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The Rise of Luxembourg Securitisation Partnerships


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As the saying goes, statistics do not lie; people do. With 28.9% of all EU financial vehicles corporations being incorporated in Luxembourg[1] and a total of €395 billion in securitised assets in 2022,[2] Luxembourg confirmed its position as one of the leading jurisdictions when it comes to structured finance transactions. This success is largely due to a piece of legislation that was introduced almost two decades ago and which proved to be decisive when it comes to Luxembourg's success as a hub for the establishment of securitisation undertakings: the law of 22 March 2004 on securitisation (the "**Securitisation Law**"). On 9 February 2022, the Luxembourg Parliament (*Chambre des Députés*) adopted the bill of law number 7825 (the "**2022 Law**"), amending, among others, the Securitisation Law. With the aim of clarifying the existing legal framework and further adapting it to the expectations of the securitisation market, the 2022 Law introduced several amendments to the Securitisation Law, touching on the various stages of securitisation transactions. The amendments seek to address the evolving needs of the securitisation market by providing market participants with new structuring possibilities while retaining legal certainty and ensuring an efficient investor protection.

This contribution seeks to, firstly, outline the key amendments to the Securitisation Law brought by the 2022 Law (Chapter 1), before presenting the Luxembourg limited partnership regime, from which market participants can now benefit to structure their securitisation undertakings (Chapter 2).

The Modernisation of the Securitisation Law

The financing of securitisation undertakings

To achieve its objectives, on the financing side, the 2022 Law notably increased the possibilities for a securitisation undertaking to finance the acquisition of the underlying assets through the issuance of financial instruments (*instruments financiers*), as such term is defined in the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended, thereby increasing the scope of eligible instruments that can be issued by a securitisation undertaking. In addition, the 2022 Law introduced the possibility for securitisation undertakings to finance the entirety of the underlying assets through the contracting of loans, thereby aligning the Securitisation Law with the Regulation (EU) 2017/2402 of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the "**Securitisation Regulation**"), which does not distinguish between financial instruments and loans as financing tools.

According to the 2022 Law's parliamentary works, the loans that may be contracted by a securitisation undertaking comprise, irrespective of their accounting treatment, any kind of debt that gives rise to the obligation to reimburse the creditors, including instruments where such reimbursement obligation is dependent on the performance of the underlying assets, or the financial situation of the securitisation undertaking.

The 2022 Law also seeks to increase legal certainty, by clarifying the criteria used to determine whether a securitisation undertaking will be subject to supervision by the Luxembourg Supervisory Commission of the Financial Sector (*Commission de Surveillance du Secteur Financier*) (the "**CSSF**"). Indeed, securitisation undertakings are not subject to the CSSF's supervision unless they issue financial instruments (i) to the public, and (ii) on a continuous basis. The Securitisation Law was, however, mute on what such criteria would capture, and one had to refer to the CSSF's frequently asked questions to obtain guidance. In order to remedy this situation, the 2022 Law included the CSSF's guidance in the Securitisation Law, while aligning it with the latest changes to the European prospectus regime. Accordingly, the Securitisation Law now makes it clear that financial instruments are deemed to be issued on a continuous basis should a securitisation undertaking issue financial instruments more than three times per year. In addition, an issuance of financial instruments will be deemed to be made to the public where the issuance: (i) is not made to professional clients, as such term is defined in article 1(5) of the law of 5 April 1993 on the financial sector, as amended (which corresponds to the definition of professional clients for MiFID II purposes); (ii) relates to financial instruments having denominations of less than €100,000; and (iii) is not made by way of private placement.

Management of the securitised assets

On the asset management side, the old regime was silent with respect to the possibility for a securitisation undertaking to actively manage the securitised assets. The CSSF had, however, taken the position that any management of securitised assets by a securitisation undertaking should be limited to a "prudent man" passive management. This restriction rests on the view that the nature of a securitisation activity requires that risks stem exclusively from the underlying securitised assets and not from any entrepreneurial or commercial activity of the securitisation undertaking. Departing from the old regime and with the intent of increasing legal certainty, the 2022 Law introduced the possibility for a securitisation undertaking or a third party (acting on behalf of such securitisation undertaking) to actively manage certain classes of assets. Any such active management will, however, be subject to two conditions, namely that the portfolio of assets being subject to active management be composed only of debt securities, loans, debt financial instruments or

receivables, and that the securitisation undertaking shall not be financed through the issuance of financial instruments to the public. This creates opportunities for actively managed collateralised loan obligations ("**CLO**") and collateralised debt obligations ("**CDO**") structures to be established in Luxembourg.

The 2022 Law also reformed the existing framework with respect to security interests and guarantees granted by securitisation undertakings. Under the old regime, securitisation undertakings were prohibited from granting security interests, unless they were granted in favour of their own investors and creditors. Any security interest granted in contravention of this rule was automatically null and void. If this restriction was designed to protect investors and ensure that third parties do not benefit from security interests over securitised assets, it in fact hindered financing arrangements, by requiring the adoption of alternative financing arrangements and complex cascading pledges structures. Under the new regime, securitisation undertakings are now able to grant security interests over their assets in order to cover their own obligations, but also those of any other person, as long as the secured obligations are related to the securitisation transaction at hand. It is also interesting to note the removal of the sanction of nullity for transactions that are not compliant with the newly relaxed security interest framework.

Additional corporate forms for securitisation undertakings

On the structuring side, in order to increase flexibility for market participants, the 2022 Law introduced four new legal forms in which a securitisation undertaking can be established, thereby catching up with developments in Luxembourg companies' law. These new legal forms are: (i) unlimited companies (*sociétés en nom collectif*); (ii) common limited partnerships (*sociétés en commandite simple*) ("**SCS**"); (iii) special limited partnerships (*sociétés en commandite spéciale*) ("**SCSp**"); and (iv) simplified public limited liability companies (*sociétés par actions simplifiées*).

These new legal forms consolidate the variety of legal forms that a securitisation undertaking may adopt, which, until the introduction of the 2022 Law, comprised public limited liability companies (*sociétés anonymes*), partnerships limited by shares (*sociétés en commandite par actions*), private limited liability companies (*sociétés à responsabilité limitée*), cooperative companies organised as public limited liability companies (*sociétés cooperatives organisées comme sociétés anonymes*) and securitisation funds (*fonds de titrisation*) without legal personality.

By allowing market participants to also structure securitisation undertakings in the form of limited partnerships (such as SCS and SCSp), the legislator effectively incorporated two highly successful Luxembourg vehicles.

While historically, initiators have resorted to companies with limited liability (notably private limited liability companies (*sociétés à responsabilité limitée*)), when looking to establish securitisation undertakings, there is a growing interest from the market for the more flexible structuring alternatives, such as securitisation limited partnerships.

The Luxembourg Limited Partnership Regime

To start with, the legal regime governing SCS and SCSp rests on the principle of contractual freedom (*principe de la liberté contractuelle*). It mainly contains suppletive rules, thereby allowing a level of flexibility akin to those of the popular Anglo-Saxon limited partnerships. It must be noted that the legal regimes governing the SCS and the SCSp are aligned with one another, as the Luxembourg legislator intended for those vehicles to be governed by similar rules.

One main feature distinguishes the SCS from the SCSp: while the former has legal personality, the latter does not. That being said, even if the SCSp does not have legal personality, this does not prevent it from operating as an entity with legal personality. Accordingly, the SCSp has its own registered office, acts in its own name and, for its own account (through the intermediary of its manager (*gérant*)), may issue partnership interests and debt financial instruments and contract loans.

For the purpose of this contribution, the rules pertaining to the SCS will be exposed, noting that due to the similarities between the SCS and the SCSp, these rules will be substantially applicable to the SCSp as well.

Establishment rules

An SCS will be established by a written contract, under private seal or notarial deed, between at least one limited partner (*associé commanditaire*) and one general partner (*associé commandité*) (the "**LPA**"). Only an extract of the LPA will be required to be published with the Luxembourg Register of Commerce and Companies (the "**RCS**"). Such extract will only touch upon specific points contained in the LPA, namely the corporate name of the partnership, the corporate names of the general partner(s), the corporate object of the partnership, the corporate name of any manager (*gérant*) and the duration of the partnership. Excluded from this extract are the identity of the limited partners, their commitments and contributions (*apports*) towards the partnership, as well as the rules on the allocation of profits and losses, decision-making or transfer of partnership interests. The identity of the limited partners, as well as their commitments and contributions, will be contained in a register held at the registered office of the SCS. It is important to note that such register can, in principle, be accessed by the partners of the partnership, unless the LPA provides otherwise. It is, accordingly, possible to increase or restrict access to the register contractually. This overall allows to retain a high level of confidentiality, which is often much appreciated by market participants.

An SCS comprises two types of partners, namely general partners (*associés commandités*) and limited partners (*associés commanditaires*). While the former are jointly liable with respect to the obligations of the SCS, on an unlimited basis, the latter are liable only up to the amount contributed or agreed to be contributed to the SCS.

Management rules

The management of an SCS can be undertaken by one or more managers (*gérants*) which can be, but are not necessarily, general partners. By contrast, limited partners cannot act as managers of an SCS. Rules with respect to the management of an SCS are flexible and the LPA will regulate the appointment and removal of the managers, which can be either natural or legal persons. Where no manager is nominated, the general partners will be deemed managers. In terms of responsibility, only the general partners are liable on an unlimited basis. Should the management of the SCS be entrusted to one or more managers that are not general partners, their liability will be limited to cases of negligence having arisen during the course of their mandate. Delegation of certain management functions is possible in certain circumstances. The managers will be able to bind the SCS towards third parties.

If general partners can act as managers of an SCS, management restrictions apply with respect to limited partners. Limited partners are prohibited from undertaking acts of management

relating to the SCS going further than "internal management acts". Limited partners are, accordingly, prohibited from undertaking "external management acts", which would capture acts undertaken by the limited partners with third parties. On the contrary, internal management acts undertaken within the SCS, remain possible. Based on the above distinction, the limited partners are allowed to: (i) exercise partners' rights; (ii) provide opinions and advice to the SCS, its affiliated entities or their respective managers; (iii) perform acts of control and supervision; (iv) grant loans, guarantees, securities or any other type of assistance to the SCS or its affiliated entities; and (v) grant authorisations to the managers as provided by the LPA for acts exceeding the managers' powers. Should limited partners have undertaken isolated external management acts (*actes sociaux isolés*), they will be jointly and severalty liable towards third parties for the obligations of the SCS to which they have participated in violation of the prohibition. Should limited partners have regularly engaged in the external management (*gestion externe*) of the SCS, they will be responsible for all obligations of the SCS, including the obligations of the SCS to which those limited partners have not contributed. Lastly, it should be noted that it is possible for a limited partner to act as the manager of a legal entity which in turn acts as manager of the SCS.

Voting rights, distributions and transfers of partnership interests

The flexibility of the Luxembourg limited partnership regime can also be illustrated by reference to rules applying with respect to voting rights, distributions and the transfer of partnership interests, in which a high level of contractual freedom is afforded, allowing initiators to tailor the LPAs to the needs of the partners.

Indeed, in terms of voting rights, the law only provides a default rule, stipulating that, should an LPA be silent as to voting rights, each partner will have voting rights in proportion of its interest in the SCS. Voting rights can, however, be modulated in the LPA, in order afford different voting rights to limited partners or grant a veto right to the general partners.

Similar rules apply with respect to distributions. Should the LPA be silent on the topic, distributions shall be shared among all partners in proportion of their partnership interest. Distributions can, however, be freely governed in the LPA, with the only constraint that no limited partner be entirely excluded from any participation in the profits or losses.

The default rule with respect to transfers of partnership interests provides that, where the LPA is silent, any transfer of limited partner interest requires the consent of the general partner(s). Any transfer of the general partner's interest will require the consent of the partners who deliberate in the manner provided for the amendment of the LPA. Parties are, however, free to deviate from these rules and to regulate transfers of interests in the LPA.

Financing of securitisation partnerships

Equity contributions to an SCS can be made in cash, in kind or in industry. Partnership interests, representing contributions to the SCS, may or may not be represented by securities. If partnership interests are not in the form of securities, they will be represented by partners' capital accounts (*comptes d'associés*).

An SCS can issue debt instruments. There are no minimum capital requirements to establish an SCS. In addition, an SCS does not have to comply with any debt/equity ratios. Accordingly, it is possible to establish a securitisation SCS with a minimum equity and to finance such vehicle through the issuance of debt financial instruments and/or the contracting of loans.

Compartmentalisation

The Securitisation Law allows for securitisation undertakings (including limited partnerships), to create one or more compartments, provided that this is authorised by the constitutional documents of the entity.

Each compartment corresponds to a distinct part of the assets and liabilities of the umbrella securitisation undertaking. Accordingly, compartments constitute protected cells that are not affected by the risks and liabilities of other compartments, including in the case of insolvency. The rights of investors and creditors alike, related to a specific compartment and created during the course of its establishment, existence and liquidation will be limited to the assets of such compartment, provided that the constitutional documents of the umbrella entity do not provide otherwise.

Compartmentalisation also allows for an umbrella securitisation undertaking to have multiple compartments governed by different terms and conditions or investment policies, with each compartment having distinct terms and/or investment policies. In such case, the constitutional documents of the umbrella entity must contain compartment specifications, outlining the terms and the investment policy of each compartment. The ability for an umbrella securitisation undertaking to segregate terms and policies is interesting from an issuance and financing perspective, as it allows for each compartment to issue different classes of equity and/or debt financial instruments, representing a different collateral and being governed by different terms, including with respect to their valuation, yields and redemption terms. In terms of management, even if management will sit at the level of the umbrella entity, each compartment may appoint its own collateral manager or servicer in relation to its underlying securitised assets. The autonomy of compartments also plays a role in their liquidation, as the liquidation of a compartment will not lead to the liquidation of the remaining compartment nor of the umbrella entity itself.

The 2022 law allows multi-compartments securitisation undertakings that are financed by equity to approve the balance sheet and the profit and loss statement of each compartment by virtue of the votes of such compartment's shareholders only, provided that such option is included in their constitutional documents. Similarly, the articles of association of a securitisation undertaking may provide that profits, distributable reserves and mandatory legal reserves of a compartment, are determined on a separate basis and without reference to the financial situation of the securitisation undertaking as a whole.

Annual accounts, audit and regulatory aspects

All securitisation undertakings (including securitisation partnerships established as SCS and SCSp) must prepare and publish annual accounts. The annual accounts and financial statements of all securitisation undertakings must be audited by one or more approved Luxembourg independent auditors (*réviseurs d'entreprises agréés*). In the case of a multi-compartments securitisation undertaking, each compartment must be separately detailed in the financial statements of the securitisation undertaking. Both regulated and unregulated securitisation undertakings are subject to reporting obligations to the Luxembourg Central Bank for statistical purposes.

On the regulatory front, it is important to note that certain securitisation undertakings (including securitisation partnerships established as SCS and SCSp) may fall within the scope of the Securitisation Regulation, if the securitised credit risk is

tranched. Should the Securitisation Regulation apply, a broad array of obligations will be imposed on the involved securitisation special purpose entities, originators, sponsors and investors (including obligations with regard to risk retention, due diligence, transparency and disclosure, restrictions on sale to retail investors, etc.).

In addition, given that securitisation undertakings (including limited partnerships) may raise capital from investors, it must be assessed whether the vehicle may be considered an alternative investment fund ("**AIF**") caught by the Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers, as amended (the "**AIFMD**") and the Luxembourg law of 12 July 2013 on Alternative Investment Fund Managers, as amended (the "**AIFM Law**"). However, the AIFMD and AIFM Law will not apply in relation to securitisation special purpose entities ("**SSPEs**") whose sole purpose is to carry out a securitisation within the meaning of the Regulation ECB/2008/30 of the European Central Bank of 19 December 2008 (as replaced by the Regulation ECB/2013/40). Indeed, it is the current view of the CSSF that, independently from their potential qualification as SSPEs (for the purpose of the AIFMD and the AIFM Law), securitisation undertakings that only issue debt instruments to the investors should not constitute AIFs.

Tax regime

Being transparent for Luxembourg tax purposes, SCS and SCSp are not subject to corporate income tax nor net wealth tax. However, Luxembourg imposes a municipal business tax on commercial businesses located in Luxembourg and, should such limited partnerships conduct or be deemed to conduct a commercial enterprise, their profits will be subject to a municipal business tax at a rate of 6.75% in Luxembourg – City (in 2023). For a limited partnership to conduct or be deemed to conduct a commercial enterprise would also impact its partners, as non-resident partners would be found to have a permanent establishment in Luxembourg and be subject to corporate or personal income tax, with respect to their share of the partnership's profit. Usually, securitisation undertakings in the form of SCS or SCSp governed by the Securitisation Law would not be considered to conduct a commercial enterprise, but an assessment on a case-by-case basis is necessary.

Tax-transparent SCS and SCSp should monitor the potential impact of the so-called "reverse hybrid rules" under ATAD 2, which apply as from tax year 2022.

Interest payments and profit distributions by SCS or SCSp governed by the Securitisation Law are not subject to Luxembourg withholding tax, subject to certain limited exceptions in the case of individual investors located in Luxembourg.

Conclusion

The Luxembourg legislator proved that it has been attentive to the market's needs and has, through the adoption of the 2022 Law, modernised the existing Securitisation Law, with the aim of affording the flexibility sought after by market participants, while retaining legal certainty and an efficient investor protection. Amongst the various novelties brought forward by the 2022 Law, the introduction of the Luxembourg limited partnerships as additional corporate forms to structure securitisation undertakings is likely to have an impact on Luxembourg's attractiveness as a hub for the establishment of securitisation undertakings. The flexible limited partnership regime, coupled with the contractual freedom, has afforded market participants with the increased structuring possibilities that they are pursuing. It would not be surprising to see a rise of Luxembourg securitisation partnerships in the coming years.

Endnotes

1. Banque centrale du Luxembourg – Securitisation Vehicles (no date b). Available at https://www.bcl.lu/en/statistics/series_statistiques_luxembourg/12_securitisation_vehicles/index.html.
2. ECB Statistical Data Warehouse (no date). Reports > Financial corporations > Financial vehicle corporations balance sheets > National tables > National tables: euro area > Luxemburg > Aggregated balance sheet. Available at https://sdw.ecb.europa.eu/reports.do?node=1000003654.

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Loyens & Loeff has a securitisation practice in Luxembourg that handles the structuring, regulatory and tax aspects of structured finance and securitisation transactions, including true-sale and synthetic securitisation deals, CLOs, commercial mortgage-backed securities, inventory securitisations, securitisation platforms and issuances of asset-backed securities. It has an outstanding record of representing issuers, originators and investors (including financial institutions, investment funds and large corporates) and working on both traditional and innovative securitisations involving various asset classes (for example, the first ever Islamic finance sukuk securitisation of IP rights). The team is part of a fully integrated firm with home markets in the Benelux and Switzerland, and offices in all major financial centres, such as London, New York, Paris, Tokyo and Zurich.

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