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Banking & Finance 2021

Luxembourg: Trends & Developments

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Trends and Developments

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Current Perspective

While certain cross-border transactions were adversely affected by the pandemic (notably due to the disruption caused to industries such as aviation, hospitality, healthcare and retail) last year, 2021 has, to date, proven to be a very active year for the banking and finance practice.

The cross-border real estate finance market has been particularly dynamic, with many new transactions and old deals that had been put on hold picking up to completion. While the market has not fully recovered to the level preceding the crisis yet, new properties are emerging on the market, which suggests a new dynamism.

Fund finance

Fund finance has shown unprecedented levels of activity. 2020 had already been exceptional, but there has been a further 25% increase in deal volume. This includes technical amendments to existing facilities (upsizes, accessions of additional borrowers or guarantors, higher advance rates, extension of terms and adjustments to LIBOR related provisions), sponsors launching new funds to seize the opportunities arising from the unprecedented circumstances and putting in place bridge facility arrangements. The UK and North American institutional lenders remain keen to respond to funds' demand for traditional bridge financing arrangements. More and more net asset value (NAV) or hybrid financing arrangements are being seen, an option where higher advance rates may not be borne or as means to provide long term financing facilities that shall remain available throughout the entire life cycle of the funds, regardless of whether there remain unfunded capital commitments to be drawn down.

Alternative lenders have continued to step in to largely negate the prospect of higher pricing and fund sourcing issues (due to regulatory thresholds). Already, 2021 has seen a surge of ESG-linked subscription credit facilities governed by New York or English law.

The remainder of 2021

The outlook for the remaining months of 2021 and the year to come is very positive and Luxembourg lawmakers have been proactive in drafting new laws and regulations (a number of which will be addressed later on in this article) to prepare and adapt the financial centre and to seize new opportunities.

Inspiring Perspectives for the Securitisation Practice

In the securitisation market, 2021 has likewise, proved to be very dynamic, a continuation of the impressive volumes seen during Q3 and Q4 of 2020.

Implementation of regulations

On the regulatory front, further progress was made to clarify the implementation of Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific structure for simple, transparent and standardised Securitisation (the EU Regulation on Securitisation). Firstly, on 25 March 2021 the EBA, ESMA and the EIOPA (European Insurance and Occupational Pensions Authority) jointly published an opinion to the Commission on the jurisdictional scope of application of the STSR.

This opinion is particularly interesting in post-Brexit Europe, as it clarifies the position of regulators with respect to the risk-retention, due diligence and transparency obligations of non-EU parties, which participate in a securitisation transaction subject to the STSR. While this instrument is not binding, it provides valuable insight on how the relevant regulators approach the questions treated therein.

A day later, on 26 March 2021, the same authorities published a Q&A which, amongst other topics addressed therein, confirms that underlying exposure-level documents (such as term sheets, final terms, prospectuses, facility agreements, intercreditor agreements, mezzanine documents and hedging documents) must be made available pursuant to Article 7 of the EU Regulation on Securitisation only to the extent it is "essential for the understanding of the transaction". The Q&A provides helpful insight by stating that in most securitisation transactions, it is not essential to make the underlying documentation available in order to understand the transaction, but that there would likely be a need to make documentation available in the context of commercial mortgage-backed securities with only a few underlying exposures. On 28 May 2021, ESMA published a further update to its Q&A clarifying technical and practical issues.

Securitisation transactions

A trend which initiated in late 2020 and has continued into 2021 is the strong flow of securitisation transactions originating out of the US, Asian, Middle East and/or Latin American markets. These transactions which were, in the past structured through foreign jurisdictions are now being implemented through Luxembourg because of new constraints (such as diversified payment rights securitisations or REPO transactions) in originators' or lenders' jurisdictions.

These deals, where the parties are seeking to replicate, to the widest extent possible, the agreements, arrangements and structures that were previously used in (foreign) jurisdictions, may sometimes be challenging to implement in Luxembourg, and therefore require careful consideration regarding restrictions and limitations that are specific to the securitisation regime under the Luxembourg law of 22 March 2004 on securitisation, as amended (the "Securitisation Law"). These restrictions and limitations constitute a significant proportion of the subject matter of a draft law that aims at increasing the attractiveness of the Luxembourg securitisation regime.

Amendments to the Securitisation Law

On 21 May 2021, the long-awaited draft law 7825 amending the Securitisation Law (the "Draft Law on Securitisation") was lodged at the Luxembourg Parliament. The amendments contained in the draft, whether aimed at enhancing legal certainty or strengthening the flexibility of the Luxembourg securitisation regime are very ambitious and address a number of issues that have been generating legal discussions over the last 15 years. The legislative process is still in its early stages and many changes may be made before the amendments are adopted. However, a number of the contemplated amendments are expected to increase tremendously the attractiveness of the financial centre as a European hub for securitisations.

One of the main changes alleviates the conditions pertaining to the means of funding and financing for Luxembourg Securitisation Vehicles (SVs). As a matter of principle, SVs established under the Securitisation Law must finance their operations primarily through the issuance of securities (in practice, through the issuance of notes, preferential shares or units, but also derivative instruments). Additionally, they may

also seek leverage by way of loans that do not qualify as securities:

- on a transitional basis (for warehousing and bridging purposes between the acquisition of the assets and the issuance of securities – prudent market practice suggests that a securitisation transaction may be entirely loan-financed at the beginning of the transaction for a period of time not exceeding 18 months); and/or
- on the basis that any lasting loan financing would not account for more than one third of the total financing.

The Draft Law on Securitisation removes these restrictions and authorises SVs to be entirely financed through borrowings.

Another existing limitation under the Securitisation Law is that, irrespective of whether the management has been delegated by the SV, the management must at all times be limited to a passive, prudent man management of the securitised risks and the administration of financial flows linked to the securitisation operation itself. Under no circumstance may the activity of an SV amount to an economic activity that would requalify the SV as an entrepreneur. The Draft Law on Securitisation authorises the active management of securitised debt portfolio to the extent that it is not offered to the public. The elimination of this limitation means that Luxembourg will now offer an efficient legal framework for actively managed collateralised loan obligations (CLOs) and collateralised debt obligations.

Collateralised obligations

CLOs have been in existence since the late 1980s and constitute a form of securitisation of debt obligations (senior loans or bonds, unsecured senior or mezzanine obligations, etc). The vast majority (approximately 85%) of CLOs are issued in the USA. Despite the negative effects of the pandemic in 2020, the new issuance level for CLOs in Europe was EUR22.11 billion from 43 deals and 2021 has, so far seen strong volumes of new European issuances of CLOs continue in addition to the resets and refinancings. Additionally a recent trend, the introduction of loan tranches has been adopted from the US market and continues to gain ground. Since the post financial crisis resurgence of European CLOs in 2013, Ireland has become issuers' jurisdiction of choice. Since 2020, all European CLOs are established in Ireland following the migration of nearly all existing Dutch CLO transactions (over 70) in Q4 2020.

The changes contemplated by the Draft Law on Securitisation may be reasonably expected to attract some of the transactions that were previously structured either through other European jurisdictions or issued in the US but structured through offshore jurisdictions, making Luxembourg one of the preferred jurisdictions for European CLOs.

When putting in place Luxembourg securitisation deals that used to be structured through foreign jurisdictions, another limitation that at times leads to some controversy is the limitation relating to the granting of security interests and guarantees.

According to Article 61(3) of the Securitisation Law, SVs are not allowed to grant security over their assets to third parties to the securitisation transaction, unless such security is granted to the SV's investors or for the purpose of securing the obligations subscribed in connection with the securitisation of those same assets. This sometimes goes against the expectations of third-party creditors extending loans to the SV and expecting to take security over the SV's assets. The Draft Law on Securitisation grants some flexibility in this respect by expressly authorising the SV to grant security interests to a

wider scope of beneficiaries, ie, any creditor, be it direct or indirect, to the securitisation transaction, and any reference to the current sanctions applicable in case of the granting of a security interest in breach of the rules currently set forth in the Securitisation Law will be removed.

Future amendments

A few other amendments and changes are contemplated, such as enlarging the panel of options for legal forms available to SVs, and in particular the inclusion of partnerships (general corporate partnerships (*sociétés en nom collectif*), simple limited partnerships (*sociétés en commandite simple*), simplified joint stock companies (*sociétés par actions simplifiées*) and special limited partnerships (*sociétés en commandite spécial*)), clarifications on the legal subordination by including express rules in the law, refining the definition of issuance of securities to the public as per the Luxembourg Supervisory Authority, the *Commission de Surveillance du Secteur Financier* (CSSF) recommendations or clarifying the treatment and distribution of profits and losses of equity-financed compartments or reducing ambiguity of omissions regarding the registration of securitisation funds.

As anticipated last year, heightened interest was shown in securitisation funds, as tax-transparent structures are exempt from the interest limitation rules under ATAD, which confirmed the actual trend in favour of securitisation funds in the form of fiduciary estates. The law of 27 July 2003 on trust and fiduciary contracts (Fiduciary Law) allows the issuance of notes on a fiduciary basis in the name of the securitisation vehicle but for the benefit of the noteholders. It is believed that this trend will continue until hearing back from the European Commission following Luxembourg's response to their letter of formal notice issued on 14 March 2020, whereby the Commission requested Luxembourg to amend its ATAD I law so as to exclude SSPEs, ie, securitisation vehicles that are subject to the EU Regulation on Securitisation, from the list of interest limitation rule exempted entities.

Financial Assistance

The latest and major Luxembourg legal updates while preparing this overview are the new law adopted on 16 August 2021 amending the law of 10 August 1915 on commercial companies (the "Law on Commercial Companies") and the provision of long-awaited clarification on the scope of the prohibition of financial assistance.

The Law on Commercial Companies

According to Article 430-19 of the Law on Commercial Companies, "a company may not directly or indirectly, advance funds or make loans or provide security with a view to the acquisition of its shares by a third party" except under stringent conditions expressly set out in the Law on Commercial Companies. From a practical perspective, the issue is encountered from time to time in the context of acquisition finance transactions as this would prevent a target subsidiary whose shares have been acquired to guarantee or grant a security interest to secure the obligations subscribed by the acquiring parent or its affiliates to fund the purchase price.

The obligations pertaining to the amounts corresponding to the purchase price of the shares in the target entity need to be carved out of the scope of the repayment obligations guaranteed by such target entity in any guarantee or security interest granted by it. Criminal penalties are provided for in the Law on Commercial Companies at Article 1500-7 2° and apply to any person acting in the capacity of director or manager of a company who knowingly granted advances, loans or sureties in violation of the financial assistance rules.

Article 430-19 is part of the legal provisions applicable to *société anonymes* (public lim-

ited liability companies), *sociétés européennes* (European companies) and *sociétés en commandite par actions* (corporate partnerships limited by shares). Absent any similar provision in the section dedicated to *sociétés à responsabilité limitée* (private limited liability companies or SARLs), there used to be a consensus among the vast majority of professionals in Luxembourg that the prohibition was not applicable to such legal form.

Amendments to increase flexibility

On 16 August 2021, the Law on Commercial Companies was amended to modernise the Law on Commercial Companies, further increasing the flexibility it offers. During the legislative process, it was originally considered whether to extend the rules on financial assistance to SARL. While the concept of "shares" is often being used in English to refer to the equity ownership interests issued by SARL or SA, the concepts are differentiated under Luxembourg law as drafted in French between "actions" for SA and "*parts sociales*" for SARL (which could be translated into "corporate units" instead).

Hence, in order to implement the originally contemplated extension of the prohibition to SARL, one of the amendments that needed to be made to the Law on Commercial Companies was to add a reference to "*parts sociales*" in the relevant provisions (as well as an express reference to *société anonymes* which became supererogatory). The proposal to extent the prohibition to SARL was later set aside, but due to an oversight, the added reference to *parts sociales* remained in the amended version of Article 1500-7 2°.

Financial assistance rules

While the majority of professionals on the market nevertheless considered that financial assistance rules remained applicable to SA and SCA only, a minority took the opposite view as a result of the retention of the reference to *parts sociales*. This resulted in different views and a level of uncertainty which could not be easily resolved absent conclusive case law on the matter. In some cases, abiding by a conservative approach, certain transactions were consequently structured through foreign jurisdictions.

The clarification made by the law of 16 August 2021 whereby the erroneous reference to "*parts sociales*" was removed from Article 1500-7 2° has therefore been welcomed in the market. While the concerns relating to financial assistance are now eliminated, attention should still be paid to ensuring that any support granted by a SARL in the context of such transactions is within its corporate interest. The amendment may be expected to strengthen the popularity of the financial centre as a hub to structure cross-border financing transactions combined with the reliability of the creditor friendly regime of sureties (in particular, financial collateral arrangements and professional guarantees of payment), and the continued use of SARL as a flexible, inexpensive and adaptive legal form for special purpose vehicles and holding companies.

Blockchain

On 21 January 2021 and as foreseen in last year's overview where insight was given on the related draft law, Luxembourg's Parliament adopted a law supplementing the Luxembourg law of 6 April 2013 on dematerialised securities, confirming that securities (whether listed or unlisted) may be issued and recorded via secure electronic registration mechanisms, including distributed ledger technology (DLT or the "Blockchain Law"). The validity of transfers of securities executed through DLT has been recognised under Luxembourg law since the implementation of the law of 1 March 2019.

The Blockchain Law enables central account keepers or clearing systems to record securities via DLT on securities issuance accounts. An

issuer still needs to resort to a central account keeper (a role that can be held by investment firms and credit institutions in respect of unlisted securities) or a clearing system to intermediate between it and the ultimate securities holders. The Blockchain Law is nonetheless an important step towards achieving the ultimate goal, ie, the effective reduction of intermediation.

Some market participants have already availed themselves of new possibilities offered by the Blockchain Law, with the issue earlier in the year of digital bonds on Ethereum public blockchain in particular, making headlines.

Expectations are that, within a few years, syndicated loans in the form of blockchain-based smart contracts will become commonplace. The limited formalism required for taking security under the Collateral Law makes Luxembourg pledge agreements relatively blockchain-compatible. It will only be a matter of time before security may be taken over shares registered on a DLT platform.

Crowdfunding

Luxembourg lawmakers have been anticipating the entry into force of Regulation (EU) 2020/1503 of 7 October 2020 on the European Crowdfunding service providers (ECSPs) for business (the "Regulation re crowdfunding"). A draft law was lodged with the Luxembourg Parliament on 21 May 2021. The draft law designates the CSSF as the competent authority to supervise ECSPs and to grant the necessary license to exercise the supervisory and investigation powers listed in the Regulation re crowdfunding and to impose administrative sanctions in case of violation. Investors will therefore be able to benefit from an adequate level of protection as from the date the Regulation becomes applicable.

Liberalisation of the Covered Bonds Market

Under the current regime, the issue of covered bonds is restricted to credit institutions to which specific authorisations have been granted, ie, covered bonds banks, or *banques d'émissions de lettres de gage*. According to a draft law submitted to the Luxembourg Parliament on 7 May 2021, the purpose of which is to implement the EU Directive 2019/2162 of 27 November 2019 (the "Directive") and the EU Regulation 2019/2160 (the "Regulation re covered bonds").

According to the draft law, all credit institutions duly authorised in Luxembourg, regardless of whether they have received the specific licence dedicated to the issue of covered bonds will be able to issue covered bonds to the extent that the aggregate exposure of this activity (calculated on the dedicated asset pool) will not exceed 20% of their total commitments. Additional changes will be implemented to cover all features of the Directive and Regulation re covered bonds, including the introduction of European Covered Bonds and (high-quality) European Covered Bonds as new types of covered bonds.

Clarification on Loan Origination

Pursuant to the Luxembourg law on the financial sector of 5 April 1993, as amended, lending activities may in the absence of specific exemptions be performed by:

- credit institutions; or
- specialised professionals of the financial sector, but subject to obtaining authorisation and several stringent conditions to be met (including evidence showing the existence of a subscribed and fully paid-up share capital of no less than EUR730,000).

This would apply to any professionals engaging in the business of granting loans to the public for their own account. Unfortunately, there remains uncertainties, as the concept of public is not

legally defined. On 15 June 2021, the CSSF updated its FAQs and clarified that:

- it will not consider such condition as being met where:
  - (a) loans are granted to a limited number of previously determined persons) as opposed to a multitude of non-identifiable persons);
  - (b) the nominal value of the loan amount is at least EUR3 million; and
  - (c) loans are granted solely to professionals; and
- the professional character of the lending activity will be met when performed repetitively (excluding one-off operations).

This will allow further legal certainty where loan origination operations are contemplated to be performed by market players under exceptional circumstances.

Modernisation of the Authorisation Regime for Entities of the Financial and Insurance Sector

On 30 July 2021, the Luxembourg law of 21 July 2021 modernising the authorisation regime for entities in the financial and insurance sector entered into force.

The law modernises the authorisation regime by directly transferring to the CSSF and the *Commissariat aux Assurances* the power to grant, refuse and withdraw the authorisation of entities subject to their respective supervision.

Hence, the authorisation for these entities is no longer granted by the *Ministere des Finances*, ie, the ministry responsible for the financial and insurance sectors, but solely by the relevant national supervision authority.

This change has been triggered by taking into consideration the legal and regulatory developments at the European Union level leading to an allocation of authorisation powers to competent national authorities responsible for prudential supervision in order to strengthen their roles.

To that end, a series of Luxembourg laws in relation to the financial sector have been amended, including the financial sector law dated 5 April 1993 (as amended), the CSSF law dated 23 December 1998 (as amended), the payment services law dated 10 November 2009 (as amended), the insurance sector law dated 7 December 2015 (as amended), the securitisation law dated 22 March 2004 (as amended) and the markets in financial instruments law dated 30 May 2018 (as amended).

The law provides for a transitory provision according to which already authorised entities continue to benefit from their existing ministerial authorisation.

Maples Group advises global financial, institutional, business and private clients on the laws of the British Virgin Islands, the Cayman Islands, Ireland, Jersey and Luxembourg through its leading international law firm, Maples and Calder. With offices in key jurisdictions globally, the Maples Group has specific strengths in the areas of corporate commercial, finance, investment funds, litigation and trusts. Maintaining relationships with leading legal counsel, the Group leverages this local expertise to deliver an integrated service offering for global business initiatives. In Luxembourg, the independent law firm, Maples and Calder (Luxembourg) SARL, provides full-service legal advice on Luxembourg law with regard to corporate, finance, funds and investment management, tax and associated regulatory matters. The finance team acts as lead and local counsel for lenders, borrowers and international law firms on a wide range of domestic and cross-border debt financing, including corporate and leveraged finance, real estate finance and funds finance.

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