IFLR
INTERNATIONAL FINANCIAL LAW REVIEW

GLOBAL HIGH YIELD REPORT 2014

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Section 1: STATUTES AND REGULATION

1.1 Briefly explain how you would categorise the high yield market in your jurisdiction: nascent, moderately advanced or very advanced? And why?
The high yield market may be considered as very advanced in Luxembourg.

As high-yield bonds have become an increasingly popular source of financing for European corporates, Luxembourg ranks as an undisputable leading listing centre in this market.

Considering that Luxembourg ranks first in Europe in terms of listed international bonds generally, the Luxembourg Stock Exchange (the LuxSE) is also naturally the favourite listing market for European issuers of high-yield bonds.

In addition, the LuxSE has built innovative products and services which meet the needs of international issuers that commonly use Luxembourg to structure holding and financing companies.

The LuxSE operates two markets, a European-regulated market called the *Bourse de Luxembourg* which offers a European passport for securities, and an exchange-regulated market called Euro MTF.

For the most part, high yield bonds are listed on the Euro MTF Market of the LuxSE in order to have the offering memorandum approved by the LuxSE in accordance with the Stock Exchange Rules and Regulations. Otherwise, the offering memorandum must be approved as a prospectus by the Luxembourg Financial Regulator (*Commission de Surveillance du Secteur Financier*, the CSSF) under the requirements of the Prospectus Directive.

1.2 Is there a market for high yield offerings in your jurisdiction in which the high yield notes are governed by local law versus the more typical New York law?
The vast majority of notes are governed by New York law.

Section 2: DISCLOSURE

2.1 What additional disclosure or other information (if any) would a high yield issuer be required to provide in connection with an offer and sale of high yield notes to sophisticated/institutional investors in your jurisdiction over and above what would be included in a prospectus for such notes prepared in connection with an offering to be registered with the US Securities and Exchange Commission or a prospectus that satisfied the requirements of the EU Prospectus Directive?
No additional disclosure or information is required.

2.2 What regulatory filings must be made in your jurisdiction in connection with a public offering of high yield securities? And what information must be included in such filings or made available to potential investors over and above what would be included in a prospectus for such notes prepared in connection with an offering to be registered with the US Securities and Exchange Commission or a prospectus that satisfied the requirements of the EU Prospectus Directive?
Under the law of July 10 2005 on prospectuses for securities, as amended (the Prospectus Law), the issuer is required to file with the CSSF an approved prospectus. If the notes are intended to be listed on the LuxSE, a request of admission to trading in one of the securities markets operated by the LuxSE should be filed with the LuxSE.

The information provided in the filings is standard information.

Section 3: PUBLIC AND PRIVATE OFFERINGS

3.1 Briefly outline, with respect to any public offering of high yield notes, any registration and filing process in your jurisdiction, including reference to the stages necessary and time for a typical review process to conclude. Please also indicate whether an offering may commence while regulatory review is in progress.
The registration and filing process of the public offering of high yield notes under Luxembourg law is subject to the Prospectus Law.

In relation to the filing process, the issuer should prepare and submit a prospectus to be approved by the CSSF together with an information document (the entry form). If the documents are complete, and no supplementary information is needed, the CSSF will notify the prospectus's approval within 10 working days of its submission. The approval timeframe is extended to 20 working days if the public offer involves securities issued by an issuer who does not yet have any securities admitted to trading on a regulated market, and has not previously offered securities to the public.

Once the prospectus is approved, the issuer should file it with the CSSF and render it public as soon as possible (and in any case, at a reasonable time in advance of the offering). In practice, the prospectus is published on the very day (or on the following day) of its approval by means of a publication on the LuxSE website. In addition, the issuer may use other publication means, such as publishing the prospectus in an electronic format on the issuer's website.

If the notes are intended to be listed on the LuxSE, the issuer may file an application with the LuxSE as soon as a first draft prospectus is submitted to the CSSF.

Offerings may not commence before the prospectus's publication.

3.2 Briefly outline the publicity restrictions that apply to a public offering of securities and any restrictions in place on the ability of the underwriters to issue research reports.
Under the Prospectus Law, the information contained in an advertisement should: (i) not be inaccurate or misleading; and (ii) be consistent with the information contained in the prospectus, if already published, or with the information required to be in the prospectus, if it is published afterwards.

All information concerning the public offering disclosed in an oral or written form, even if not for advertising purposes, should always be consistent with the information contained in the prospectus. The CSSF has the power to exercise control over the compliance of advertising activities, relating to a public offering of securities within the territory of Luxembourg.

Research reports are notably governed by the Law of May 9 2006 on market abuse, as amended (the Market Abuse Law). Under the Market Abuse Law, persons who produce or disseminate investment recommendations in Luxembourg in the practice of their profession or the conduct of their business should take reasonable care to ensure that such information is fairly presented and disclose their interests or indicate any conflicts of interest concerning the financial instruments to which that information relates. In particular, they should take reasonable care to ensure that: (i) facts are clearly distinguished from interpretations, estimates, opinions and other types of non-factual information; (ii) all sources are reliable or, where there is any doubt, this is clearly indicated; and (iii) all projections, forecasts and price targets are clearly labeled as such and that the material assumptions made in producing or using them are indicated.

3.3 Please explain the rules in place (if any) in your jurisdiction (other than any EU, UK or US rules) for the private placing of high yield notes, with reference to the procedures that must be implemented to effect a valid private placing and what information must be made available to potential investors in connection with a private placing of high yield notes.
Private placing of high yield notes is not subject to the provisions of the Prospectus Law governing public offerings. In practice, high yield notes are generally admitted to trading on the Euro MTF market of the LuxSE, which is an exchange-regulated market not included in the European Commission's list of regulated markets.

When high yield notes are listed on the Euro MTF, the Rules and Regulations of the LuxSE govern such admission to trading. In addition, the LuxSE is the competent entity that approves the prospectus before admitting the notes to trading.

The issuer must submit its prospectus for approval to the LuxSE with an application form for the admission to trading of the notes on the Euro MTF and the required supporting documents (such as articles of incorporation and the annual reports for the past three years of the issuer and guarantors, if any).

The LuxSE usually notifies its decision regarding the approval of the draft prospectus within five days of its submission. Upon the LuxSE's approval of the prospectus, the notes will be listed on the LuxSE's official list, and admission to trading will follow. After listing, the issuer will be subject to continuing obligations, including: (i) the communication of any event affecting the notes admitted to trading or any material change in the situation of the issuer; and (ii) financial reporting.

3.4 Are there any specific domestic rules apply to offerings of securities outside your jurisdiction made by an issuer domiciled in your jurisdiction?
Except for the EU Prospectus Directive provisions, there are no specific local requirements.

Section 4: DOCUMENTATION FORMALITIES, GOVERNING LAW AND GOVERNMENT APPROVALS

4.1 Briefly explain any issues or requirements in your jurisdiction relating to the selection of New York law (or English law, in the case of intercreditor agreements) as the governing law in relation to:
a) the indenture governing an issuance of high yield notes;
b) the purchase agreement;
c) the intercreditor agreement;
d) guarantees.
Under Luxembourg law, there are no specific limitations or requirements when choosing New York law or English law for such agreements. However, the Luxembourg courts will not apply a chosen foreign law if the choice of law is abusive or manifestly incompatible with Luxembourg international public order.

4.2 Please describe any local law limitations (if any) on an issuer domiciled in your jurisdiction with respect to:
a) indemnities;
b) force majeure clauses; and
c) success fees.
Under Luxembourg law, contractual limitations of liability are unenforceable in case of gross or intentional negligence (*faute lourde*).

As a principle under Luxembourg civil law, the debtor is not liable for damages when, due to an event of force majeure, it has not been able to execute its obligations, or has done something it was forbidden to do.

Regarding the success fees, there is no limit applicable in Luxembourg.

Section 5: INTERCREDITOR AGREEMENTS

5.1 Please explain how high yield creditors' enforcement rights and ranking in this jurisdiction compare with the enforcement rights and ranking of senior lenders.
High yield creditors usually benefit from junior-ranking security over shares, bank accounts and receivables, which are governed by the Luxembourg law dated August 5 2005 on financial collateral arrangements (the Collateral Law). Under the Collateral Law, and unless otherwise agreed between the parties, in case of an enforcement of the junior-ranking pledge, the pledgee under the latter should try to come to an agreement with the senior-ranking pledgees in relation to the method of enforcement, payment order and distribution of the enforcement proceeds. If the senior-ranking pledgees and the junior-ranking pledgees do not reach an agreement, any pledgee may ask the president of the Luxembourg District Court to fix the enforcement method, the payment order and the distribution of the proceeds of the enforcement between the pledgees. The part of the proceeds of the enforcement belonging to pledgees that have not yet enforced the security will be kept as security to their benefit.

For enforcement of the senior-ranking pledge, the pledgee can enforce the pledge without consideration to the junior-ranking pledgees, unless otherwise agreed between the parties.

5.2 Briefly outline the typical use of liens in this jurisdiction and any issues with respect to granting second priority liens as well as timing issues in the granting of liens that may affect ranking.
The security in high yield debt transactions usually includes shares, bank accounts and receivables pledge agreements governed by the Collateral Law.

The Collateral Law allows the granting of second-ranking pledges, which are subject to perfection requirements that depend on the type of financial instrument. The ranking of the pledges are determined by the date such pledges were perfected and became opposable to third parties.

Section 6: GUARANTEES AND SECURITY

6.1 Briefly outline the security available over high yield debt, with reference to the documentation formalities and costs required to create, perfect and maintain such security and confirm whether or not a universal security agreement which grants security over assets can be utilised.

For security over shares, depending on the type of issuer and shares, the perfection requirements can be the registration of the pledge in the shareholders' register, the delivery of the shares to the pledgee or the notification or acceptance of the shares' issuer.

For the perfection requirement of security over a bank account, a notice of pledge should be sent to the bank, which will be required to issue a notice of acknowledgement of pledge waiving any rights of pledge or set-off over the balance of the pledged account.

In relation to the security over receivables, the perfection requirement is satisfied by the agreement between the pledgor and the pledgee; however, it is advisable to notify the debtors under the receivables and obtain a waiver of any set-off rights.

There is no universal security agreement suitable for a high yield transaction.

6.2 Highlight any issues with securing obligations that may arise in the future.

The Collateral Law allows the granting of pledges securing future obligations.

6.3 Can security be granted by an entity that is neither a borrower nor a guarantor (third party security) and are there any rights of contribution, subrogation or similar that might arise as a result of granting/enforcing purely third party security that ought to be/can be waived?

The Collateral Law allows third party security; furthermore, the pledgor may waive any rights of recourse it may have against the debtor under the secured obligations.

6.4 Briefly outline the registration requirements, if any, applicable to security interests in this jurisdiction including any practical considerations such as the time and expense associated with registration.

There are no registration requirements under Luxembourg law.

6.5 Briefly outline any regulatory or similar consents that are required to create security over a local companies' assets.

There are no regulatory consents required in order to create security governed by the Collateral Law.

6.6 Briefly, explain the downstream (parent to subsidiary), upstream (subsidiary to parent) and cross-stream (between sister companies within one group) guarantees available, with reference to the any particular restrictions or limitations (such as corporate benefit, and capital maintenance rules). Are there any techniques typically employed to enhance credit support/guarantees that might otherwise be limited (such as debt pushdown)?

There are no particular limits regarding downstream guarantees.

In relation to upstream and cross-stream guarantees, it is market practice to include limitation language, since they are considered not necessarily in the corporate interest of the guarantor which is an issue of directors' personal liability.

The objective of the limitation language is to limit the guarantee to a certain percentage (usually around 90% to 95%) of available funds (which include the guarantor's own funds, that is, share capital, share premiums, reserves and profit brought forward, and any intragroup indebtedness) to avoid having the guarantor become insolvent as soon as the guarantee is called.

6.7 Briefly explain any formalities required for guarantees to be enforceable.

There are no specific formalities required for the enforceability of a guarantee.

Further, under common Luxembourg private international law, a foreign court decision (other than a court of an EU member state) in relation to a guarantee is subject to exequatur proceedings and requirements.

Section 7: TAX CONSIDERATIONS

7.1 What Is interest on debt tax deductible for borrowers incorporated in your jurisdiction?

Interest is tax-deductible in the hands of a high yield bond issuer with the exception of certain types of profit-sharing interest, and provided that the interest is at arm's length and not economically linked to tax-exempt income. For corporate tax payers, the tax deduction applies on an accrual basis.

7.2 Are there any thin capitalisation rules in effect in this jurisdiction, which would impact the amount of debt that can be borrowed/guaranteed by entities incorporated there?

Under Luxembourg transfer pricing principles, a Luxembourg company should be funded on an at-arm's-length basis (in accordance with a debt to equity ratio under which a third party would have funded the company, having as sole collateral the assets held by the company). Where the tax payer cannot demonstrate such ratio, the tax authorities generally use an 85:15 debt:equity ratio as a default. The ratio generally aims at limiting the amount of interest charges a tax payer can incur. Therefore, shareholder loans in excess of the ratio are acceptable if the interest rate is reduced accordingly, so that the company does not incur interest charges in excess of a market rate of interest on the 85% debt (or any other acceptable debt ratio).

7.3 Are there any other important tax concerns that borrowers incorporated in this jurisdiction should be aware of?

With the exception of interest due on certain specific types of profit-sharing debt instruments, Luxembourg generally does not levy a withholding tax on at-arm's-length interest. However, under the European Council Directive 2003/48/EC of June 3 2003 on the taxation of savings income in the form of interest (the EU Savings Directive) and the Luxembourg laws of June 21 2005 implementing the EU Savings Directive and ratifying several agreements concluded between Luxembourg and certain dependent or associated territories of the European Union (the June 21 2005 Law), interest paid by or the payment which is secured by a Luxembourg paying-agent for the benefit of: (i) beneficial owners who are individuals resident in another EU member state (or in one of the dependent or associated territories of certain EU member states); or (ii) residual entities (within the meaning of the EU Savings Directive) established in an EU member state or in one of the EU dependent or associated territories, is subject to a withholding tax of 35%. Said withholding tax does not apply if the beneficiary or residual entity opts for exchange of information in accordance with the principles and procedures laid out in the EU Savings Directive. The EU Commission has made certain proposals for amending the EU Savings Directive and it is expected that Luxembourg will agree to automatic exchange of information under the EU Savings Directive in the future, so that the withholding tax will no longer apply. As long as it applies, it is important to take it into account with respect to the drafting of gross-up clauses in the issuing documents and, in particular, the exceptions to such gross-up clauses (as the withholding tax applies where the beneficiary does not want to exchange information, it should normally be borne by the beneficiary, and gross-up or indemnity will not lie with the issuer of the debt).

In the case of court proceedings in a Luxembourg court or the presentation of the documents – either directly or by way of reference – to any official authority (*autorité constituée*) in Luxembourg, the relevant court or authority may require the prior registration of all or part of the documents with the *Administration de l'Enregistrement et des Domaines* in Luxembourg, which may result in registration duties being levied at a fixed rate of €12 ($16.6) or an ad valorem rate which depends on the nature of the registered document (such as for the registration of certain debt instruments an ad valorem rate of 0.24%, calculated on the amount of obligation under the debt instrument), if and at the time when the documents are exhibited in any court proceeding or presented before an authority in Luxembourg. This is especially relevant for jurisdiction clauses in the issuing documents in combination with the drafting of tax gross-up or indemnity clauses, as the above ad valorem duties may become an economic impediment for a party seeking to exercise its right to bring a dispute before the Luxembourg courts.

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Stéphane Hadet heads OPF Partners' banking and finance practice. With over 18 years' professional experience, he advises a domestic and international clientele of companies and financial institutions. He provides legal advice and support across a range of matters with respect to Luxembourg finance, leveraged finance, securitisations, financial sector regulatory matters, and aircraft finance.

Hadet also assists clients in relation to specialist areas including debt and equity financing, enforcement of security interests, and financing arrangements for groups facing financial difficulties, including negotiations with lenders. Over recent years, he has assisted major groups facing financial pressures on both their financing and restructuring activities.

Hadet frequently gives presentations and publishes articles on banking and finance and restructuring topics. He is fluent in English, French, Italian and Spanish. A French national, he graduated from the University of Nancy II (France). He is a member of the IBA and has been a member of the Luxembourg Bar since 1994.

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Feyten has specialised in Luxembourg and international taxation for around 18 years, and has extensive advisory experience in matters relating to direct and indirect taxation (including VAT). He regularly advises a broad range of clients, including international corporate clients, investment banks and financial institutions on all aspects of their international tax planning, structured finance and financial products involving Luxembourg.

After practising law in Brussels, New York and Rotterdam, Feyten headed NautaDutilh's Luxembourg tax practice as equity partner. He is also a former associate of Loyens & Loeff.

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