

LUXEMBOURG: An Introduction to Capital Markets

Luxembourg's capital market stands out for its resilience in times of crisis, and innovative spirit. The Luxembourg financial market is already recognised as an innovative hub for fintech companies and is expected to play a significant role in international finance markets, offering extensive opportunities for market participants.

Financial Securities Under Luxembourg Law

The issuance of debt securities is governed by Articles 470-1 et seq of the Luxembourg Law of 10 August 1915 on commercial companies. This includes all types of securities available in international capital markets that can be issued in registered, bearer or dematerialised form. Debt securities typically entitle their holder to fixed or variable interest payments until their maturity, upon which the principal amount owed under the debt securities must be repaid.

Luxembourg regulations provide diverse financial instruments for securities use. The Luxembourg Law of 6 April 2013 on dematerialised securities (the "Dematerialised Securities Law") distinguishes between (i) equity securities issued by companies, including shares, beneficiary shares, subscription rights and common fund units; and (ii) debt securities, such as financial instruments likely to be in the form of bearer instruments and public debt instruments. While both equity and debt securities have the purpose of providing financing and investment to a company, equity securities give holders shareholder rights, while debt securities give holders a claim for interest payments and principal repayment at maturity against the issuer.

Beneficiary shares, or profit units, are hybrid instruments between equity and debt. Such shares do not represent a company's capital but entitle holders to profits before ordinary shareholders. If acquired through a contribution in kind, the same rules apply as for conventional share capital contributions. However, subscription proceeds from beneficiary shares do not increase the company's subscribed share capital, and they are not considered conventional shares under Luxembourg law. The rights vested with beneficiary shares must be detailed in the company's articles of association.

Securitisation Undertakings

The Luxembourg Law of 22 March 2004 on securitisation undertakings (the "Securitisation Law"), as amended, is very flexible and contains provisions applicable specifically to securitisation undertakings. It allows any type of securitisation transaction, by enabling market participants to complete them:

1. through a true sale, where the securitisation vehicle acquires full legal ownership of the underlying assets; or
2. via a synthetic transfer of the risk pertaining to the underlying assets through the use of derivative instruments, including double layer structures with an acquisition and an issuing vehicle or through a guarantee.

The Securitisation Law ensures that a true sale securitisation is enforceable and cannot be recharacterised by simplifying how underlying assets are transferred to the securitisation vehicle.

The flexibility of this framework was further reinforced with the recent modernisation of the Securitisation Law which enhanced its flexibility by broadening funding options for securitisation transactions. Securitisation vehicles may now finance themselves not only through securities issuance but also by issuing financial instruments or borrowing. This change enhances legal certainty, allowing securitisation vehicle to be financed with loans, securities, and instruments which do not qualify as transferable securities under foreign law. Further, Luxembourg securitisation undertakings may now securitise a pool of risks consisting of debt securities, financial debt instruments, or receivables which are actively managed, either by the undertaking itself, or by a third party. In practice, the new legal framework allows for securitisation of actively managed collateralised debt obligations and collateralised loan obligations in private placements.

Furthermore, the amendment of Article 64 of the Securitisation Law provides for ranking between different types of financial instruments that can be issued by a securitisation vehicle. The legislature created a hierarchy of repayment priorities, in the event of financial distress or bankruptcy of the issuer. This gives market participants additional reassurance if they envisage structuring their transaction under Luxembourg law. Such legal subordination does not constitute a tranching within the meaning of the EU Securitisation Regulation. However, Article 64 (2) of the Securitisation Law also allows for contractual subordination, meaning the ranking can also be structured differently than provided in the Securitisation Law.

Infrastructure of the Luxembourg Capital Market

Regarding capital markets infrastructure in Luxembourg, the operation of the Luxembourg stock exchange (LuxSE) and Clearstream, acting as, among other things, central securities depositaries in Luxembourg, further contributes to the country's success as a financial centre. The LuxSE operates a regulated market and an exchange-regulated alternative market named Euro MTF, which qualifies as a multilateral trading facility (hence the "MTF") under the European Markets in Financial Instruments Directive II (MiFID II). In both these markets, LuxSE hosts more than 44,000 financial instruments in over 60 currencies.

LuxSE attaches great importance to green finance. It has operated, since its launch in 2016, the Luxembourg Green Exchange (LGX), a dedicated platform for sustainable securities, where the Grand Duchy of Luxembourg listed Europe's first green sovereign bond. This wide variety of products provides investors with numerous choices when structuring their portfolios, thus enabling them to diversify their investments. With the implementation of the Regulation (EU) 2023/2631 on European Green Bonds (EuGB) it is to be expected that this platform will be even more attractive in the future.

In terms of market infrastructure, LuxSE co-operates with Euroclear and Clearstream as central securities depositaries performing settlement functions. This enables efficient cross-border settlement, since these organisations are the only international central securities depositaries in Europe. Clearstream and LuxCSD play another pivotal role in promoting the efficiency of the capital markets infrastructure in Luxembourg, since they are the only institutions connected with the T2 system, which enables real-time gross settlement in central bank money across the EU (which is not the case for institutions outside the T2 system that also settle on this basis).

Further Important Aspects of the Legal and Regulatory Framework

A robust regulatory framework underpins Luxembourg's capital market, primarily overseen by the *Commission de Surveillance du Secteur Financier* (CSSF). This sophisticated regulatory framework provides a wide range of options for market participants.

The Law of 5 August 2005 on financial collateral arrangements, as amended, provides investor-friendly provisions for the creation of securities relating to the simple manner of perfecting the securities and the various enforcement rights recognised to the pledgee. Most importantly, the pledgee benefits from a safe harbour regime protecting its rights on the pledged assets even in the event of the insolvency of the pledgor. In this respect, the pledgee can enforce the collateral without the limitations of insolvency law. This is especially relevant for high-yield corporate bonds. Due to the risk that high-yield bonds carry, investors demand the provision of collateral provided either by the parent company or by other operating companies of the group.

The Law of 17 July 2020 on professional payment guarantees (the "PPG Law") introduced a new form of guarantee. This guarantee may be adapted to the needs of each specific transaction, and its provisions receive full recognition under Luxembourg law. The PPG Law introduced an optional (opt-in) contractual guarantee regime which allows the parties to structure their contract by combining features of the existing guarantee types, without them facing the risk of recharacterisation. The provisions of the PPG Law are now widely used in high-yield bond issuances and facilitate the structuring of deals.

The Law of 7 August 2023 on the preservation of business and modernisation of bankruptcy law implemented Directive (EU) 2019/1023 on restructuring and insolvency, introducing several new insolvency procedures, in particular concerning judicial reorganisation. These new provisions apply to the restructuring of all kinds of obligations of the debtor, including with respect to issued securities.

The Luxembourg Blockchain Laws

As one of the first European countries to recognise blockchain as equal to traditional transactions, Luxembourg introduced the Law of 1 March 2019 (the "Blockchain I Law") which amended the law of 1 August 2001 on the circulation of securities to allow the use of secured electronic registration systems to hold and manage securities accounts.

Shortly after this, the Law of 22 January 2021 (the "Blockchain II Law") amended the Dematerialised Securities Law. The Blockchain II Law (i) permits the issuance of dematerialised securities via systems that rely on distributed ledger technology (DLT); and (ii) expanded the range of entities that may exercise the activity of central account keeper in relation to unlisted dematerialised debt securities by including MiFID II investment firms (*entreprises d'investissement*) and credit institutions (*établissements de crédit*) based in Luxembourg or in other EU member states.

The amendments introduced by the Law of 14 March 2023 (the "Blockchain III Law") implemented the EU's DLT Pilot Regime, ensuring DLT-based infrastructure for the issuance of tokenised securities can also be made available on the market.

In July 2024, Luxembourg's Ministry of Finance proposed a Bill of Law (the "Blockchain IV Bill") to enhance the Dematerialised Securities Law by introducing a control agent for securities issuance,

ensuring, among other things, consistency on the DLT network, and supervising the custody chain. This bill also extends DLT use to equity securities, aiming to bolster Luxembourg's fintech leadership by offering more flexibility for issuers and investors.

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