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Luxembourg plays to win in musical chairs dance for CLOs

Raymond Frenken - 20 January 2022

Hopes are high in Luxembourg that the Grand Duchy this year will be able to claim a sizeable chunk of a growing European market for Collateralised Loan Obligations (CLOs), a structured financial product pooling corporate debts. With an update in its securitisation regime that allows active management Luxembourg wants to be competitive and seduce CLO managers from other countries, notably Ireland, to move their business.

"We already note a great interest amongst CLO managers to consider Luxembourg as home of their new projects," Frank Mausen, Secretary at the Luxembourg Capital Markets Association, or LuxCMA, told *Investment Officer Luxembourg*.

The country's asset management community, represented by the Association of the Luxembourg Fund Industry (ALFI), has said it looks forward to the new structure. It will "allow for more flexibility and agility," ALFI Director General Camille Thommes wrote when presenting its annual private debt survey, conducted with KPMG, in December.

Ireland overtook the Netherlands last year as leading market for European CLOs after the Dutch introduced value added tax for managing securitised loans. This left Ireland and Luxembourg as the main European CLO markets as these two EU member states don't levy a sales tax on such services, as is the case in Switzerland and the United States.

Active management with new special vehicles

Luxembourg now seeks to further open its doors for international CLO managers by modernising its 2004 securitisation regime. Its finance ministry introduced an updated law last May to enable active management of CLOs with new types of special purpose vehicles. Actively managed CLOs are considered appealing because they are managed by specialists who make their own investment decisions.

The national parliament is due to adopt the changes in the coming months. LuxCMA, which has positioned itself as a central party in the CLO debate, holding several events to prepare the market, said the change "underlines the ambition of Luxembourg to be the leading securitisation hub in Europe."

"This long-awaited change in the Luxembourg securitisation law closes a gap as to the products available in the Grand Duchy," said Mausen by email. "The new features available after the adoption of the law give the managers more flexibility and a new jurisdiction of choice to host their CLO platforms."

Relentless efforts

"These relentless efforts provide attractive solutions to enable the market to reach its full potential," said ALFI and KPMG in their recent survey on the private debt market.

Legal specialists have published a considerable number of papers expressing high hopes for Luxembourg's new securitisation regime. "This initiative supports the players concerned and, more generally, the attractiveness and continuous growth of the Luxembourg securitisation market," one law firm, Atoz, wrote.

Luxembourg, unlike Ireland and the Netherlands, has specific national legislation in place for securitisation. This makes it attractive as an international hub for private debt, said Atif Kamal, Director of Client Services Capital Markets at TMF Group, a global provider of administrative services.

Much needed remedy

"Authorisation of active management will allow CLOs to come back to Luxembourg," said Kamal. "With the new law, Luxembourg will provide much needed remedy for key jurisdiction risk."

What's more, the presence of CSSF as an active financial supervisor reassures investors, he said. CSSF is "highly responsive and understands the dynamics of the industry, which provides a much needed confidence to investors and investment managers. No surprises," said Kamal.

The size of the global CLO market topped one billion dollars last year, with the US accounting for about 80 percent and Europe for the remainder, according to S&P. Europe last year saw 38.5 billion euro priced in new CLOs, up from 22.1 billion euro in 2020, ratings agency Fitch said in a market update last week.

Subject to EU framework

Securitised financial products are viewed with a degree of caution because of the role that similar products, collateralised obligations pooling mortgages, known as CMOs, played in the 2007-8 financial crisis. The mix of complexity, leverage and exposure to low credit quality is regarded as risks that require careful assessment. EU countries from 2019 are required to apply stringent rules for securitisation products under a dedicated framework.

Market developments during the pandemic have demonstrated CLOs are resilient, also considering emergency funding by central banks to help companies keep their heads above water. "The loan market has a fair amount of flexibility in the context of the pandemic," said Christina Padgett, Head of Leveraged Finance Research and Analytics at Moody's when presenting their 2022 global outlook for CLOs Wednesday.

Huge appetite

The total market for securitised financial instruments, including CLOs, in Luxembourg is seen at some 400 billion euro and is expected to grow further. "There is increasing activity in debt funds and alternative finance. There is a huge appetite for investing in such products. CLOs will provide just that venue for such debt financing," said TMF's Kamal.