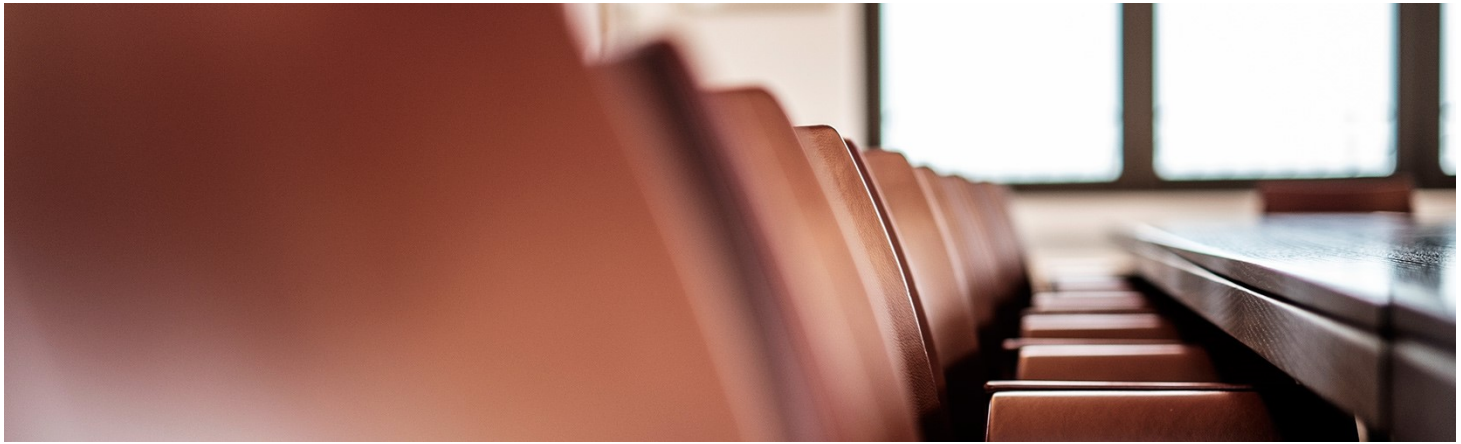
ELVINGER HOSS
LUXEMBOURG LAW

Modernisation of the Law of 22 March 2004 on securitisation



Introduction

- The bill of law number 7825 (the "**Bill**") amending the law of 22 March 2004 on securitisation (the "**Securitisation Law**") and certain other laws, was voted by the Luxembourg Parliament on 9 February 2022.
- The aim of the Bill is to further clarify the current legal framework and adapt it to the requirements of the securitisation market with a view to **strengthen the position of the Luxembourg market** as a leading European market for securitisations.
- In a nutshell, the Bill intends to clarify and broaden the way a securitisation undertaking can obtain **financing**, give more flexibility to grant **security interests**, permit an **active management** of certain securitised assets, clarify existing rules (including **accounting rules**) as regards compartmentation and add **additional corporate forms** for securitisation companies.
- With the Bill, the Luxembourg legislator wishes to offer new opportunities for market participants to accomplish securitisation transactions within a new framework with clear conditions and combining flexibility and legal certainty.

I. Accrued flexibility on the financing side – new financing methods

- The Bill intends to clarify and **broaden the way a securitisation undertaking may fund the acquisition of the underlying assets**.
- First, the clarification intended by the legislator is made by replacing throughout the Securitisation Law the references to "*valeurs mobilières*" (securities) by the term "*instruments financiers*" (financial instruments), as such term is defined in the Luxembourg law of 5 August 2005 on financial collateral arrangements. In doing so, there would be no longer uncertainty as to the type of securities that can be used to finance a securitisation transaction (including foreign securities such as the Schuldscheine in Germany) and this would extend the range of instruments that can be issued by the securitisation undertaking (other than securities) such as warrants, future, options, etc...
- Second, the Bill offers the possibility to securitisation undertakings to be either fully financed or partially financed (together with the issuance of financial instruments) by credit facilities which no longer need to be ancillary to the issuance of the securities, for wharehousing purposes or for short-term liquidity purposes (as it is currently the case). Instead, the legislator contemplates a **broad definition of credit** which shall be understood as **any form of debt creating a reimbursement obligation** for the securitisation undertaking.
- With this amendment, Luxembourg law is aligned with the Securitisation Regulation which already permits financing through credit agreements.

I. Accrued flexibility on the financing side – issuance of financial instruments to the public

- The Bill aims to provide more legal certainty as regards securitisation undertakings subject to the supervision of the CSSF by incorporating the existing guidance from the CSSF in the Securitisation Law, as follows:
  - In line with the existing CSSF guidelines, an issuance of financial instruments will be deemed to be made "***on a continuous basis***" if the securitisation undertaking makes more than 3 issuance of financial instruments to the public within the same financial period. The Bill further provides that the number of issuance should be considered taking into account all the compartments rather than on a compartment-by-compartment basis.
  - 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;
    - 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).

II. Corporate governance rules – new corporate forms and RCS publication

- With a view to offer more flexibility to market participants, the Bill adds **new forms of entities** which may qualify as securitisation companies:
  - Special limited partnership (*société en commandite spéciale*) ("**SCSp**")
  - Common limited partnership (*société en commandite simple*) ("**SCS**")
  - General corporate partnership (*société en nom collectif*) ("**SNC**")
  - Simplified joint stock company (*société par actions simplifiée*) ("**SAS**")

- **Securitisation funds** will now have to register with the Luxembourg register of trade and companies (the "**RCS**"). This will allow them to benefit from an RCS registration number (without pretending to be an FCP/mutual fund). The objective is to facilitate certain administrative processes which require an RCS registration number and provide an additional method for investors to identify the securitisation funds.
- Securitisation funds will also have to **publish their management regulations** with the RCS.

II. Corporate governance rules – new accounting rules for better investor's protection

- The Bill clarifies certain accounting rules regarding the compartments of a securitisation undertaking, it being noted that these rules only apply to compartments financed by equity.
- For such compartments, and to the extent the constitutive documents contain a relevant provision to that effect, it is possible that the **shareholders of the relevant compartment** (i) vote on the approval of the **annual accounts** of such compartment, (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 aim of this new rule is to provide greater investor protection by separating the accounts of a compartment from the other compartments and also to clarify certain uncertainties that were existing on these topics.
- A new paragraph is also inserted in order to extend the **obligation to draw up annual accounts** to securitisation undertakings taking the form of an **SNC, SCS or SCSp**, which will no longer be able to benefit from available exemptions in that respect.

II. Corporate governance rules - rules on subordination

- The Bill clarifies the rules on subordination in the context of a securitisation by adding a **comprehensive set of rules in the Securitisation Law defining subordination of the financial instruments** issued by the securitisation undertaking and thus creating a legal hierarchy between the different types of instruments, as follows:
  - 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 **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 company are subordinated to the **debt financial instruments with a fixed return** issued by the securitisation company.

II. Corporate governance rules - rules on subordination (cont'd)

- The Bill further provides that the parties to a securitisation transaction will be able to agree different subordination rules contractually.
- With this legal subordination created by the legislator, the existence of subordination or tranches should not automatically lead to the application of the EU Securitisation Regulation. The EU Securitisation Regulation should continue to apply to tranched securities created by way of contract only.

III. Rules impacting the securitised assets - active management

- The Securitisation Law was silent as regards the active management of the securitised assets, even though the European Central Bank allows securitisation undertakings to actively manage their portfolio of securitised assets.
- In order to provide more legal certainty to market participants, the Bill inserts a new provision **allowing for such active management by the undertaking itself or by a third party**, subject to the following conditions:
  - The portfolio of securitised assets shall be composed of debt security, loans, debt financial instruments or receivables; and
  - The securitisation undertaking shall be financed through **financial instruments** which are **not offered to the public** (as per the criteria set out above).

III. Rules impacting the securitised assets - accrued flexibility to grant security interests

- Currently the possibility to grant security interests on the securitised assets is limited to security interests granted to secure the obligations the securitisation undertaking has assumed for their securitisation or in favour of its investors.
- The Bill intends to broaden the scope of this provision by allowing the securitisation undertaking to grant **security interests** over the securitized assets **in the context of a securitisation transaction**. This wording allows **greater flexibility** in the way security may be taken in the context of a securitisation transaction.
- Example: a securitisation undertaking assumes a risk over, or acquires, a junior tranche of a loan facility granted by lenders (banks) to finance the acquisition of an asset held by a company. The lenders will typically require certain security from the securitisation undertaking. Previously, this was not be possible for the securitisation undertaking to grant any security interest as the bank is neither a creditor of the securitisation undertaking nor one of its investors. With the amendment to the Securitisation Law inserted by the Bill, this type of security arrangement becomes possible as there is **no longer any restriction to give security to secure the obligations of third parties**.

III. Rules impacting the securitised assets – acquisition of securitised assets

- The Bill aims at clarifying that in relation to the acquisition by the securitisation undertaking of assets, whether movable or immovable, tangible or intangible, or risks to be securitised, it is possible to do so **directly or indirectly**, including through a wholly-owned or partially owned subsidiary of the securitisation undertaking.
- This amendment, however, does not permit the possibility for the securitisation undertaking to develop a commercial or entrepreneurial activity. The transfer of ownership of the underlying assets shall remain a way to refinance the underlying assets.

Karl PARDAENS
karlpardaens@elvingerhoss.lu
Tel: +352 44 66 44 5368

Contact us to discuss how we can support your business in Luxembourg

LUXEMBOURG I HONG KONG
Elvinger Hoss Prussen
www.elvingerhoss.lu

NEW YORK
Elvinger Sàrl PLLC
www.elvinger.us