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Securitisation

The Law passed by the Luxembourg parliament on 9th March 2004 (hereafter the “Law”), lays the foundations for the legal, regulatory and fiscal framework for securitisation vehicles in Luxembourg. The securitisation process generally starts with the owner of the assets (the “originator”) pooling assets together and transferring them to a special purpose vehicle (“SPV”), which will usually be a bankruptcy-remote entity. The SPV will issue shares, bonds or other securities (“the securities”), in the public or private markets. The proceeds from the issuance of these securities provide the funds, needed by the SPV or another entity, to pay the purchase price of the assets to the originator.

Securitisation vehicles have been incorporated within the legal framework of many countries such as the United States, the United Kingdom and other European countries for many years. In the light of its success in the financial world, securitisation law has been introduced in Luxembourg in order to modernise its financial system. On the one hand, the Law seeks to harmonise and balance the interests of companies willing to remove certain assets from their balance sheet and to stop bearing the risk linked to the securitised assets. On the other hand, it protects the rights of those investors who finance the acquisition of or who undertake the risks connected to these assets. The main points of the Law are summarised below.

1. Defining the term “securitisation” as specified in the Law

The definition of “securitisation”, given by the Law, is very broad. It encompasses all transactions whereby an SPV acquires or assumes (directly or indirectly) any risk linked to an asset. This SPV is financed by the issue of shares, bonds or other securities, whose return value depends on the investment risks.

Securitisation vehicles must specifically provide in their by-laws or management regulations (for funds) that they are governed by the Law.

The far-reaching implications of the conditions specified in the Law allow a wide range of assets such as trade receivables, mortgage loans, shares and essentially any tangible or intangible asset or activity with a reasonably ascertainable value or predictable future stream of revenue to be securitised. Securitisation can be achieved through a transfer of the legal ownership of the asset (“true sale”) or through a transfer of the risks linked to the assets (“synthetic”).

2. Nature of the SPV

The Law allows the securitisation vehicle to either take the legal form of a company or that of a fund run by a management company.

The main characteristics are:

2.1. The securitisation company

The securitisation company can take the form of a:

- “Société Anonyme” (“SA” equivalent to a public limited company); or
- “Société à Responsabilité Limitée” (“SARL” equivalent to a private limited liability company); or
- “Société en Commandite par Actions” (“SCA”, partnership limited by shares); or
- “Société coopérative organisée comme une SA” (a cooperative company organised as a public limited company)

Should the securities be issued in a public offering, only an SA or an SCA can be used, as an SARL cannot issue bonds on public markets.

The by-laws of the securitisation company may entitle the board of directors to create one or more separate compartments, each corresponding to a distinct part of its assets financed by distinct securities. The compartments allow for the separate management of a pool of assets and corresponding liabilities, so that the result of each pool is not influenced by the risks and liabilities of other compartments. Each compartment can be liquidated separately.

2.2. The securitisation fund

The SPV can be organised in a pure contractual form as a securitisation fund. The fund does not have a legal personality. It will, however, be entitled to issue units representing the rights of the investors and issued according to the management rules. In the absence of a legal personality, the fund may be organised as a co-ownership or a trust. In both cases, the fund will be managed by a management company, which will be a commercial company with a legal personality. As for the securitisation company, the capital may be split into compartments, which may be liquidated separately.

3. Regulatory framework

Securitisation vehicles issuing securities to the public on a regular basis fall under the supervision of the Supervisory Commission of the Financial Sector (“the CSSF”) which grants the authorisation to the former to perform their activities. The supervision by the CSSF extends to the following aspects:

- Approval of the by-laws or management rules of the SPV or the management company;
- The CSSF should be notified of the board members of the SPV and the management company as well as of the shareholders of the management company;
- The assets of the SPV need to be held in custody by a Luxembourg bank;
- The CSSF may request the SPV to file accounts on a periodic basis.

No regulatory formalities are provided for the securitisation vehicles issuing securities in a private placement.

4. Accounting and tax framework

4.1. Accounting aspects

Securitisation companies need to comply with common accounting rules. All SPVs are subject to an audit by an auditor approved by the CSSF. In case of an SPV under CSSF supervision, the auditor reports any irregularities to the CSSF. If the securitisation

vehicle is structured as a fund, it needs to comply with the accounting rules as laid down in the fund law of 30 March 1988.

4.2. Tax aspects

4.2.1. Corporate income tax

Securitisation companies are subject to the ordinary corporate income tax, while securitisation funds are tax transparent.

Securitisation companies will be taxed based on their net accounting profit (i.e. gross accounting profits minus expenses). However, the commitment to remunerate the security holders (both capital or debt) issued by the securitisation company qualifies as interest on debt even if paid as return on equity. Interest is not subject to withholding tax in Luxembourg.

4.2.2 Net wealth tax

Securitisation companies are not subject to net wealth tax in Luxembourg.

4.2.3 Capital duty

Contributions made to a securitisation vehicle are subject to a flat capital duty, whose amount may not exceed EUR 1.250. A grand-ducal regulation will provide the detailed rates.

4.2.4 VAT

The management of securitisation vehicles is exempt from VAT. Therefore, the exemption applies to the services rendered by management companies of funds and third parties performing management services for securitisation vehicles.

5. Legal framework

5.1. The securitised risks

5.1.1 Transfer of the risks to the SPV

The transfer of risks to the SPV may occur by means of (i) the transfer by the originator of the legal ownership of the assets or (ii) any undertaking by the SPV in relation to the activity of the originator (guarantees, etc).

The Law aims to facilitate the securitisation of receivables, by limiting the transfer formalities relating to receivables and all guarantees thereto attached, and by ensuring the effectiveness of such transfers even in the event of bankruptcy of the originator (without prejudice to any foreign regulations, when applicable).

5.1.2 Protection of the securitised assets

As the securitised assets guarantee payment to investors and creditors of the SPV, their transfer by the SPV is only valid in the cases authorised by the founding documentation of the SPV and they can only be pledged in favour of a limited number of persons. In case the SPV delegates the recovery of the receivables to any third party, the securitised assets are protected from the bankruptcy of any such third party since the SPV has the right to receive full payment of the sums recovered.

5.2 Rights of the investors and creditors of an SPV

5.2.1 Individual rights

The Law provides for flexibility regarding the organization of the financial rights of the investors and creditors of the SPV. In particular, the shares, bonds or securities issued by the SPV may vary in nominal value. The return attached to such instruments can be linked to a specific compartment or to any specific asset or risk.

The investors and creditors can subordinate their right to payment to the prior payment by the SPV of any other securities issued or debts. They can also waive the rights to enforcement against the SPV and request the bankruptcy of the SPV.

In case of plurality of compartments, the investors and creditors have exclusive rights over the assets allotted to their compartment.

5.2.2 Collective rights

The investors may choose to be collectively represented by a representative (représentant-fiduciaire) who will be in charge of defending their interests, without having to disclose their identity.

Such a representative can notably be a trustee (fiduciaire) and therefore be entitled to receive on his own behalf any payment owed to the investors and creditors, and exercise any guarantee attached to their rights.

When the SPV issues bonds or securities, a collective representation is required, which can notably be similar to the mechanism provided for bondholders in the law on commercial companies dated 10 August 1915 (articles 86 to 97). The SPV can transfer to the representative any rights deriving from agreements it has concluded with third parties, thus protecting the rights of the investors and creditors. The representative must be a limited company with minimum net assets amounting to EUR 400,000. The representative needs to be approved by the competent Luxembourg minister and can, in principle, only be dismissed by the CSSF, at the request of any investor or creditor.

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