Luxembourg Securitisation Vehicles

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Securitisation transactions can be implemented under common law provisions or within the scope of the Luxembourg law of 22 March 2004 on securitisation (the Securitisation Law). This summary focuses on securitisations subject to the Securitisation Law.

What is a Securitisation Vehicle?

A securitisation vehicle (**SV**) is a securitisation undertaking which 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[1].

A securitisation may be carried out by a single SV or through two distinct entities, the first one acquiring all or part of the securitised risks (the **Acquisition Vehicle**) and the second one issuing securities financing the acquisition of the securitised risks (the **Issuing Vehicle**)[2].

Each such undertaking qualifies as an SV under, and can opt to be governed by, the Securitisation Law.

Which risks can be securitised / What activities can be undertaken by an SV?

Traditional Securitisation Activities

An extremely wide range of assets can be securitised, such as commercial loans, mortgage backed loans, commercial papers, consumer credits, non-performing loans, commodities, income from operating businesses and, more generally, any asset which has a certain value and/or a predictable future income, as well as any risks attached thereto, provided that the securitised risks originate exclusively from assets, receivables or obligations assumed by, or inherent to the activities of, third parties.

An SV shall not engage into any activity for its own account, provided that:

Loan Origination

An SV may originate loans (or acquire partially drawn credit lines or revolving facilities on the secondary market) in the limited circumstances where:

- it does not use funds collected from the public to finance credit activities for its own account, and
- its investors are (as of the date of issuance of securities) well informed about:
  - The underlying assets securing the service of the debt and its repayment;
  - The borrowers, and/or method of determining eligible borrowers, and
  - The essential terms and conditions of the loans to be originated, such that the credit risks and predictable return of its credit activities can be properly appraised by its investors[3].

Holding of Participations

An SV may hold shares and/or funds' units provided that it does not actively manage the issuing entities or otherwise interfere in their management and exclusively acts as their financial sponsor.

No Active Management of the Securitised Assets

As a general principle, an SV shall not act as an entrepreneur; its role shall be limited to the administration of financial flows and exclude any kind of active management bringing a further layer of risks to its securitisation activities, whether directly or through delegation to an agent[4].

This does not in itself preclude a dynamic management of the securitised assets of an SV, for example to change an asset or portfolio of assets affected by specific credit risks, or to increase the performance. The change of some of the assets shall however not aim at taking advantage of short-term market fluctuations and/or

[1] Article 1 (1) of the Securitisation Law.
[2] Article 1 (2) of the Securitisation Law.
[3] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, p. 7.
[4] *Ibid*., pp. 10-11.

become a continued renewal of the portfolio of securitised assets to increase its value[5].

What are the rules of enforceability and perfection of the transfer of the securitised assets?

An SV can acquire and assign present and future claims or other assets or risks in one or several times or on a continuous basis, subject to any limitation in its articles of association or issuing documentation, as applicable[6]. The issuing documents must further explain by whom and how decisions to assign the SV's assets can be taken.

Where an SV acquires or assigns claims, the governing law to the assigned claim determines its assignability, the relationship between the assignee and the debtor, the conditions under which such assignment can be invoked against the debtor and whether the debtor's obligations have been discharged. The conditions of enforceability of the assignment towards third parties are determined by the laws of the State of the assignor[7].

Notwithstanding any contractual restrictions to the assignability of a claim, its assignment is enforceable against the debtor if (i) he consented thereto, (ii) the assignee could not be aware of the transfer restrictions or (iii) each time the assignment concerns monetary claims[8].

Unless otherwise agreed, an existing claim is validly assigned and such assignment is enforceable towards third parties as from the date of the assignment agreement[9]. The effective assignment of a future claim is subordinated to it coming into existence, but is then effective between the assignor, the assignee and any third parties as from the date of the assignment agreement, provided that it could be identified or identifiable at the time the assignment agreement was entered into[10]. Any such claim forms part of an SV's estate as from its effective assignment, and such assignment cannot be re-qualified by the mere fact that the SV committed to sell such a claim back[11].

How can an SV be financed?

Issuance of Securities

An SV must be financed by the issuance of Luxembourg or foreign law governed securities (*valeurs mobilières*) whose value or yield will depend on the risk assumed, whether through equity or debt, without having to comply with any specific debt-to-equity ratio[12].

The *Commission de Surveillance du Secteur Financier* (the **CSSF**) takes position that the securities that can be issued by an SV shall either (i) qualify as securities (*valeurs mobilières*) under their expressed governing law or (ii) constitute securities (*valeurs mobilières*) within the meaning of Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (**MiFID**). The shares issued by an SV incorporated under the form of a private limited liability company (*société à responsabilité limitée*) qualify as securities within the meaning of the Securitisation Law[13].

The securities may be issued in registered, dematerialised or bearer form, subject to the limitations arising of the choice of corporate form adopted by the SV. They may be tracking a specific asset, a pool of assets, or a whole compartment[14], or otherwise grant limited recourse to an underlying asset or pool of assets.

The issuing documentation of the securities or the management regulation can provide that an SV may issue several tranches of securities corresponding to different profiles of risks, with most senior tranches having priority of payment on the cash flow deriving from the securitised assets, and junior, mezzanine or other subordinated tranches assuming the highest level of risks and offering better yield or interest rates.

Temporary Financing

An SV may further have recourse to temporary bridge financing for the acquisition of risks or assets to be securitised, pending the issuance of linked securities to its investors, or in the form of liquidity financings, to bridge payment of accrued yield falling due on issued securities pending cash flows originating from the securitised assets[15].

[5] *Ibid*., p. 7.
[6] Article 54 of the Securitisation Law.
[7] Article 58 of the Securitisation Law.
[8] Article 57 of the Securitisation Law.
[9] Article 55 (1) of the Securitisation Law.
[10] Articles 55 (2) and (3) of the Securitisation Law.
[11] Article 56 (1) of the Securitisation Law.

[12] COURET Alain ; *PRÜM André; Les axes directeurs de la loi sur la titrisation in La Titrisation* (dir. PRÜM André), Anthemis, 2008, p. 18.
[13] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, pp. 9-10.
[14] COURET Alain ; *PRÜM André; Les axes directeurs de la loi sur la titrisation in La Titrisation* (dir. PRÜM André), Anthemis, 2008, p. 19.
[15] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, p. 9.

Leverage

An SV may leverage its investments to improve its investors' return provided that any associated risks are disclosed to the investors. The leverage shall in any case remain limited and ancillary to the financing of the acquisition of the securitised assets out of the proceeds of the linked issued securities[16].

Collateral & Guarantees

An SV can only grant security interests over its assets or guarantees of any nature to secure (i) claims from its investors or their representatives, (ii) claims arising of its commitments for the purpose to have such assets securitised, or (iii) if such SV acts as an Acquisition Vehicle, the connected claims of the Issuing Vehicle.

Any guarantee or security interests granted in breach of this rule will *ipso jure* be null and void[17].

What are the specific rules that apply to SVs and their operations towards insolvency regulations?

Acquisition of assets

An SV which acquires a future claim will be, upon its coming into existence, considered as the owner of that claim as from the date of the agreement on the transfer of such claim, notwithstanding the opening of an insolvency proceeding against the assignor since that date[18].

If the assignor or the person in charge of the debts' recovery for the account of an SV is subject to an insolvency proceeding, an SV shall be entitled to claim any sums collected on its behalf prior to the opening of such proceeding, without the other creditors having any rights to such amounts[19].

Securitisation of assets

Any mortgage or security interests granted by an SV on securitised assets after the date of its cessation of payments will not be invalidated on the ground that such a security right secures pre-existing debts of the SV as long as such a security right is granted at the latest on the date of issuance of the secured securities or of the conclusion of the agreements secured by such security rights[20].

Issuance and repayment of securities

The conditions of issuance and repayment of securities issued by an SV are binding upon it and the investors and are effective against any other person even if the SV is subject to any insolvency proceeding affecting creditor's rights, provided that no prejudice is born to the rights of the creditors of the SV who did not consented thereto[21].

Fiduciary representation

The fiduciary agent in charge of representing the investors and creditors' interests may accept, take, hold and exercise all guarantees and receive all payments on their behalf in deviation from the main insolvency regulations[22].

To this respect, any security interests may be granted and/or all payments related to matured and un-matured claims of the SV may be made to the fiduciary agent after the date of cessation of payments of an SV.

Additionally, an SV may transfer to the fiduciary agent all or part of its rights and actions arising from a contract entered into with a third party despite the insolvency proceeding[23] and more generally, all acts and payments towards the fiduciary agent affecting the other creditor's rights shall be permitted, irrespective of the date on which they have been made.

Which tools are available to organise the bankruptcy remoteness of an SV?

The Securitisation Law offers the possibility to use different mechanisms in order to segregate the securitised assets from any insolvency risks of an SV.

Most of these mechanisms may be provided for by contractual arrangements between investors, creditors, the SV and any other involved party.

Non seizure of the assets

Investors and creditors may contractually waive their rights to seize the assets of an SV[24].

Non petition clause

Investors and creditors may contractually waive their right to initiate any insolvency proceeding against an SV[25].

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16 *Ibid.*
17 Article 61 (3) of the Securitisation Law.
18 Article 55 (3) of the Securitisation Law.
19 Article 61 (2) of the Securitisation Law.
20 Article 61 (4) §2 of the Securitisation Law.
21 Article 65 (1) of the Securitisation Law.
22 Article 71 (2) of the Securitisation Law.
23 Article 72 of the Securitisation Law.
24 Article 64 (1) of the Securitisation Law.
25 *Ibid*.

This clause protects an SV against the actions of anyone who could have, for instance, an interest in opening a bankruptcy proceeding against the vehicle.

Such provisions may be included in its constitutional documents, and will then be enforceable towards the investors and any third parties.

Subordination clause
Investors and creditors may subordinate their right of payment to the prior payment of other creditors or other investors[26].

Limited / Non-recourse clause
Investors and creditors may limit their financial recourse against an SV to the amount of proceeds received by the vehicle from the related underlying assets financed by such investors / creditors (*limited recourse clause*)[27].

Investors and creditors may also waive their financial recourse against an SV for a temporary period. For instance, if a payment of yield is in default, the investor may agree to wait for payment and not initiate any legal proceedings against the vehicle, as the situation is known and/or temporary (*non-recourse clause*).

Compartmentalisation
A particularly useful tool in order to organise the bankruptcy remoteness of an SV is the possibility to create several compartments within the same entity, in order to allow each compartment to correspond to a distinct pool of assets financed by distinct securities.

The sole requirement for using this mechanism is that the constitutional documents of the SV should expressly authorise the management to create such compartments[28].

The compartments allow a pool of assets and corresponding liabilities to be managed separately, so that the performance of one compartment shall not be impacted by the risks and liabilities of the other compartments.

Therefore, each compartment could be treated as a separate entity performing distinct transactions so that, as a result, the assets of a compartment are exclusively available to satisfy the rights of investors in relation to that compartment and the rights of creditors whose claims have arisen in connection with the creation, the operation or the liquidation of that compartment[29].

This means that, at the opposite, no recourse shall be possible against the assets allocated to other compartments in case that their respective claims have not been fully satisfied.

This mechanism also offers the possibility for an SV to issue several types of securities with different value, yields and redemption terms depending on the level of risks associated to the assets of each compartment[30].

Finally, each compartment could be liquidated separately or be subject to any bankruptcy proceeding without having any impact on the SV and the other remaining compartments[31].

What is the difference between a true sale securitisation and a synthetic securitisation?

In a *true sale* securitisation, an SV acquires the legal and beneficial ownership of loans or other receivables from the originator, out of the proceeds of the issuance of securities whose repayment is linked to the cash flows generated from the acquired assets. The securitised assets are removed from the balance sheet of the originator who obtains cash in consideration thereof.

In a *synthetic* securitisation, an SV acquires the risks attached to underlying assets through derivatives or guarantees, hence creating new financial assets. The legal and beneficial ownership of the assets remains with the originator, who in fact acquires any kind of credit risk protection in consideration for the payment of swap premiums[32]. The amount payable by an SV to the originator is usually calculated by reference to the loss in value that affects the underlying portfolio of assets. The counterparty risks may be immediately funded by the investors in the SV (e.g. as deposit or collateral) or remain as undrawn commitments of the SV against its investors. Any securitisation transactions governed by the Securitisation Law falls out of the scope of the insurance sector law[33].

What type of structures may be used as an SV?
An SV may take the form of:

[26] *Ibid*.
[27] DUPONT Philippe, *Mécanismes particuliers de protection contre la faillite in La Titrisation* (dir. PRÜM André), Anthemis, 2008, p. 68.
[28] Article 5 of the Securitisation Law.
[29] Article 62 (2) of the Securitisation Law.
[30] Article 63 (1) of the Securitisation Law.
[31] Article 33 of the Securitisation Law.
[32] COURET Alain ; *PRÜM André; Les axes directeurs de la loi sur la titrisation in La Titrisation* (dir. PRÜM André), Anthemis, 2008, p. 12.
[33] Article 53 (3) of the Securitisation Law.

- a **private limited liability company** (*société à responsabilité limitée*) ;
- a **public limited liability company** (*société anonyme*);
- a **partnership limited by shares** (*société en commandite par actions*); or
- a **cooperative organised as a public limited company** (*société coopérative organisée sous forme de société anonyme*)[34].

The securitisation companies will in substance be subject to the same applicable legal regime as for any ordinary commercial companies, with the additional benefit of an advantageous regime on any applicable stamp duties[35], the absence of any internal auditor, to which is substituted the need for an independent auditor (*réviseur d'entreprise*)[36] and the exoneration to produce German or French translations of English documents submitted to registration formalities[37].

An SV may also be incorporated under the form of a fund, which will not have the legal personality and will be represented towards third parties by its management company (*société de gestion*). The securitisation fund may further be set up under a fiduciary arrangement, whereby the assets are held by a fiduciary agent for the account of the investors[38].

How can the investors' interests be represented?

The Securitisation Law provides that provisions applicable to bondholders' representation may also apply to the investors and creditors within the context of a securitisation transaction[39], so that one or several persons may be designated in order to represent their collective interests.

This is also possible to organise a representation by an authorised fiduciary representative established in Luxembourg in charge of managing their interests, and specifically:

- Accepting and exercising all guarantees on the securitised assets and receiving all payments on behalf of the investors/creditors;
- Acquiring from an SV all or part of its rights and actions from a contract entered into with a third party;
- Acting as liquidator on behalf of the investors / creditors in case of voluntary or compulsory liquidation of an SV or of one of its compartments, and
- More generally, doing all acts in the name and on behalf of the investors / creditors within the limits of the powers conferred to it and without the obligation to disclose their respective identities[40].

This is finally possible to appoint a trustee governed by foreign law and acting for the benefit of the investors / creditors, provided that the terms of this representation are defined in the agreements relating to the issuance of securities[41].

When are the activities of an SV regulated?

Only the SV issuing securities to the *public* on a *continuous* basis must be regulated and supervised by the supervisory authority of the CCSF to carry out their activities[42]. According to the CSSF, i) securities are not alleged to be issued to the public if they are issued with a minimum nominal value of EUR 125,000.- each and ii) an SV will not be considered to issue such securities on a *continuous* basis if it does not make more than three issuances per year[43].

For multi-compartments SVs, this threshold is determined at the level of the SV on a consolidated basis and not at the level of each compartment.

In case of cross-border structure, where the Acquisition Vehicle is located in Luxembourg and the Issuing Vehicle abroad, the CSSF considers that the Acquisition Vehicle shall not be subject to the authorisation requirement, even though the foreign Issuing Vehicle issues securities to the public on a continuous basis from a Luxembourg law perspective[44].

[34] Article 4 (1) of the Securitisation Law.
[35] Article 27 (2) of the Securitisation Law.
[36] Article 48 (1) of the Securitisation Law.
[37] Article 52 (2) of the Securitisation Law.
[38] Article 14 of the Securitisation Law.
[39] Article 66 (1) of the Securitisation Law.
[40] See Title IV, Chapter 2, Section 1 of the Securitisation Law on the rights and powers of fiduciary-representatives.
[41] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, p. 12.
[42] Article 19 of the Securitisation Law.
[43] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, p. 4.
[44] *Ibid*., p. 3.

The prudential supervision exercised by the CSSF aims to ensure the fulfilment by the regulated SVs of their statutory obligations under the Securitisation Law as well as the respect of their contractual obligations towards the investors and any third parties[45].

Although unregulated SVs are not required to appoint a custodian bank, regulated ones shall transfer the custody of their liquid assets and securities to a credit institution established in Luxembourg[46].

In any case, and irrespective of the fact whether a SV is regulated or not, the annual accounts and financial statements of all SVs shall be audited each year by one or more auditors (*réviseur d'entreprises*)[47].

When is an SV subject to the Prospectus Law?[48]

In principle, no offer of securities to the public shall be made within the territory of Luxembourg without prior publication of a prospectus approved by the CSSF pursuant to one of the three regimes defined therein:

- Offer of securities to the public and admission to trading of securities on a regulated market subject to the Prospectus Directive (the ordinary regime);
- Offer to the public and admission to trading on a regulated market outside the provisions of the Prospectus Directive (the simplified regime); and
- Admission of securities to trading on a Luxembourg market not being on the list of regulated markets established by the European Commission (the special Luxembourg regime dealing, for example, with admission to the EuroMTF of the Luxembourg Stock Exchange).

However, there are an important number of exceptions and exemptions regarding the application of the provisions of the Prospectus Law.

The Prospectus Law does not apply and the issuer is exempted to publish a prospectus in the following cases (this list being non-exhaustive):

- **Qualified investors**: an offer of securities addressed solely to qualified investors as such term is defined in the Prospectus Law, i.e. setting out a list of professional clients or recognised as eligible counterparties in accordance with the MiFID[49].
- **Small offers**: i) an offer of securities addressed to fewer than 150 natural or legal persons (being non-qualified investors) per Member State; (ii) an offer of securities addressed to investors who acquire securities for at least EUR 100,000, per investor, for each separate offer; iii) an offer of securities with denominations per unit for at least EUR 100,000, and iv) an offer of securities in all EU member States where the total consideration for the offer is less than EUR 100,000, calculated over a period of 12 months.

  It is noted that any subsequent resale of securities which have been previously subject to one of the exemptions above shall be regarded as a separate offer, i.e. it should be verified if the new offer meets the criteria for an exemption.

- **Employee share schemes**: securities offered, allotted or to be allotted to employees or directors by their employer (or by an affiliate undertaking) provided i) this employer has its head office/registered office in a EU member State and ii) a document of information on this offer is available to the interested parties.

What are the residual reporting obligations of an SV?

An SV shall comply with reporting obligations provided for in Regulation ECB/2013/40 of the European Central Bank of 18 October 2013 (**the 2013 ECB Regulation**) which have been completed in Luxembourg by Circular 2014/236 of the Luxembourg Central Bank of 25 April 2014.

Pursuant to the 2013 ECB Regulation, all SVs, irrespective of whether they are submitted to the Securitisation Law or not, shall provide the European Central Bank (**ECB**) with adequate statistics on their financial activities.

[45] Commission de Surveillance du Secteur Financier, *Rapport annuel 2007*, p. 100 et seq., spéc. p. 106 et seq.

[46] Article 22 of the Securitisation Law.

[47] Article 48 (1) of the Securitisation Law.

[48] Luxembourg law of 10 July 2005 on prospectuses for securities (as amended) (the **Prospectus Law**) which has transposed mainly the Directive 2003/71/EC on the prospectus (as amended and supplemented) (the **Prospectus Directive**).

[49] Article 24 of the MiFID refers to eligible counterparties mainly as: investment firms, credit institutions, insurance companies, UCITS and their management companies, pension funds and their management companies, other financial institutions authorised or regulated under European community legislation or the national law of a EU member State, undertakings exempted from the application of the MiFID under Article 2(1)(k) and (l), national governments and their corresponding offices including public bodies that deal with public debt, central banks and supranational organisations.

In practice, any Luxembourg SV shall inform the Luxembourg Central Bank (**LCB**) of its existence within one week as from the date of the beginning of its activities, which will in turn inform the ECB[50].

Additionally, an SV shall provide the LCB with data on outstanding amounts, financial transactions and write-offs/write-downs on its assets and liabilities on a quarterly basis[51]. Derogations may be granted notably if this data can be established in accordance with minimum statistical standards as detailed in the 2013 ECB Regulation or from any other statistical, public or supervisory data sources[52].

In addition, the LCB may decide to grant derogations provided that the coverage rate exceeds 95% of the aggregated assets of all Luxembourg securitisation vehicles[53].

An SV which benefits from derogation shall however report their annual financial statements to the LCB if they are not available from public source, i.e. published in the Luxembourg trade and companies register, within seven months following year-end[54].

Finally, since July 2016, the ECB and LCB have increased their surveillance of the reporting obligations compliance. Any breach of the minimum reporting requirements as well as incorrect, incomplete or delayed reporting and, more generally, insufficient degree of diligence and/or cooperation with the relevant central bank will be recorded in a database and various sanctions could be imposed to this respect.

When shall the SVs be subject to the AIFM Law?

Luxembourg law of 12 July 2013 on alternative investment fund managers (the **AIFM Law**) provides a regulatory and supervisory framework for managers of an Alternative Investment Fund (the **AIF**) and notably defines rules regarding the marketing of AIF and the substance and organisation of their managers.

The AIFM Law shall not apply to securitisation special purposes entities (**SSPE**), whose sole purpose is to carry out securitisation operations[55] and, in general, to all SVs which only issue debt instruments[56] and/or are not managed in accordance with "a defined investment policy"[57].

Subject to criteria set out in the ESMA guidelines[58], SVs which issue structured products offering synthetic exposure to assets (equities, commodities or indices thereof), and acquire underlying assets and/or enter into swaps with the sole purpose of covering the payments obligations arising from the issued structured products shall not be considered to be managed in accordance with "a defined investment policy"[59].

According to the clarifications provided by the European Central Bank[60], an SV issuing collateralised loan obligations would be considered as being engaged in securitisation transactions and, consequently, shall not be subject to the AIFM Law.

On the contrary, entities which primarily act as "first" lenders, i.e. originating new loans, shall not be considered as being engaged in such transactions and will fall within the scope of the AIFM Law accordingly[61].

What is the impact of the EU Regulation adopted on 26 October 2017?

The European Parliament adopted on 26 October 2017 a regulation on securitisation (the **New EU Regulation**)[62] the purpose of which is to (i) improve the control of systemic risks in securitisation operations and (ii) ensure that the European Union works as a single market for simple, transparent and standardised securitisations (the

[50] Article 3.2 of the Circular 2014/236 of the Luxembourg Central Bank of 25 April 2014.

[51] Article 4 § 1 of the 2013 ECB Regulation.

[52] Article 5 of the 2013 ECB Regulation.

[53] *Ibid.*

[54] Article 5 § 3 of the 2013 ECB Regulation and Article 4.2 of the Circular 2014/236 of the Luxembourg Central Bank of 25 April 2014.

[55] Article 2 (2) of the AIFM Law.

[56] European Commission, *Questions on Single Market Legislation / Internal Market ; General question on Directive 2011/61/EU* ; ID 1169, Scope and exemptions.

[57] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, p. 15.

[58] *ESMA Guidelines on key concepts of the AIFMD, ESMA/2013/611* of 13 August 2013, p. 7.

[59] Commission de Surveillance du Secteur Financier, *Frequently Asked Questions Securitisation*, p. 15.

[60] European Central Bank, *Guidance note on the definitions of "financial vehicle corporation" and "securitisation" under Regulation ECB/2008/30*, point 4.1, p. 3.

[61] *Ibid.*

[62] European Parliament legislative resolution of 26 October 2017 on the proposal for a regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

STS), in order to facilitate and support cross-border transactions[63].

The New EU Regulation shall apply as from January 1st, 2019 and to securitisation in which the securities are issued on or after this date (the **Effective Date**)[64]. However, the STS designation will be available for use with securitisations issued before the Effective Date provided that the New EU Regulation's requirements are satisfied.

General framework applicable to any securitisation transactions

As from the Effective Date, major changes can be described as follows:

- The originators, sponsors or original lenders will have to retain an economic interest in the securitisation of not less than 5%[65];
- Institutional investors will be subject to proportionate due-diligence requirements ensuring that they properly assess the risks arising from all types of securitisation, for the benefit of the ultimate investors[66];
- The originator, sponsor and SVs will be subject to extended obligations of information towards investors[67];
- Re-securitisations will be prohibited in order to improve transparency on exposure, subject to limited derogations[68]; and
- Criteria for credit-granting will be straighten in order to avoid poor and weak underwriting policies from original lenders to ascertain that credit-granting is based on a thorough assessment of the obligor's solvency[69].

Specific framework for STS securitisations

All SVs will be able to request the European Securities and Markets Authority (**ESMA**) to be listed as an SV which performs STS, subject to the fulfilment of specific risk-sensitive criteria, offering investors a pledge of confidence and reliability.

The list of STS will be published on the official website of ESMA and thus available to any potential investors. STS will be certified by an authorised third party.

The main criteria for an SV to be qualified as STS could be summarised as follows:

- The SV shall perform true sale securitisation[70];
- The SV shall not knowingly invest in defaulting underlying assets nor create exposure to debtors or guarantors that have already been in financial difficulties (e.g. insolvency proceedings) to the best of the originator's knowledge[71];
- The debtors of the securitised assets shall have started the repayment of their debt (except bullet repayment or maturity of less than one year) [72];
- The transfer of the underlying assets shall not be subject to clawback provisions in case of seller's insolvency[73];
- The SV shall constitute homogeneous pools of assets in terms of asset type, taking into consideration *inter alia*, their contractual, credit-risk and prepayment characteristics[74];
- The SV shall not enter into derivative contracts and shall ensure that the pool of underlying assets does not include any derivatives assets[75] (other than for hedging currency exchange or interest rate risks);
- The SV shall procure that the originator makes available to all potential investors any data on static and dynamic historical default and loss performance for substantially similar exposure to those being securitised, for a period of at least five years and a sample of underlying assets shall be audited by an independent party[76]; and

[63] In addition, the European Parliament adopted, on the same day, the new securitisation prudential regulation which sets out the framework under which certain institutional investors (e.g. banks and investment firms) can potentially benefit from more favourable regulatory capital treatment for STS securitisation exposure.

[64] In the meantime, the European Supervisory Authorities shall draft, negotiate and agree all related technical standards that will provide details on how the legislation will be implemented.

[65] A multiple application of the retention requirement is not necessary, so that only the originator, the sponsor or the original lender may be subject to this requirement - Article 6 (1) of the EU Regulation on Securitisation.

[66] Article 5 (1) of the EU Regulation on Securitisation.

[67] Article 7 of the EU Regulation on Securitisation.

[68] Article 8 of the EU Regulation on Securitisation.

[69] Article 9 of the EU Regulation on Securitisation.

[70] Article 20 – 1. of the EU Regulation on Securitisation.

[71] Article 20 – 11. of the EU Regulation on Securitisation.

[72] Article 20 – 12. of the EU Regulation on Securitisation.

[73] Article 24 – 1. and 2. of the EU Regulation on Securitisation.

[74] Article 20 – 8. of the EU Regulation on Securitisation.

[75] Article 21 – 2. of the EU Regulation on Securitisation.

[76] Article 22 – 1. of the EU Regulation on Securitisation.

- Finally, the STS designation will be available only where the issuer, originator and sponsor are established in the EU, which will automatically have an impact for all UK issuers, originators and sponsors post-Brexit.

Delegation of supervision and sanctioning powers to competent authorities

All Member States shall designate one or more competent authorities in order *inter alia*, to:

i. Ensure compliance of the originators, original lenders and SVs with the obligations of risk retention, transparency, clear processes for credit-granting and prohibition of re-securitisation[77];

ii. Supervise compliance of originators, sponsors and SVs with provisions relating to the STS standards requirements[78]; and

iii. Supervise compliance of institutional investors with due-diligence requirements[79].

The New EU Regulation leaves a certain level of liberty to the Member States to define appropriate administrative and/or pecuniary sanctions for SVs and/or their management for breaching their legal obligations[80].

Such sanctions will be published by the competent authorities on their respective official websites[81] and all administrative sanctions imposed against SVs notified as being STS should further immediately be notified to ESMA for their inclusion on the STS notifications lists allowing investors to be informed about such sanctions[82].

Taxation

Corporate taxation

An SV company is fully subject to corporate income tax (**CIT**) and municipal business tax (**MBT**) on its worldwide income. For the fiscal year 2018, the CIT rate is 19.26% (including the 7% solidarity surcharge for the employment fund) and the MBT rate is 6.75% in Luxembourg city.

An SV company benefits from a specific tax deduction regime which aims to achieve tax neutrality. Under such regime, any commitments to remunerate investors and other creditors, even if considered as a dividend from a legal point of view, are deductible for tax purposes. Therefore, typically an SV company has a taxable basis close to nil.

An SV company is subject to a minimum annual net wealth tax (**NWT**). If the sum of fixed financial assets, transferable securities and cash at bank of the SV company exceeds 90% of its total gross assets and EUR 350,000, the annual minimum NWT amounts to EUR 4,815. If the SV company does not meet these requirements, the minimum NWT varies between EUR 535 and EUR 32,100 depending on the SV company's total gross assets amount. To the extent that the assets of an SV company consist of at least 90% financial type assets, the annual minimum tax should amount to EUR 4,815.

As a company fully subject to tax in Luxembourg, an SV company should benefit from most of the double tax treaties (**Treaties**) concluded by Luxembourg and should also be entitled to the benefits of the European Directives (**EUD**).

If the SV is set up as a fund, it is considered as a tax transparent vehicle for Luxembourg tax purposes. As a result, it is not subject to CIT/MBT nor minimum annual NWT. A SV fund should in principle not be entitled to the benefits of the Treaties or EUD.

Withholding tax and non-resident taxation

Distributions and other proceeds allocated to its investors by an SV company/fund are not subject to Luxembourg withholding tax.

The taxation of capital gains realised by non-resident investors (those without a Luxembourg permanent establishment to which the interest of an SV company are allocable) are only taxable in Luxembourg if the disposal occurs within six months after the acquisition of the interest and the investors hold directly or indirectly a substantial interest in the SV company. An interest is considered as "substantial" when the investor alone (or with certain close relatives) holds or has held, during a five year period preceding the disposal, 10% of the interest of the SV company.

VAT

Management services provided to an SV are exempt from VAT.

[77] Article 29 – 4. of the EU Regulation on Securitisation.
[78] Article 29 – 5. of the EU Regulation on Securitisation.
[79] Article 29 – 1. of the EU Regulation on Securitisation.
[80] Article 32 – 2. c) of the EU Regulation on Securitisation.
[81] Article 37 – 1. of the EU Regulation on Securitisation referring to breaches of risk retention, transparency requirements and clear processes for credit-granting.
[82] Article 27 – 5. of the EU Regulation on Securitisation.

Other tax considerations

Some provision of the European Anti-Tax Avoidance Directive I & II[83], reflecting the OECD's base erosion and profit-shifting initiative should be implemented soon in Luxembourg law (including the limitation of interest deduction rules).

This new set of rules might potentially impact the Luxembourg tax regime of SV provided that SV are not carved out from the above expected new legal provisions. This will have to be carefully monitored.

[83] The European Anti-Tax Avoidance Directive I & II were adopted by the European Council respectively on 12 July 2016 and 29 May 2017.

Contact sheet

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