomination** of the financial instruments is **less than EUR 100,000** (this amount is aligned to the Prospectus Regulation); **and**
- the issuance is **not carried out by way of private placement** (which must be assessed on a case-by-case basis according to the communication means and the technique used to distribute the financial instruments).

A securitisation undertaking, in order to be authorised, will have to file a prior application with the CSSF. Once authorised, it will be subject to ongoing disclosure obligations vis-à-vis the CSSF. The obligations however do not involve any approval by the CSSF of securitisation transactions.

V. BANKRUPTCY REMOTENESS AND LIMITED RECOURSE

The validity of clauses by which investors or creditors commit neither to attach the assets of the securitisation undertaking, nor to initiate bankruptcy proceedings against the securitisation undertaking (non-petition and non-attachment clauses) is explicitly recognized by the Securitisation Law.

The Securitisation Law further recognises that the rights and obligations of investors and creditors are limited in recourse to the assets of the securitisation undertaking or to the particular compartment to which they relate and that the securitised assets are reserved to satisfy such rights.

VI. LEGAL SUBORDINATION

The 2022 Amendment clarified the rules on subordination in the context of a securitisation by creating the following legal hierarchy between the different types of instruments:

- The units of a securitisation fund are subordinated to the financial instruments and credit agreements issued or entered into by the securitisation fund;
- Likewise, the shares (*actions or parts sociales*) or partnership interests of a securitisation company are subordinated to the debt financial instruments and credit agreements issued or entered into by the securitisation company;

- The shares (*actions or parts sociales*) or partnership interests of a securitisation company are subordinated to the profit units (*parts bénéficiaires*) issued by the securitisation company;
- The profit units *(parts bénéficiaires*) issued by a securitisation company are subordinated to the debt financial instruments and credit agreements issued or entered into by the securitisation company; and
- The debt financial instruments with a variable return issued by the securitisation undertaking are subordinated to the debt financial instruments with a fixed return issued by the securitisation undertaking.

The Securitisation Law however provides for the possibility, notwithstanding the above, that the documentation of the securitization undertaking provides for another ranking of the rights of the various investors and creditors.

VII. ACCOUNTING RULES AND AUDIT

Financial statements of securitisation undertakings must comply with the Luxembourg generally accepted accounting principles ("**LuxGAAP**") provided by the Law of 19 December 2002 on the trade and companies register and the accounting and the annual accounts of companies, as amended or IFRS. Certain other accounting principles are accepted (ex: US GAAP), but certain requirements for additional forms providing a summary in LuxGAAP or IFRS may apply.

Financial statements of a multi compartment securitisation undertaking must include a break-down of asset and liabilities per compartments and clearly state the financial data for each compartment. Generally separate balance sheets and profit and loss accounts for each compartment are disclosed in the notes to the annual account in addition to the combined ones. However, it is possible to aggregate the notes to the financial statements for several compartments.

It is possible to organize that the shareholders of the relevant compartment (i) vote on the approval of the annual accounts of such compartment (and such compartment only), (ii) determine the distributions of the profits and reserves without taking into account the whole financial situation of the securitisation undertaking and (iii) decide on the allocation to the legal reserve at the level of the compartment.

The Securitisation Law also extends the obligation to draw up annual accounts to securitisation undertakings taking the form of an SNC, SCS or SCSp, which will not be able to benefit from exemptions available under the Companies Law.

The management body of a securitisation undertaking must always appoint a statutory auditor (*réviseur d'entreprise*).

VIII. SECURITISATION UNDERTAKINGS AND AIFMD

Securitisation undertakings may qualify as alternative investment funds ("**AIF**") under Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers, as amended (the "**AIFMD**"), and the Luxembourg law of 12 July 2013 on alternative investment fund managers, as amended (the "**AIFM**"), which has transposed such directive.

The AIFMD excludes from its scope "securitisation special purpose entities" ("**SSPE**"). The definitions of "securitisation special purpose entity" and "securitisation" contained in the AIFMD refer to the definition of securitisation set out in Regulation ECB/2013/40 of the European Central Bank and do not match the definition of "securitisation" provided in the Securitisation Law. As a result, entities qualifying as securitisation undertakings under the Securitisation Law may not qualify as SSPE under the AIFMD, and therefore qualify as AIF.

The CSSF has clarified that securitisation undertakings whose principal activity is loan origination, and securitisation undertakings which issue structured products with principal purpose to offer a synthetic exposure to assets other than credit and where the transfer of the credit risk is only ancillary, cannot benefit from the AIFMD exemption since they do not qualify as SSPEs under the AIFMD. In practice, securitisation undertakings engaging in direct lending will therefore not benefit from the exemption.

However, the CSSF has stated that irrespective of whether or not they qualify as SSPEs under the AIFMD, securitisation undertakings which issue debt instruments **only** do not qualify as AIF.

An assessment on a case-by-case basis will be required to determine whether a securitisation undertaking will qualify as AIF.

IX. SECURITISATION REGULATION

Securitisation transactions carried out by securitisation undertakings may fall under the scope of 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 (the "**Securitisation Regulation**").

The definition of "securitisation" under the Securitisation Regulation differ from the definition of securitisation under the Securitisation Law, and the definition of securitisation under the AIFMD.

"Securitisation" under the Securitisation Regulation is defined as a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranched, having all of the following characteristics:

(a) payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures; and

(b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

The two main elements of this definition are the tranching and the credit risk

Credit risk covers the securitisation of non-recourse credit risk associated with underlying exposure(s) upon whose performance the payments in the transaction or scheme exclusively depend.

Tranching covers securities issued in tranches with contractual subordination that determines the distribution of losses during the ongoing life of the transaction. If the subordination is legal, and not contractual (for instance, equity is legally subordinated to debt), there is no tranching, hence no securitisation under the Securitisation Regulation. Each securitisation transaction needs to be assessed on a case by case basis. Many securitisation undertakings in Luxembourg carry out securitisations that are not captured by the Securitisation Regulation.

If a securitisation transaction falls under the scope of the Securitisation Regulation, the involved securitisation undertaking, but also the originator and the sponsor will be subject to transparency and disclosure obligations and risk retention requirements. Institutional investors will be subject to certain due diligence obligations.

X. TAXATION

• Securitisation undertakings under the form of a corporation

A securitisation undertaking established under the form of a corporation (e.g. S.A., S.àr.l, S.C.A) is fully subject to corporate income tax and municipal business tax (at the current tax rate of 24.94% for 2023 for Luxembourg city). Any operational costs including all obligations assumed vis-à-vis its shareholders, investors and/or creditors are however tax deductible (save application of the ILR, see below). Given the nature of its activities and the possibility to deduct all obligations under the securities they have issued to shareholders, investors and creditors, a securitisation company should not generate significant taxable profits and should therefore to a large extent be tax neutral.

Securitisation companies are subject to the interest deduction limitation rule – "**IDLR**" deriving from the European Anti-Tax Avoidance Directive I (referred to as "ATAD I"), unless it qualifies as an AIF.

Thin capitalisation rules do not apply to securitisation companies.

Securitisation companies should only be subject to the lump sum net wealth tax *(impôt sur la fortune)* of EUR 4,815.

As fully taxable Luxembourg resident companies, securitisation companies may under certain conditions be able to benefit from double taxation avoidance treaties.

Distribution and interest payments by a securitisation company to investors are in principle not subject to Luxembourg withholding tax.

• Securitization undertakings under the form of a partnership

Securitisation undertakings established under the legal form of a partnership (i.e. SCS or SCSp) are fully tax transparent vehicles for Luxembourg income tax and net wealth tax purposes. As such, any profit realised by the SCS/SCSp is in principle taxable at the hands of its partners in proportion to their participation in the results of the SCS/SCSp but irrespective of whether the profits realised by the SCS/SCSp have been distributed or not.

One specific point of attention is given to rules targeting Luxembourg hybrid entities and reverse hybrid entities under Luxembourg ATAD II rules (deriving from the European Anti-Tax Avoidance Directive II (referred to as "ATAD II") which may apply to securitisation vehicles, established under the form of a SCS/SCSp, which are seen as opaque from the tax perspective of one or more of its investors (and provided all other conditions are met) while they are tax transparent from a Luxembourg perspective. In this scenario, a tax adjustment may be required either at the level of the securitisation undertaking itself (under the so-called "Reverse Hybrid EntityRule") or, where the Reverse Hybrid Entity Rule could not apply, at the level of its investments, depending on the case, in order to neutralise a hybrid mismatch in tax outcome.

The SCS/SCSp is not considered as tax transparent with respect to municipal business tax, meaning that if municipal business tax is due, it will be paid by the SCS/SCSp directly and not in the hand of its partners. However, no municipal business tax will in principle be due by an SCS/SCSp except if it effectively exercises a commercial activity or it is tainted by its unlimited partner (*associé commandité*) being a corporation (e.g. a *société de capitaux*) under the so-called *Geprägetheorie* (i.e. if its unlimited partner is a Luxembourg corporation which holds 5% or more of the interests (*parts d'intérêts*) in the SCS/SCSp.

It should be noted that, on 9 January 2015 the Luxembourg tax authorities issued a tax circular (L.I.R. n° 14/4) on the Luxembourg tax treatment of income realised by SCS/SCSp, which provides that an SCS/SCSp that is an alternative investment fund is deemed never to carry on a trade or business and is therefore never subject to Luxembourg municipal business tax, to the extent that its unlimited partner holds an interest of less than 5% in the SCS/SCSp.

Distribution and interest payments by a securitisation undertaking to partners / investors are in principle not subject to Luxembourg withholding tax.

Non-Luxembourg resident limited partners who do not have a permanent establishment, a permanent representative or a fixed place of business in Luxembourg to which the interests in the partnership are attributable, should not be subject to any Luxembourg taxation on income and wealth derived from the securitization undertaking.

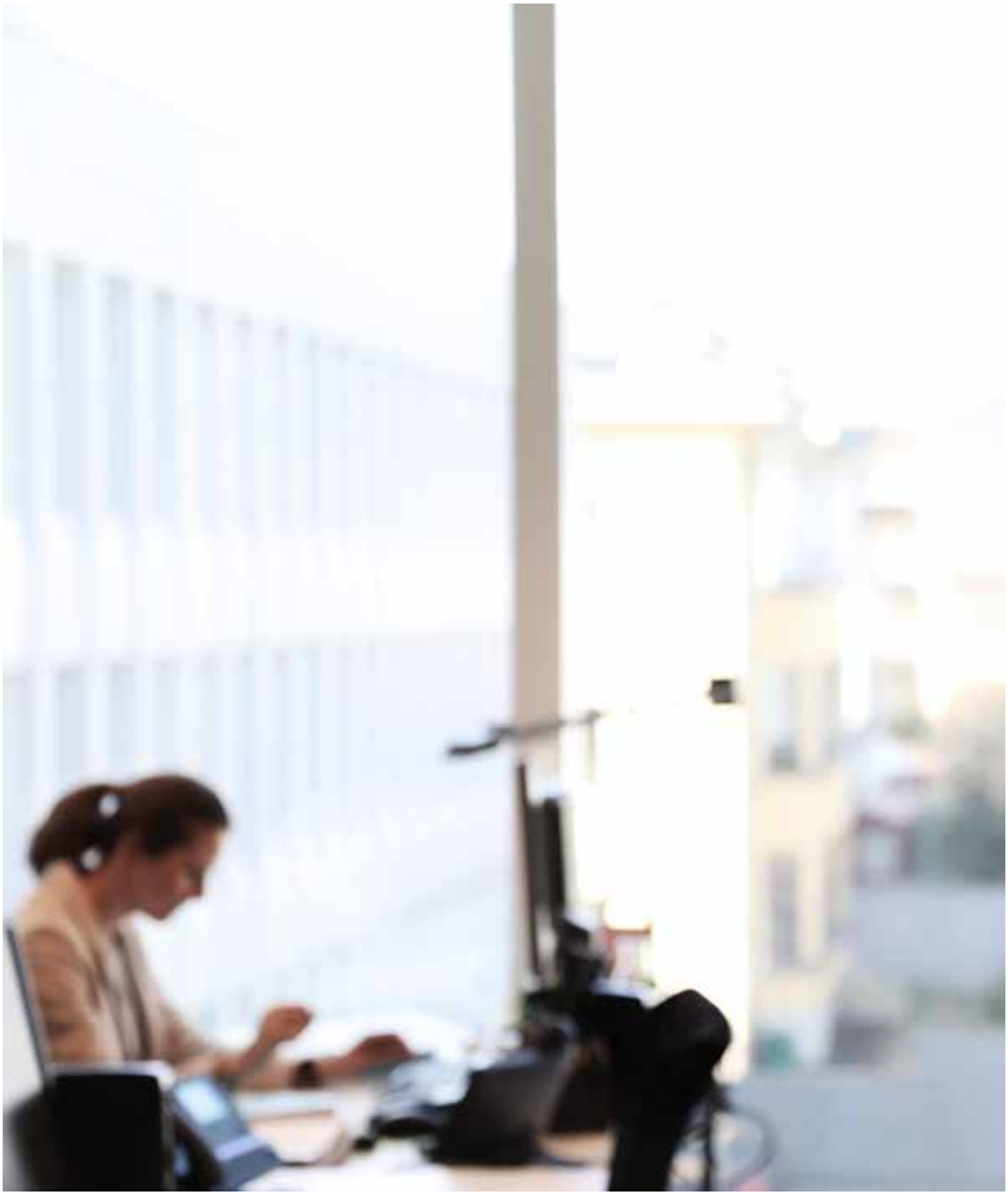
• Value Added Tax (VAT)

Management services provided to a securitisation company benefit in principle from a VAT exemption.

XI. CONCLUSION

The Securitisation Law, and even more after 2022 Amendment, offers an attractive environment for sponsors and investors to structure their securitisation transactions in Luxembourg.

Luxembourg securitisation undertakings were already a popular vehicle and the new possibilities opened of the Securitisation Law will further strengthen the position of Luxembourg as leading market for securitisation structures.



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