

Modernization of Luxembourg Securitization Law voted on 9 February 2022

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BACKGROUND

The Luxembourg law on securitizations dated 22 March 2004 (the “Securitization Law”) provides for a sound, flexible and very efficient legal, regulatory and tax framework for securitization transactions. The definition in the Securitization Law is broader than the definition provided by the Regulation EU 2017/2402 as amended, and is therefore not solely limited to the transfer of credit risks while issuing multi-tranche securities. Amongst the well-known features of the Securitization Law, there are investor protection rules provided by subordination, non-recourse, and non-petition clauses as well as the full ring-fencing of assets and liabilities within separate compartments. The purpose of the modernized Luxembourg Securitization Law is to further clarify on the existing legal framework and to adapt it to the current requirements of the securitization market, while maintaining high protection for investors.

What is mainly changing with the modernization of Luxembourg Securitization Law?

Loan financing

The long-standing restriction for Securitization vehicles to only issue securities for their financing is lifted. Henceforth, any financial instruments can be used, including loans. The involvement or extent of other means of financing was often discussed in practice. This change will increase the clarity on certain structures (e.g., a securitization undertaking could be financed via the use of bank loans).

Active management

The activities of securitization vehicles were traditionally limited to the passive management of its assets while active management, e.g., trading or active replacement of assets in the collateral pool, was not easy to achieve. This also often raised questions in practice for securitization structures which require active management of the collateral pool like Collateralized Loan Obligations (CLO's) or the granting of loans. The modernization of Luxembourg Securitization Law now makes it possible for a Luxembourg securitization vehicle to actively manage a debt portfolio as long as no issuance of financial instruments is made to the public with the aim to achieve easier the administration of actively managed CLO's and to revive this market for Luxembourg.

Regulation

The vast majority of Luxembourg securitization vehicles are currently unregulated. However, a few securitization vehicles are Commission de Surveillance du Secteur Financier (CSSF) - regulated under certain circumstances. The modernized Law defines the authorization requirement criteria which is mainly aligned with the existing CSSF guidance referring to the continuous issuance to the public. The definition of “continuous” has still the meaning of more than three issuance per calendar year. In addition, the concept of “public” refers to three cumulative criteria i.e., (i) the issuance of financial instruments are aimed at non-professional clients, (ii) the issuance of financial instruments do not exceed EUR 100k and (iii) the financial instruments are not distributed as private placement.

Available legal forms

The available legal forms for securitization companies were limited to public limited liability company (S.A.), a private limited liability company (S.à r.l.), a partnership limited by shares (S.C.A), or a co-operative company organized as a public limited liability company (S.C.O.S.A). The modernized Law introduces additional legal forms to setup securitization companies, as general partnerships (sociétés en nom collectif), common limited partnerships (S.C.S.), special limited partnerships (SCSp) and simplified public limited liability companies (sociétés par actions simplifiées). This is adding additional flexibility as it is the first time that a fully unregulated Luxembourg partnership can use compartments.

Guarantees

Before the modernized Law, a securitization vehicle could provide securities/guarantees over its portfolio solely to its investors. Therefore, banks could not benefit from such guarantees making the structuring of the transaction complex or impossible. The modernized Law allows to provide securities/guarantees to third-party creditors whilst maintaining high protection for the investors adding further flexibility in structured financing.

Compartment rules

Securitization vehicles may either issue debt or equity securities (now extended to financial instruments). In case of equity financed securitization vehicles, the Securitization Law was silent about the governance rules applicable to structures with compartments. The modernized Law now clarifies that financial statements of such equity financed compartments shall only be approved by the respective shareholders and that the decision to allocate legal reserve shall also be taken at the compartment level.

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