Securitisation in Luxembourg

Legal Framework

The law of March 22, 2004 on undertakings for securitisation, as amended, (the "Securitisation Law") was developed to provide an optional and favorable regulatory framework to Luxembourg based securitisation projects. This adaptable legal and tax framework provides ample flexibility with regard to the form of issuing vehicles and the various structures that can be used. It ensures an environment which protects investors’ interests while as the same time offering considerable flexibility in structuring such transactions.

The preparatory works to the Securitisation Law emphasize that one of the crucial elements of securitisation transactions is the isolation of securitised assets within a specific estate which must be exposed only to liabilities related directly to the holding or enforcement of the securitised claims. In this context, the initial purpose of the Securitisation Law was to create a legally secure and flexible environment for the securitisation of a wide range of assets.

The application of the Securitisation Law by a Luxembourg issuer remains optional which means that this issuer can choose whether to be governed by the Securitisation Law in addition to all the other legal and tax provisions applicable in Luxembourg. Given its multiple legal and tax advantages, incorporating a new securitisation vehicle under the Securitisation Law is strongly recommended. The Securitisation Law will only apply to securitisation vehicles located and with a registered office established in Luxembourg.

After more than ten years in existence, the Securitisation Law still provides one of the more favorable and stable environments in Europe in which to structure and run securitisation transactions. It is estimated that since 2004, more than 1,000 securitisation vehicles have been incorporated in Luxembourg and more than 3,000 transactions have been conducted through the creation of independent compartments.

Incorporating an SPV

The Securitisation Law allows securitisation vehicles to be set up either as: (i) a securitisation company; or (ii) as a securitisation fund managed by a management company. In practice however, securitisation funds are rarely used.

The main difference between securitisation companies and securitisation funds is that companies are opaque while securitisation funds are transparent entities.

In practice, and depending upon the transaction’s characteristics, the favored corporate forms for securitisation vehicles in Luxembourg are: (i) public limited liability company (société anonyme); followed by (ii) private limited liability company (société à responsabilité limitée). Furthermore, the securitisation company is usually set up as a so-called "orphan structure" by having its shareholder(s) legally separated from the Originator of the transaction. This legal
separation ensures the "bankruptcy remoteness" of the structure and allows a cheaper source of financing for the assets securitised.

**Features of the Securitisation Law**

**A broad scope of risks that may be securitised**

One of the most significant advantages of the Securitisation Law lies in the fact that any predictable stream of income or risk may be securitised. Furthermore, assets arising in the future may also be part of a securitisation transaction.

**Securitisation vehicles with multiple compartments**

The Securitisation Law also provides for the establishment of securitisation vehicles with multiple compartments, allowing the segregation or "ring-fencing" of assets and liabilities within each of the vehicle’s independent compartments. Using this structure, which involves the creation of a new compartment each time the securitisation vehicle enters into a new transaction, the investors and creditors whose claims arise with respect to a particular transaction will only have recourse to the assets of the specific compartment associated with that transaction, without any rights to claim over the assets of another compartment. This ability to create independent compartments within one securitisation undertaking is almost unique in continental Europe, and allows a significant reduction in the costs as well as the formalities for multiple or recurrent transactions initiated by the same Originator and/or arranger.

**Restriction on transfer of assets**

In order to provide additional protection to investors, the Securitisation Law provides that a securitisation vehicle can only sell its assets in accordance with the specific provisions of its constitutional documents.

"Limited Recourse", "Subordination" and "Non-Petition" provisions

The Securitisation Law specifically upholds these key provisions commonly found in the agreements documenting a securitisation transaction and which contribute to the bankruptcy remoteness of the securitisation vehicle.

**Securitisation Structures**

**Warehousing transaction**

The assets to be securitised may be pre-financed by third-party loans or intra-group financing subject to the following conditions: (i) the "warehousing phase" of the transaction should last for a limited period of time; and (ii) following this initial phase, the financing of the transaction should include the issuing of securities for a substantial amount.

"One-Tier" or "Two-Tier" transactions

The Securitisation Law expressly authorises the use of two-tier structures whereby a first vehicle (the issuing vehicle) is used to issue securities and assign the proceeds of the issue to a second vehicle (the acquiring vehicle) that will acquire the assets being securitised.
"True-Sale" or "Synthetic" securitisations

Both true sale and synthetic securitisation transactions (i.e. transactions where only the default risk of the portfolio of assets is transferred to the securitisation vehicle using derivative instruments, with the actual ownership of the portfolio remaining on the balance sheet of the Originator) are allowed under the Securitisation Law.

Tax

The tax advantages offered by the securitisation framework in Luxembourg are another major driving factor behind the selection of jurisdiction when structuring a new transaction.

Incorporation or amendment of the constitutional documents of a Luxembourg registered securitisation vehicle is limited to a fixed €75 registration fee.

Securitisation companies are fully liable to corporate income tax as are all companies registered under the same corporate form in Luxembourg. However, commitments assumed vis-à-vis the investors and any other creditor by securitisation companies are considered to be fully tax-deductible business expenditures (regardless of whether the securities issued to investors take the form of shares, beneficiary unit, notes, bonds, or another form). As a result, the tax impact for securitisation companies should allow the tax neutrality of the transaction.

Securitisation funds are also exempted from corporate income tax and subscription tax.

Dividend distributions made by a securitisation vehicle are exempt from withholding tax. Interest payments are also exempt from withholding tax, with the exception of withholding tax that may be levied on certain interest payments falling under the European Savings Directive.

Securitisation companies (as opposed to securitisation funds) are as a matter of principle fully entitled to benefit from the double tax treaties that Luxembourg has entered into.

Finally, securitisation vehicles are exempt from net wealth tax.

Regarding VAT, management services received by a securitisation vehicle incorporated in Luxembourg are expressly exempted. Securitisation undertakings are generally not required to register for VAT with the Luxembourg administration except where they are in receipt of taxable services from abroad, such as legal or accounting services.

Accounting treatment

Securitisation companies registered in Luxembourg are subject to all the accounting rules applicable to commercial companies. Furthermore, where multiple compartment have been established, a specific individual presentation for each compartment should be prepared within the financial reports.

Securitisation funds will be subject to the specific accounting regime applicable to Fonds Commun de Placement (i.e. collective investment schemes existing under a contractual form).

The Securitisation Law also requires the appointment of an external auditor for both forms of securitisation vehicle.
Supervisory and regulatory concerns

Only securitisation vehicles which fulfil the cumulative conditions of "continuously issuing securities to the public" (i.e. proceed with more than three issues per year to investors that do not qualify as "professional investors") will be subject to the regulation of the Luxembourg financial regulator (Commission de Surveillance du Secteur Financier, or "CSSF").

Securitisation vehicles regulated by the CSSF should submit for prior approval to the CSSF: (i) their constitutional documents; (ii) information about their administrative, management and supervisory bodies; and (iii) details of direct or indirect shareholders who have the ability to exercise significant control. Furthermore, financial information should be disclosed to the CSSF on a periodic basis.

Securitisation vehicles incorporated in Luxembourg and subject to the Securitisation Law are out of the scope of the EU Directive on Alternative Investment Fund Managers provided that: (i) they do not securitise loans originated by themselves; or (ii) synthetic transactions only concern the securitisation of credit-related risks. Furthermore, and irrespective of the assets securitised, Luxembourg securitisation vehicles remain out of the scope if: (a) they have been financed through the issue of debt instruments; or (b) they are not managed following a defined investment policy.

Since securitisation undertakings commonly enter into different types of derivatives contract, rules derived from the European Market Infrastructure Regulation ("EMIR") may be applicable to them. However, due to the ability to create independent compartments, Luxembourg-based are able to mitigate some of the constraints resulting from EMIR (for example, the threshold that must be reached in order to trigger the legislation's clearing and risk mitigation obligations should be calculated at the level of each compartment, rather than at the level of the whole vehicle).

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