

LUXEMBOURG OPENS COVERED BONDS ISSUANCES TO UNIVERSAL BANKS AND IMPLEMENTS COVERED BONDS DIRECTIVE

The Luxembourg law of 8 December 2021 on the issue of covered bonds (*lettres de gage*), which implements Directive (EU) 2019/2162 on the issue of covered bonds and covered bonds public supervision ("**CB Directive**") and Regulation (EU) 2019/2160 on exposures in the form of covered bonds ("**CB Regulation**") into Luxembourg law has recently been published in the Official Journal and will enter into force on 8 July 2022. While the existing framework is already largely in line with the CB Directive, the new law introduces so-called "European" covered bonds along the traditional Luxembourg covered bond types and brings some technical adjustments and clarifications.

The new law also abandons the specialisation principle under which only covered bond banks with a specialised banking licence were allowed to issue covered bonds in Luxembourg.

This briefing is aimed at providing an overview of the main novelties brought by this new law and further explores the opportunities for universal banks to issue covered bonds.

THE OPENING OF THE LUXEMBOURG COVERED BONDS MARKET

As mentioned, the new law abandons the mandatory specialisation principle (*Spezialbankenprinzip*) and Luxembourg incorporated banks operating under a universal banking licence will now also be authorised to issue covered bonds. Existing specialised covered bond banks (*banques d'émission de lettres de gage*) may continue their activity and keep their status. The status of specialised covered bond banks will continue to be available going forward also for new banks.

The issuance of covered bonds will however be subject to strict rules to ensure bank creditor protection. Universal banks issuing covered bonds will have to ensure that the aggregate cover asset pools linked to the covered

Key issues

- New refinancing option through covered bonds issuances offered to Luxembourg banks operating under a universal banking licence, subject to certain asset encumbrance limits.
- Introduction of EU labelled covered bond classes:
 - the "European covered bonds"; and
 - the "(high-quality) European covered bonds".
- The new European covered bonds will be subject to traditional Luxembourg covered bonds requirements plus additional European requirements deriving from the CB Directive.
- The new law will enter into force on 8 July 2022.

bonds issued by the bank represent not more than 20% of the bank's total liabilities (Article 2 of the new law). The total liabilities of the bank for the purpose of this calculation include also own funds, but not deposits eligible for the deposit protection scheme. This limitation aims at controlling the overall encumbrance of the bank assets by ensuring that the bank always have recourse to other sources of financing.

Besides, new issuance programs by specialized or universal banks must be submitted for prior approval to the CSSF.

THE INTRODUCTION OF NEW EUROPEAN COVERED BONDS

The new law implements the EU's CB Directive into Luxembourg law and notably introduces two new types of European covered bonds:

- "European covered bonds" (*obligations garanties européennes*) which are issued in respect of loans secured by physical assets (e.g. real estate) subject to public registration (or an assimilated type of registration) or in respect of loans granted to or secured by public sector entities; and
- "(high-quality) European covered bonds" (*obligations garanties européennes (de qualité supérieure)*) which are issued in respect of loans secured by high-quality "eligible assets" (including certain public sector, immovable and movable property assets) meeting the criteria set out under article 129 of the Capital Requirements Regulation (EU) No 575/2013 ("**CRR**").

These new European covered bond classes will have to respect the requirements applicable to traditional covered bonds (i.e. mortgage, public, movable assets and renewable energy covered bonds), but also specific additional requirements foreseen under the CB Directive and the CB Regulation. These European covered bonds will therefore always be considered also as traditional covered bonds, while the traditional covered bonds will not always meet the condition to qualify and benefit from the EU labelling as European Covered Bonds.

The new law also implements into Luxembourg law certain other requirements set out in the CB Directive which will apply to both traditional and new European covered bonds and require some technical adjustments to the existing framework already largely compliant with the CB Directive. These relate to (i) certain requirements for issuing covered bonds, (ii) the structural features of covered bonds, (iii) covered bond public supervision, and (iv) publication requirements in relation to covered bonds.

OTHER TOPICS AND ENTRY INTO FORCE

The new law further brought certain simplifications and clarifications to the existing framework, among which the following can be mentioned:

- the abolition of the mutual covered bonds (*lettres de gage mutuelles*) category which has never been used in practice since its introduction in the last decade;
- cover pool exposures to securitisation issues will no longer be permitted;

- more explicit provisions for dual recourse protection offered to investors are introduced;
- an increase of the minimum level of overcollateralization and conditions under which this level can be adjusted depending on the type of covered bonds; and
- the provisions applicable to all covered bond issuers, i.e. universal banks and specialised banks are re-grouped in a dedicated self-standing law, while specialised banks specific provisions remain in the Luxembourg financial sector law of 5 April 1993 (as amended). The insolvency related provisions specific to covered bonds and their cover pools have been moved from the FSL to the Luxembourg law of 18 December 2015 on the failure of credit institutions and certain investment firms (as amended).

The new law will enter into force, in line with the CB Directive, on 8 July 2022. Issuances existing before this date need to continue to comply with the covered bonds regime in force before this date. The adoption and publication of the law in the Official Journal well ahead of this date will permit to existing covered bond issuers to adapt to the changes and to universal banks interested in exploring or using the new refinancing options of establishing a covered bond programme to plan with legal certainty and sufficient head time.

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