Securitisation in Luxembourg – a vibrant market with a flexible toolbox

by Andreas Heinzmann, GSK Stockmann

The Luxembourg law of March 22, 2004 on securitisation undertakings, as amended (the Securitisation Law) and the Regulation (EU) 2017/2402 of the European Parliament and of the Council of December 12, 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the EU Securitisation Regulation) apply to securitisation transactions carried out in Luxembourg.

Applicable legal framework

The Securitisation Law is very flexible and allows any type of securitisation transaction. The Securitisation Law defines securitisation as a transaction by which a securitisation undertaking acquires or assumes, directly or through another undertaking, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties and issues securities, whose value or yield depends on such risks.

With respect to the placement of securities to investors, the framework set out by the Markets in Financial Instruments (MiFID II) – Directive 2014/65/EU (MiFID II) and by the Regulation (EU) 2017/1129 of the European Parliament and of the Council of June 14, 2017 on the prospectus to be published when securities are offered to the public (the Prospectus Regulation), and the Regulation (EU) No. 1286/2014 on key information documents for packaged retail and insurance-based investment products (the PRIIPs Regulation) should be taken into account, in particular when the securitisation undertaking is offering securities to the public.

Overview regarding the Luxembourg securitisation market

Since the adoption of the Securitisation Law in 2004, Luxembourg has been a very active market for the set-up of multi-compartment securitisation undertakings and the structuring of securitisation transactions and has become one of the major hubs for securitisation transactions in Europe.

Andreas Heinzmann, LL.M., Partner
GSK Stockmann
tel: +352 271802 30
email: andreas.heinzmann@gsk-lux.com

The Securitisation Law is very flexible and allows any type of securitisation transaction, be it a private placement or an offer of securities to the public, true sale or synthetic, tranched or untranched. Securitisation undertakings may be regulated or unregulated and can create compartments to ring fence the assets and liabilities of a securitisation transaction from the ones of other transactions of the same securitisation undertaking. There are currently ca. 1,400 securitisation undertakings (having ca. 6,000 compartments) active in Luxembourg, only a very small portion of them are regulated.

Eligible assets under the Securitisation Law

The Securitisation Law does not provide for any limitation with respect to the assets and risks that may be securitised. The Luxembourg Commission for the Supervision of the Financial Sector (*Commission de Surveillance du Secteur Financier*) (the CSSF) issued frequently asked questions on securitisation (the CSSF FAQ), that are generally used as guidance for regulated but also for unregulated securitisations.

Available securitisation undertakings under the Securitisation Law

The Securitisation Law allows securitisation undertakings to be set up either in the form of a transparent fund or in the form of a company. For both types of securitisation vehicles, Luxembourg law offers a great deal of flexibility. Hence, there are no actual regulatory or practical restrictions on the nature of securitisation undertakings.

Securitisation funds can be legally structured either as co-ownership(s) or as fiduciary estate(s); either option must be specified in their management regulations. While securitisation funds structured as co-ownerships are also governed by the Luxembourg civil code, the very specific civil law rules pertaining to undivided co-ownerships (*indivision*) are expressly excluded by the Securitisation Law. The purpose of this exclusion is to avoid the unanimous decision-making rules applying to undivided co-ownerships as provided for in the civil code. Securitisation funds, which have been organised as a fiduciary estate, are also governed by the Luxembourg law dated July 27, 2003 on trust and fiduciary agreements, as amended. Both types of securitisation funds are managed by a management company. The only practical restriction in this respect is that their structuring will need specific attention to avoid the risk of qualification as an alternative investment fund. While solutions exist to avoid such qualification, which mainly relate to the types of securities issued, the absence of a defined investment policy and the absence of active management, a tailored and cautious drafting of the management regulations of the securitisation fund is paramount.

Securitisation companies may in accordance with the provisions of the Securitisation Law be set up either as a public limited liability company (*société anonyme*), a corporate partnership limited by shares (*société en commandite par actions*), a private limited liability company (*société à responsabilité limitée*) or a co-operative company organised as a public limited company (*société cooperative organisée comme une société anonyme*) only. These entities are also governed by the provisions of the Luxembourg law of August 10, 1915 on commercial companies, as amended (the Companies Law).

Bankruptcy remoteness under the Securitisation Law

In accordance with the provisions of the Securitisation Law, bankruptcy remoteness of securitisation undertakings is achieved through the use of statutory or contractual limited recourse and non-petition clauses set out in the issuance and incorporation documentation of the securitisation undertaking.

Limited recourse clauses provide that the rights of investors and creditors of the securitisation undertaking or of its compartments are limited to the assets of such undertaking and its compartments. These clauses are associated with non-petition clauses, whereby the investors and creditors of the undertaking or its

compartments commit not to start bankruptcy proceedings against the undertaking once the assets allocated to the vehicle or the relevant compartments have been realised but there is a shortfall.

Subordination under the Securitisation Law

The Securitisation Law expressly acknowledges the validity of subordination clauses in the context of securitisation transactions even if the relevant agreements or terms and conditions of the securities are not governed by Luxembourg law. Therefore, subordination provisions will be upheld by Luxembourg courts.

True sale or synthetic securitisations under the Securitisation Law

A securitisation can be completed (i) on a true sale basis, whereby the securitisation undertaking acquires full legal title in relation to the underlying assets, or (ii) by the synthetic transfer of the risk pertaining to the underlying assets through the use of a derivative instrument or a guarantee. With regard to the latter instrument, on July 10, 2020 the law on professional payment guarantees was passed (the Professional Guarantee Law). The Professional Guarantee Law will certainly strengthen the use of Luxembourg law governed guarantees in the context of synthetic securitisations and provide more legal certainty as regards the potential insurance-like character of such a risk transfer.

Effectiveness of the asset transfer in a true sale scenario under the Securitisation Law

In accordance with the provisions of the Securitisation Law, the assignment of an existing receivable to a securitisation undertaking becomes effective between the parties and against third parties as from the moment the assignment is agreed on unless the contrary is provided for in such agreement. The receivable assigned to a securitisation undertaking becomes part of its property as from the date, on which the assignment becomes effective. There exists, under article 1690 of the Luxembourg civil code, a requirement to notify the obligor of the assignment. However, a failure to comply with this requirement does not make the assignment void, neither between the parties nor as against third parties.

Further, the assignment of future claims to a securitisation undertaking is possible provided that the future claim can be identified as being part of the assignment at the time it comes into existence.

Type of securities to be issued under the Securitisation Law

The securities issued by a securitisation undertaking may be untranched, i.e. all noteholders' claims will rank *pari passu* or tranched providing for junior and senior noteholders. In accordance with the provisions of the Companies Law the securities issued by the securitisation undertaking can be issued in bearer, registered or dematerialised form. Further, in accordance with the law dated March 1, 2019, a securitisation undertaking may also issue security tokens, which can be held in the blockchain.

It should be noted that in the context of the issue of securities by a Luxembourg securitisation undertaking the articles 470-3 – 470-19 of the Companies Law applying to noteholder meetings can be contractually excluded and be replaced by more flexible terms agreed between the parties.

As a matter of principle, a securitisation undertaking may also issue securities governed by a law other than Luxembourg law.

Due diligence requirements under the EU Securitisation Regulation

The Securitisation Law does not provide for a regulatory obligation for investors to conduct due diligence before investing in a securitisation position.

However, if a transaction qualifies as a securitisation under the EU Securitisation Regulation, institutional investors are required to perform a minimum due diligence involving several verifications. Prior to holding the securitisation position, institutional investors must verify that the originator or original lender has established and actually applies "sound and well-defined criteria" in the granting of the credits, which constitute the underlying exposures and that it is compliant with the risk retention and transparency requirements imposed by the EU Securitisation Regulation for all qualifying securitisations.

The investors must also carry-out a due diligence assessment, which enables them to assess the risks involved with the securitisation. Once they are holding the securitisation position, institutional investors are also bound by ongoing due diligence requirements (i) to establish appropriate written procedures that are proportionate to the risk profile of the securitisation position, (ii) to perform stress tests on the cash flows, the collateral of the underlying and the liquidity of the sponsor, as the case may be, (iii) to ensure internal management reporting and (iv) to be able to demonstrate to the CSSF upon request that they have a comprehensive and thorough understanding of the securitisation position and exposures and of the credit quality of the sponsor.

Further, some additional due diligence obligations may arise as a result of an investment strategy or specific guidelines agreed between the investor and its clients on behalf of whom the investment is made. They may also arise as a result of the regulatory status of the investor itself.

Risk retention under the EU Securitisation Regulation

There are no risk retention requirements under the Securitisation Law. However, provided a securitisation transaction falls within the scope of the EU Securitisation Regulation, the originator, sponsor or original lender of such a securitisation must retain, on an ongoing basis, a material net economic interest in the securitisation transaction of no less than 5%.

Data protection in the context of securitisation transactions

In Luxembourg there are not any specific data protection principles applying to debtors in the context of a securitisation. However, as in other Member States, data protection is ensured by the direct application of Regulation (EU) 2016/679 of the European Parliament and of the Council of April 27, 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (the GDPR). In practice, where a securitisation implies a transfer of personal data to the securitisation entity, this issue is dealt with, on the one hand, by getting the consent of the data subject *ab initio*, when the receivable is created or, on the other hand, using a data trustee, where only those information which are strictly necessary to the securitisation issuer are communicated to it, until a default occurs under the receivable. This type of mechanism is often used in cases of securitisation of consumer receivables.

Outlook

The Luxembourg legal framework on securitisation is very sophisticated, flexible and recognised by the market. A very limited number of certain underlying assets may, however, require a more active management than a simple buy and hold strategy to address the common practice of international capital markets and securities transactions. In this respect, it seems quite likely that certain amendments to the Securitisation Law will be carried out to address these issues.

Contact us:

GSK Stockmann

44, Avenue John F. Kennedy

L-1855 Luxembourg

tel: +352 2718 02 00

web: www.gsk-lux.com