

Securitisation in Luxembourg



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Types of Luxembourg Securitisation Undertakings

- A securitisation undertaking subject to the Luxembourg act dated 22 March 2004 on securitisation, as amended (the Securitisation Act 2004), may take the form of a securitisation company or a securitisation fund.
- A securitisation undertaking wishing to benefit from the favourable regime of the Securitisation Act 2004 must be located in Luxembourg.
- It is possible to set up the Luxembourg structure as
 - (i) a single tier structure or (ii) a two-tier structure comprising an issuing vehicle and an acquisition vehicle.

1 Securitisation company (LuxSecCo)

	SA ¹	S.à r.l. ²	S.C.A. ³	Scoop ⁴	SNC ⁵	SCS ⁶	SCSp ⁷	SAS ⁸
Securities may be listed on a market	●	● ⁹	●	●	● ⁹	● ⁹	● ⁹	● ⁹
Securities may be offered to the public	●	● ⁹	●	●	● ⁹	● ⁹	● ⁹	● ⁹
Securities may be cleared in clearing systems	●	● ⁹	●	●	● ⁹	● ⁹	● ⁹	● ⁹
“Check the box” for U.S. tax purposes	–	●	●	–	●	●	●	●
Flexibility in terms of increase or decrease of the share capital	–	–	–	●	●	●	●	–

1 société anonyme – public limited liability company.

2 société à responsabilité limitée – private limited liability company.

3 société en commandite par actions – partnership limited by shares.

4 société coopérative sous forme de société anonyme - cooperative society organised as a public limited liability company).

5 société en nom collectif – general partnership.

6 société en commandite simple – common limited partnership.

7 société en commandite spéciale – special limited partnership.

8 société par actions simplifiée – simplified limited company.

9 except for equity.

2 Securitisation fund

- Co-ownership of assets.
- No legal personality.
- Represented by a management company vis-à-vis third parties.
- No requirement for management company to be regulated.
- No annual subscription tax (taxe d’abonnement) (as due by investment funds).

Regulatory Supervision by the CSSF

Regulated securitisation undertaking

- Licence required if offers of securities are made to the public on a continuous basis
- Out of scope of the Banking Act 1993
- Out of scope of the AIFMD (subject to conditions)
- Securities and cash must be held with a Luxembourg custodian
- Must appoint a statutory auditor
- Full benefit of the provisions of the Securitisation Act 2004
- Only reputable credit institutions and investment firms may act as hedging counterparties
- The CSSF must approve the members of the respective management bodies of the LuxSecCo and its shareholder(s). Any mandates held by such persons with other entities need to be disclosed to the CSSF

Non-regulated securitisation undertaking

- Suitable for private placements of securities and occasional public offers of securities (ie not made on a continuous basis)
- Out of scope of the Banking Act 1993
- Out of scope of the AIFMD (subject to conditions)
- Assets (including securities and cash) may be held with a Luxembourg or foreign custodian
- Must appoint a statutory auditor
- Full benefit of the provisions of the Securitisation Act 2004

1 Offers of securities to the public on a continuous basis

A securitisation undertaking must obtain a licence (agrément) from the CSSF (Commission de Surveillance du Secteur Financier – Luxembourg financial sector regulator) if the following conditions are met cumulatively:

Financial instruments are offered to the public

The financial instruments are offered to the public if they are (i) issued to persons that do not qualify as professional clients within the meaning of the MiFID II and (ii) issued with denominations below EUR100,000, and (iii) not distributed as private placement (an analysis has to be carried out in this respect on a case-by-case basis).

Public offers are made on a continuous basis

A securitisation undertaking makes public offers on a continuous basis if it offers its financial instruments to the public more than three times per financial year.

2 Key aspects of regulated securitisation undertaking

- The approval process involves the submission of an application file and, in practice, a meeting with the CSSF.
- A number of intervening parties, such as the Luxembourg custodian, the board of directors, the shareholder(s), the management company and the statutory auditor are subject to the CSSF's approval.
- Ongoing disclosure obligations vis-à-vis the CSSF (but no need to seek the prior approval of individual transactions).

Key Advantages of the Securitisation Act 2004

Wide range of securitisable assets

- Residential and commercial mortgage loans, corporate loans, credit card receivables and trade receivables
- Debt and equity securities
- Rights and claims relating to financial contracts (eg derivative agreements, synthetic transactions, fully funded swaps)
- Rights and claims relating to operating businesses
- Commodities
- Assets covered by financial leases
- Real estate (subject to certain restrictions)
- IP rights

Multiple ways to finance a securitisation undertaking

Through the issue of financial instruments, including:

- All types of debt securities (notes, bonds, certificates) in registered, bearer or dematerialised form
- Warrants
- Equity securities (ordinary equity, preference shares/ non-voting shares and tracker shares)
- Units, in case of a securitisation fund
- Beneficiary shares
- Loans (on an exclusive basis or in combination with equity or debt securities)

Possibility of active management of CDOs and CLOs

- A securitisation undertaking is allowed to actively manage repackaged debt (in the form of loans (CLOs) or debt securities (CDOs)) where it issues its financial instruments by way of a private placement.

Bankruptcy remoteness and statutory recognition of contractual arrangements

- Non-petition
- Limited recourse
- Claim subordination
- Non-seizure of assets

Statutory subordination for different types of financial instruments

- Subordination of different types of debt and equity instruments issued by a securitisation undertaking is embedded in law. Unless the relevant contractual terms provide otherwise, instruments issued by a LuxSecCo rank in the following order (starting with the most senior):
 - Fixed income debt instruments.
 - Non-fixed income debt instruments.
 - Beneficiary shares.
 - Shares, corporate units or partnership interests.
- In a securitisation fund, fund units are subordinated to other financial instruments.

Favourable tax regime

- Direct taxes
- LuxSecCo under the form of a SA or S.à r.l. are fully taxable companies subject to Luxembourg corporate income tax and municipal business tax
- LuxSecCo under the form of a SCS or SCSp and a securitisation fund are tax transparent for Luxembourg tax purposes (thus not subject to income taxes in Luxembourg except under specific conditions)
- Tax deductibility of all payments and commitments (including dividends) made in respect of financial instruments issued by the LuxSecCo, subject to the interest deduction limitation rules which may apply depending on the assets held by the LuxSecCo
- Exempt from standard net wealth tax and in most cases subject only to a minimum lump sum taxation of EUR4,815
- No withholding tax applicable to payments made by the securitisation undertaking to its investors
- Possibility to obtain advanced tax agreements from tax authorities
- VAT: VAT exemption for management services
- DTTs: 80 double tax treaties in effect and a dozen under negotiation

Other Benefits

A LuxSecCo can create an unlimited number of segregated compartments:

- Compartmentalisation is embedded in Luxembourg statutory law and is not merely a contractual arrangement.
- Each compartment forms an independent part of a LuxSecCo's estate; assets allocated to the compartment are segregated from those allocated to any other compartment (notwithstanding the fact that a compartment does not have a distinct legal personality).
- A decision of a LuxSecCo's board of directors is sufficient to set up a new compartment (hence low operational costs even if each individual transaction is conducted under a new compartment).
- Assets in a compartment are ring-fenced: on the one hand, only creditors whose claims have arisen in connection with the relevant compartment have access to its assets; on the other hand, such creditors have recourse only against the assets of the relevant compartment.
- Under one compartment, a LuxSecCo may issue multiple series and tranches of financial instruments denominated in different currencies and linked to different underlying assets.
- Compartments are generally regarded as separate issuers under the U.S. Investment Company Act of 1940, as amended and thus each compartment may rely on different exemptions under such Act (Rule 3a-7, Section 3(c)(7)), which provides programme sponsors with flexibility in offering various securitisations under one structure. It is unclear whether a multi-series issuer enjoys the same treatment with respect to the U.S. Commodity Futures Trading Commission (CFTC) or under the Volcker Rule, and market participants have taken various approaches.
- Luxembourg securitisation fund can also create compartments, which have similar characteristics to the compartments of the LuxSecCo.
- No requirement for risk diversification.
- Debt recovery exempt from Luxembourg licensing requirements.
- A securitisation undertaking may (if agreed contractually) invest non-invested cash in money market instruments in order to mitigate interest rate risks.
- No requirement for arrangers, managers or agents to be based in Luxembourg.
- Security interests (including Luxembourg law financial collateral arrangements benefiting from the favourable regime provided for in the Luxembourg law act of 5 August 2005 on financial collateral arrangements, as amended) and guarantees (including Luxembourg law professional payment guarantees benefiting from the favourable regime provided for in the law of 10 July 2020 on professional payment guarantees, as amended) are available to all parties involved in the securitisation transaction (the beneficiary of the security interest does not need to be a direct creditor of the securitisation undertaking).
- Enforceability of contractual set-off and close-out netting.
- Recognition by Luxembourg law of foreign law-governed trusts.
- Rating agencies are familiar and comfortable with securitisation transactions by LuxSecCos
- Robust legal opinions can be issued on securitisation transactions.
- Luxembourg State has an AAA credit rating.



Variety of Structuring Options

1 Types of securitisations

- Both true sale securitisations and synthetic securitisations (including those linked to static indices or actively managed indices) are possible.
- A securitisation undertaking may itself enter into securities lending transactions, repurchase agreements and derivatives in furtherance of a securitisation transaction.
- A securitisation undertaking may carry out fund repackaging (subject to restrictions in offer jurisdictions).
- Portfolio of securitised assets may be managed by an external asset manager or remain static.
- Cash may be securitised to the extent that it is used as a collateral under a swap arrangement designed to hedge payment obligations of a securitisation undertaking under its financial instruments. Certificates of deposit may be used directly as securitised assets.
- Structures subject to the Securitisation Act 2004 are also used for Islamic financing purposes.

2 Granting of loans by a securitisation undertaking

- A securitisation undertaking must not use funds received from the public for purposes of granting loans for its own account (as this would constitute a banking activity).
- Documentation relating to the issue of securities must contain adequate disclosure of: (i) the underlying activity financed out of the issue proceeds (the Activity); (ii) the borrower(s); or (iii) the borrower selection criteria; and (iv) the main characteristics of the loan(s) granted or to be granted by the securitisation undertaking.
- Return on Activity must be sufficient to allow the securitisation undertaking to meet its obligations under the financial instruments it has issued.

3 Repackaging of assets held by an investor

- If repackaged assets/risks are not linked in any way to the investor, investors' objectives (such as rationalisation of asset management/risk management/creation of ECB eligible collateral) must be analysed in order to determine if a transaction falls within the scope of securitisation.
- If repackaged assets/risks are linked in some way to an investor, a transaction will be regarded as securitisation only if such investor becomes a minority investor of the securitisation undertaking or subscribes for equity tranche.

Certain U.S. Regulatory Issues

1 U.S. Investment Company Act of 1940

- Securitisations offered to U.S. investors are generally structured to be exempt from registration under the U.S. Investment Company Act of 1940, as amended.
- Exemptions depend on the specific structure of each securitisation. For example, static pool securitisations involving a U.S. bank as a trustee may be structured to rely on the exemption under Rule 3a-7, while receivables securitisations and securitisations involving real estate assets may be structured to rely on the exemptions under Section 3(c)(5).

2 U.S. Commodity Exchange Act

- Securitisations that make use of commodity interests (including commodity total return swaps, options, forwards and futures) and that have some U.S. nexus (eg, U.S. investors, a U.S. manager, among other things) may be a commodity pool under the U.S. Commodity Exchange Act, as amended, and may be required to have a CFTC-registered manager and operator.
- Certain exemptions may apply, including an exemption for securitisations that enter into commodity interests for purposes of hedging interest rate or currency discrepancies between the underlying asset and the issued notes.

3 Volcker Rule

- The covered fund prohibitions under the Volcker Rule prohibit banking entities from sponsoring, holding an ownership interest in, or having certain relationships with, a “covered fund.”
- Securitisations are generally structured such that they are able to benefit from an exemption from the definition of “covered fund” under the Volcker Rule. Commonly used exemptions include the loan securitisation exemption and securitisations relying on the Investment Company Act exemptions mentioned in paragraph 1. Certain non-U.S. banking entities may also be able to benefit from the foreign funds exemption in connection with securitisations with limited U.S. nexus.
- The lack of an exemption significantly limits sponsoring and investing activity by a bank subject to the Volcker Rule (which would include most U.S.-based banks and their non-U.S. affiliates, and non-U.S. banks with U.S. banking affiliates).

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