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Security Rights and Similar Security Arrangements - Neighbours against all Odds

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1 The views expressed are solely those of the author and do not reflect the legal position of any organisation the author may be affiliated with.

1. FROM TRADITION TO MODERNITY

Luxembourg secured transactions law operates today within a relatively modern statutory and institutional framework. The current system has developed as the result of an incremental transformation of traditional rules over the past thirty years, influenced by evolving court precedent and selective legislative developments in neighbouring jurisdictions relating to the form and to the effectiveness of available types of security rights. The existence of efficient title security systems in competing financial centres complemented the foregoing developments. In a word, modernisation became the order of the day and policies strengthening Luxembourg as an international financial centre had to be implemented. Among other things, these policies had to address the increasing demand for collateral in light of the critical funding needs of credit institutions and the operational requirements of securities settlement systems.

The current framework also largely reflects the implementation in Luxembourg of international securities regulation and of European legislation covering financial collateral typically used in investment structures and securities transactions. The adoption of these sophisticated pieces of international legislation not only aims to address legal uncertainties, credit risks and systemic risks caused by disparities in the functioning of security rights and priority rules in different jurisdictions. On larger scale, it is also meant to achieve a level playing field among credit institutions operating in European financial markets and to facilitate the taking of security in response to massive demands for liquid collateral in the capital and derivatives markets. By simplifying complex rules, the legislator aims to address the efficiency needs of market participants rooted in different European and non-European jurisdictions and legal traditions, including those rooted in the Common law. Besides financial institutions, market participants include businesses participating in secured transactions

and ordinary debtors not habitually participating in business transactions.

Luxembourg law applicable to secured transactions strengthens contractual freedom and does away with customary distinctions based on bargaining power or on the amounts at stake, commonly drawn in secured transactions laws across the globe. It addresses the speed and flexibility needs of lenders and investors in relation to both the effectiveness and the enforcement of security rights. Generally speaking, security rights are rendered effective against third parties ("perfected") either "instantly", by mere agreement of the parties, or by some form of registration. The enforcement regime operates without court intervention and disapplies provisions relating to proceedings affecting the rights of unsecured creditors generally. Luxembourg law has adopted many features of the most developed secured transaction regimes in the above respects and has helped pave the way for similar, albeit sometimes incomplete, reforms to the secured transactions laws in some other European jurisdictions, such as France or Belgium. However, legislation has not entirely cleared the slate.

2. PURPOSE OF THIS ANALYSIS

This paper discusses aspects of Luxembourg law that are not clearly addressed by the current secured transactions framework. There are several considerations in this context:

(i) Some uncertainty appears to originate in the interplay between the conventional codified rules on security rights and the new secured lending and securities legislation covering financial assets. This will be addressed briefly in part 3 (The Scope of Regulation).

(ii) In part 4 (The Reduction of Perfection Formalities), the paper will discuss in detail the meaning of effectiveness of a security right under the Collateral Act (as defined below), because this concept has an impact on the understanding of security rights generally.

(iii) Further questions may arise as to the degree of legal flexibility in respect of atypical forms of security arrangements that are not expressly contemplated by statute. This results from the apparently wide concept of "designation" in favour of a collateral taker which the Collateral Act employs to perfect security in all types of eligible financial collateral.

The last consideration has two separate elements:

First, the recognition of arrangements governed by Luxembourg law, including set-off, that are not conventionally labelled as security rights. This will be discussed in detail in part 5 (Form and Substance in a Functional Reality).

Second, the recognition of arrangements governed by foreign law under which security grantors or their assets are located in Luxembourg, and that wish to benefit from a favourable enforcement process and from insolvency protection. The latter will be discussed in detail in part 6 (Foreign Security Arrangements in a Formal Domestic System).

This paper does not address exhaustively all relevant issues that may arise when domestic or foreign security arrangements are called to operate within Luxembourg. It aims to examine certain features of the Luxembourg regime which include not only aspects relating to the efficiency and to the resilience of the financial markets and financial institutions. These aspects also extend to the idea that property rights, security rights (*sûretés*) and preferential liens (*privilèges*) may be limited in number and operate within a closed system (*numerus clausus*). The customary security rights over movables and immovables, governed by the Luxembourg Civil Code or the Luxembourg Code of Commerce, as well as interests in mobile equipment, will not be taken into consideration in this context.

3. THE SCOPE OF REGULATION

The Luxembourg Chamber of Deputies, when enacting the Act on Financial Collateral Arrangements,[2] has chosen to consolidate novel provisions, restated provisions[3] and established practical and doctrinal approaches in a sector specific statute to facilitate transactions in qualifying financial collateral.[4] Qualifying

2 Act on Financial Collateral Arrangements of 5 August 2005 (*Loi du 5 août 2005 sur les contrats de garantie financière*, Mém. (Luxembourg Law Gazette), 15 August 2005, p. 2212 [hereinafter *Collateral Act*], transposing, *inter alia*, Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, 27 June 2002, [2002] OJ L 168, p. 43 [hereinafter *Collateral Directive*], amended by the Luxembourg Act dated 20 May 2011, Mém., 24 May 2011, p. 1638 [hereinafter *Amending Act*], transposing, *inter alia*, Directive 2009/44/EC of the European Parliament and Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims, 10 June 2009, [2009] OJ L 146, p. 37 [hereinafter *Amending Directive*].

3 These rules include the repealed provisions of the Luxembourg Act of 1 August 2001 on the transfer of title by way of security (*Loi du 1er août 2001 relative au transfert de propriété à titre de garantie,* Mém., 31 August 2001, p. 2183) and the Act of 21 December 1994 on repurchase agreements (*Loi du 21 décembre 1994 relative aux opérations de mise en pension effectuées par les établissements de crédit,* Mém., 31 December 1994, p. 3066).

4 The Collateral Act applies only to "collateral" ("*avoirs*")

financial collateral encompasses tangible and/or intangible financial assets, be they negotiable or non-negotiable. In order to respond to market expectations and to institutional pressures, and to eliminate long identified recharacterization risks and other legal risks in corporate finance and in vital financial markets transactions such as securities lending, repo and money markets transactions,[5] the Collateral Act uses modern variations of the traditional pledge (*gage*), of the transfer of title by way of security (*transfert à titre de garantie*)[6], or of set-off or close-out netting (*compensation*) as legal tools. Further, it expressly regulates repurchase agreements (*mise en pension*) amongst financial institutions. The Collateral Act embeds new and existing rules within the laws of general application, such as the Luxembourg Civil Code, the Luxembourg Code of Commerce and the framework of Luxembourg securities and financial regulatory law, with certain adjustments to the rules in place.

Notwithstanding the many benefits of the Collateral Act, the legislator has refrained from pursuing a wider codification objective. In this context, the Collateral Act appears to trifle with some systemic questions resulting from the interaction between the different pieces of new and existing legislation in the various areas of secured investment and capital market transactions. The legislative materials of the Collateral Act include, for the most part, explanations drawn from international instruments, clarifications related to doctrine or court precedent or general considerations enhancing the position of financial market participants. However, they do not always explain in detail why specific policy and drafting decisions were made or how the legislator has balanced the divergent interests of debtors, creditors or third parties.

To name a few aspects, the Collateral Act uses the terms "provision", "dispossession" ("*dépossession*") and "transfer", all of which originate in the Collateral Directive, to designate dealings in collateral.[7] These terms would not appear to bear any notable difference in meaning. Neither the Collateral Directive nor the Collateral Act define the use of the term "possession" - the linchpin of Civil law systems based on the French Civil Code -, even though modern legislative instruments refer to it as meaning "only the actual possession of a tangible asset […]. not […] non-actual possession described by terms such as constructive, fictive, deemed or symbolic possession."[8] The latter approach differs from the use of the same term in the Civil law. In another respect, the Collateral Act does not expressly coordinate its own priority rules and the priority rules in the laws of general application, such as those governing security rights over a universality of business assets (*gage sur fonds de commerce*), where relevant, or those governing general preferential rights (*privilèges*).[9] Given that the current rules appear scattered among a variety of special laws and contradictory case law, the relationship between the relevant classes

in the form of "financial instruments" and "claims". The Collateral Directive uses the term "collateral" not only for the French term "*avoirs*" (where it is used as a defined term) but also for the French term "*garantie*" which is a synonym for the term "*sûreté*" ("security right"). Similarly, the use by the Collateral Act of the French term "*biens*" ("property"), particularly in the context of the transfer of title by way of security, would appear to be inconsistent with the use of the term "*avoirs*" ("assets") elsewhere in the Collateral Act.

5 See EU, Commission, *Commission Staff Working Document accompanying the Proposal for a Directive of the European Parliament and of the Council amending the Settlement Finality Directive and the Financial Collateral Directive - Impact Assessment*, COM (2008) 213 final, SEC (2008) aaa, online: EU <ec.europa.eu/internal_market/financial-markets/docs/proposal/impact_en.pdf (date accessed: 16 May 2013). For the far reaching and potentially damaging impact on repos that would have been caused by the cascade effects of an unrestricted financial transaction tax in many EU Member States, see P. Middleton, M. Price & J. Richards, *Financial Transaction Tax - toll or roadblock*?, Bank of America Merrill Lynch, London 2013, and, for the significance of the repo market, at 16: "The repo markets are, we think, a bit like London's water mains. They are usually invisible, but when they are brought into view it becomes clear how vital they are to huge numbers of other enterprises."

6 This concept can be linked to the clauses on outright transfer of title to collateral, developed in the early 1990s under the aegis of the Bank of England to address legal risk in the context of collateral for securities lending operations, and later regulated by the Collateral Directive. See R. McCormick, *Legal Risks in the Financial Markets*, 2nd ed. Oxford University Press, Oxford 2010, pp. 237 at 240 ff. It also follows the fiduciary transfer of collateral in the German legal tradition (*Sicherungsübereignung* or *Sicherungsabtretung*), where it has developed because no other economically viable basic form of granting security rights in claims or other movable assets was available and other legal techniques are limited (*numerus clausus*).

7 The use of the term or "dispossession" ("*dépossession*" or "*mise en possession*") would appear to be inconsistent with the use of the defined generic term "provision" ("*constitution*"), suggested by the Collateral Directive which encompasses the creation of a security right through transfer of possession.

8 UNCITRAL *Legislative Guide on Secured Transactions*, UNCITRAL, New York 2010, online: UNCITRAL <www.uncitral.org> (date accessed: 28 May 2013) [hereinafter *UNCITRAL Guide*] at "possession". For purposes of French Civil law, see B. Audit & L. d'Avout, *Droit international privé*, 6th ed., Economica, Paris 2010, p. 677, no. 778; see also Conseil d'Etat, opinion of 13 April 2005 on art. 10 of the bill on the Act on financial collateral arrangements, doc 5251, at 6 ff. cited by F. Debroise, "*La floating charge au Luxembourg: pas si sûr(e)*", *Journal des Tribunaux* 2010, pp. 45 at 53.

9 A preferential creditor enjoys a super-priority over other secured creditors, in addition to a general priority over the common body of creditors (*masse des créanciers*), such as the courts and insolvency officials, employees and the tax and social security authorities. Preferential creditors have either a special preferential claim over a specific asset of the debtor or a general preferential claim over all of the debtor's assets.

of creditors appears distorted. Further, it is unclear to what extent the maxim *lex specialis derogat legi generali* applies where competing secured or preferential creditors do not waive their respective rights or where a secured creditor does not retain possession through the enforcement process. And the Collateral Act could be clearer on whether cash in a securities account should be governed by the rules on securities accounts or the rules on cash accounts.

4. THE REDUCTION OF PERFECTION FORMALITIES

A security right gives a secured creditor the fundamental right to dispose of collateral given to secure certain underlying obligations upon default of the debtor and to subsequently set off its claim against the enforcement proceeds in the order of its priority. Depending on the jurisdiction, a security right also enables a secured creditor to follow the property in the hands of a third party.[10] The secured creditor remains obliged to return any surplus to the defaulting debtor while retaining an unsecured claim on the debtor for any deficiency.

4.1 The "Provision" of Collateral

In the Civil law, to the extent based on the French Civil Code, the traditional security right (*nantissement* or *sureté réelle*) is the pledge (*gage*). The Collateral Act has refrained from fundamentally changing this concept. It has enhanced the pledge by an automatic statutory retention right (*droit de rétention*), similar to a defence of non-performance (*exception d'inexécution*).[11] It has also incorporated the - conceptually similar - transfer of title for security purposes in its system. Both forms of security right, the pledge and transfer of title, can be held against any designated insolvency official acting in respect of the Luxembourg estate of the security grantor. Although the Collateral Act encompasses non-traditional security arrangements such as set-off, repurchase agreements and transfer of title, it does not generally define a security right as a personal property right that, in its economic substance, secures payment or the performance of an obligation.[12] Therefore, it will typically not recognize other security arrangements arising from transactions where the secured creditor retains interests without regard to the form of the transaction. And it is not sufficient for a security right to exist that the intention of the parties to a transaction, examined retrospectively, was to create some sort of security.

The pledge used to employ the concept of "delivery" ("*dépossession*") both to encumber collateral and to render the security right effective against competing creditors and against the debtor of the underlying collateral (where such collateral comprises a claim for the payment of money). This rule still applies in some jurisdictions. Following the general tendency towards easing conventional restrictions on the effectiveness of security arrangements, the Collateral Act has significantly reduced - and in certain cases abolished - this formality. Although language reflecting this approach was notionally maintained in the Collateral Act, security rights over qualifying financial collateral are no longer perfected by any act of actual notice, publication, filing or physical delivery, except in the less frequent cases of security rights over bearer or order securities or in case of certain securities not expressly covered by the Collateral Act.[13] The law does not currently require information concerning the existence of a non-possessory security right over financial collateral located in Luxembourg to be made publicly accessible in a filing, recording or registration system as a condition or result of the security right obtaining priority over the rights of a competing creditor.

According to one of the general rules of interpretation of the Collateral Act, collateral is "provided" ("*constitué*") by being "delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on its behalf."[14] In light of the generic terms "otherwise designated", any form of "designation" allowing the collateral taker to give directions effecting possession or control with regard to the collateral would appear sufficient to constitute and perfect a security right.[15] The

10 See R.C.C. Cuming, C. Walsh & R.J. Wood, *Personal Property Security Law*, 2nd ed. by R.C.C. Cuming, C. Walsh & R.J. Wood, Irwin Law, Toronto 2012, 1 and arts. 2660 ff CCQ. See also Y. Emerich, "*La nature juridique des sûretés réelles en droit civil et en common law: une question de tradition juridique*?" (2010) R.J.T. 44-1, pp. 95 at 107.

11 A retention right entitles a secured creditor to retain (deemed) physical possession of the collateral as against the debtor and third party creditors until satisfaction in full of its claim. See Cass comm., 3 May 2006, Bulletin 2006 IV no 106, p. 107. For a discussion of the security character of this variation of title security (*sûreté-propriété*), see Emerich, *supra* note 9 at 121 ff. with further references. See arts. 2286 and 2367 Code civil (France). The defence of non-performance (*exception d'inexécution*) is a remedy of temporary nature resulting from the principle of reciprocity of contract. It is not subjected to a prior summons to pay (*mise en demeure*) in the way that a claim for damages or a request to the court to terminate the contract would normally be.

12 Contrary to all-obligations clauses under the English Financial Collateral Arrangements (No. 2) Regulations 2003 or the Personal Property Security Acts of the Canadian Common law provinces, Australia and New Zealand (PPSAs), such obligation must be an obligation for the payment of money or an obligation that can be converted into an obligation for the payment of money.

13 See art. 5(2)(b), (d) and (3) and, for the subordination of priority, art. 6(1)(c) and (d) Collateral Act.

14 Art. 2(3) Collateral Act, implementing art. 2(2) Collateral Directive.

15 The meaning of "possession" and "control" of intangibles

relevant provisions of the Collateral Act governing the creation and perfection of security rights use the term "provision" and would appear to be subject to the foregoing general rule of interpretation.

Article 5 of the Collateral Act is the main provision governing the provision and effectiveness as against third parties of a pledge over different types of financial collateral. It states that a pledge "may" be perfected in line with the mechanics set out therein, but would not appear to contain an exhaustive statement of perfection techniques. It follows that other forms of designation effecting possession or control remain theoretically possible. Amongst the express mechanics contemplated, the law operates two distinct types of perfection. The first type consists in automatic perfection tied to the execution of a security agreement (in case of receivables and cash collateral)[16] or of a control agreement (in case of a securities depository) and does not require any further action by the parties thereto.[17] This type is not necessarily available in other European jurisdiction having implemented financial collateral arrangements legislation.[18] The second type requires further action in that it ties perfection or transfer of title to the recording in a corporate register as a matter of evidencing proprietary rights or, in case of paperless negotiable instruments, to earmarking or crediting to a specific account, as applicable. Similarly, a subordination of priority (*cession de rang*) merely requires an approval by any competing secured creditor or a recording, as applicable, and remains undisclosed to third parties.

Where perfection is marked in a register or achieved through the marking of, or the crediting to, an account, these factual connecting factors do not run out of purely legal considerations. The factors may respond, from a practical perspective, to the expectancies of the relevant parties when performing searches in respect of the existence and/or perfection of a security right, where physical delivery is neither possible nor required and a publicly accessible registration system is inexistent. Instant perfection by agreement or control, by contrast, would appear less transparent from the perspective of competing secured creditors that are not party to a security agreement made to the benefit of another lender. An exception applies where such agreement also effects an automatic super priority as a matter of a statutory rule. In that case, interests of certain third parties are generally disregarded based on public policy considerations aiming at achieving legal certainty.[19]

Concluding in respect of the provision of collateral for the purposes of creating a security right,

has been discussed, in the context of a floating charge for purposes of the English Financial Collateral Arrangement (No. 2) Regulations 2003 of 10 December 2003, as am., by The Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 of 15 December 2010, in *Gray and others* v *G-T-P Group Limited: Re F2G Realisations Limited (in liquidation)* [2010] EWHC 1772 (Ch) and, more recently, in *Re Lehman Brothers International (Europe (in administration)* [2012] EWHC 2997 (Ch). See Financial Markets Law Committee (FMLC), *Analysis of uncertainty regarding the meaning of "possession or… control" and "excess financial collateral" under the Financial Collateral Arrangements (No. 2) Regulations 2003*, online: FMLC <www.fmlc.org/Documents/Issue1Analysis.pdf> (date accessed: 10 May 2013).

16 See art. 5(4) and (6) Collateral Act and art. 61(5) of the Luxembourg Securitisation Act of 22 March 2004 (*Loi du 22 mars 2004 relative à la titrisation)*, Mém., 29 March 2004, p. 720, as am. [hereinafter *Securitisation Act*]. In terms of terminology, the Collateral Act uses the terms "claim" (*créance*) and "cash claim" (*créance de sommes d'argent*); however, it does not use the term "credit claim" (*créance privée*) suggested by the Amending Directive. The latter has been introduced to facilitate the use of credit claims - i.e. claims in the form of a loan - as collateral in order to increase competition and to render credit more easily available (beyond the activities of the European Central Bank within the European System of Central Banks), as opposed to other claims for the repayment of money. The Collateral Act, as currently worded, seems indifferent as to either form of claim. Yet, there appear to be divergent views as to whether or not cash deposits in an account are subject to the perfection rules governing a "claim" as collateral. Further, the law assimilates the creation of a pledge with a retention right and of title security in respect of claims. Thus, Art. 6 Collateral Act appears to regulate exclusively questions related to the order of collocation and subordination once pledges have been perfected and rank in accordance with the first-in-time rule (per art. 5(6) Collateral Act).

17 See art. 5(2)(a)(ii) Collateral Act, meaning that the depositary shall act upon instructions from the secured creditor without further consent from the collateral provider. Control by way of agreement is possible in addition to control by virtue of status (if the secured creditor is the depositary) or of account control (if the secured creditor is the account holder). Under art. 16 of the Luxembourg Act of 1 August 2001 on the circulation of securities and other fungible instruments (*Loi du 1er août 2001 concernant la circulation des titres et d'autres instruments fongibles*, Mém., 31 August 2001, p.2180), [hereinafter *Securities Transfer Act*] as amended by the Luxembourg Act of 6 April 2013 on dematerialised securities (*Loi du 6 avril 2013 relative aux titres dématérialisés*), Mém., 15 April 2013, p. 890, in force since 19 April 2013 [hereinafter *Dematerialisation Act*], the depositary (*teneur de compte*), such as Clearstream, no longer benefits from a general statutory preferential lien over all assets in a securities settlement system, but instead benefits from an automatic statutory transfer of title over proceeds received from a securities transaction and undertaken for the account of a participant. See also art. 14(2) Collateral Act. In practice, this title security will trump all security rights perfected in respect of the same collateral. The general business conditions of the relevant intermediary may continue to create security rights over all other assets held on account. Luxembourg general preferential liens may affect such security rights depending on whether or not the intermediary retains possession through the enforcement process.

18 For example, pledges over financial collateral governed by Netherlands law do not appear to permit undisclosed pledges (contrary to ordinary pledges).

19 See *infra* notes 89 ff and accompanying text.

the concept of physical delivery has become an irrelevant fiction when compared to the realities of secured transactions practice. Instead, the law offers great flexibility as to available means of perfection, tailored to the practical needs of market participants dealing with certain types of financial collateral.

4.2 Secrecy vs Publicity of Security Rights

The simplified perfection rules under the Collateral Act aim at achieving finality and legal certainty in financial transactions involving qualifying financial collateral. Beyond this immediate purpose, the policy rationale of the rules is to promote a level playing field for all secured creditors, either credit institutions in the inter-bank market or persons habitually or not habitually involved in business transactions. Further, the rules avoid any true publicity of security rights which promotes the confidentiality of the taking of collateral. It is not always clear whether or not the absence of publicity is a conscious domestic policy choice or the simple consequence of the legislative response to today's realities in the international financial markets. Particularly in the area of securities collateral and cash collateral, this approach appears to be owed to the realities of the financial markets where transactions take place in matter of "days or hours rather than weeks, making it impractical to obtain waivers and subordinations from prior creditors" and to the fact that the rules governing priority "are so complex and subject to so many exceptions that few if any law firms can give the priority opinions that secured parties desire".[20] To the foregoing considerations may be added the unlikelihood that third parties may be misled where the relevant financial institution is obliged to confirm the existence of a security right upon request of an interested party (with debtor consent) and where good faith acquisitions are protected. Further, diligent professionals doing business in Luxembourg may be assumed to be alert to the possibility of competing security rights.

Thus, any form of true publicity of a security right used in international financings (except for traditional Civil code security rights over movables or immovables), be it through recording or by way of notice or notional debtor dispossession, may be deemed an unnecessary - or even undesirable - formality. In reality, the reduction or abolition, as the case may be, of formalities would point towards reducing a security right to a mere personal obligation (*contrat consensuel*) that disregards the fundamental differences between contractual preferential rights and proprietary rights. Particularly in securities and derivatives transactions, instant perfection, either through transfer of title for security purposes or through control, seems to ensure a similar degree of legal certainty as to the priority of the secured parties.

The Collateral Act aligns Luxembourg law with harmonisation initiatives in the international law and regulation of securities holding, transfer and settlement and of over-the-counter derivatives transactions, amongst others, brought about by instruments such as the Amending Directive or the Geneva Securities Convention[21] and influenced by Dodd-Frank[22] and EMIR[23] legislation on central counterparties, all of which affect the secured transactions system. This harmonisation has taken similar approaches across jurisdictions and adopted an instant perfection regime similar, to some extent, to the perfection by control regime of Article 8 of the Uniform Commercial Code (UCC) which governs the taking of security rights in investment securities in the United States. It would also appear to bring Luxembourg law somewhat closer to the corresponding developments in French law and to existing German legal practice. In France, the law has evolved to overcome the customary concept of delivery and includes a security right without delivery (*gage sans dépossession*),[24] while German legal practice traditionally embraced a regime without publicity requirements for security rights over personal property. Recently, Belgium has decided to take a similar route and to abolish the delivery (or dispossession) requirement.[25] Where no public filing is required in the relevant jurisdiction, aspects of third party protection

20 Ontario Personal Property Security Law Sub-Committee of the Ontario Bar Association's Business Law Section, "Perfecting Security Interests in Cash Collateral", 6 February 2012, online: Ontario Bar Association <www.oba.org/en/pdf/PerfectingSecurityInterest.pdf> (date accessed: 14 May 2013), p. 3.

21 UNIDROIT, *Convention on Substantive Rules for Intermediated Securities*, 9 October 2009, Unidroit, Geneva 2009, online: Unidroit <www.unidroit.org/english/conventions/2009intermediatedsecurities/convention.pdf > (date accessed: 9 May 2013) [hereinafter *Geneva Securities Convention*].

22 *Dodd-Frank Wall Street Reform and Consumer Protection Act* (H.R. 4173 (111th), Title VII.

23 EU, Parliament and Council, *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties (CCPs) and trade repositories (TRs)*, 27 July 2012, [2012] OJ L 201, p.1, in force since 16 August 2012 [hereinafter *EMIR*].

24 See art. 2336 Code civil (France) which reads as follows: "Le gage est parfait par l'établissement d'un écrit comprenant la désignation de la dette garantie, la quantité des biens donnés en gage ainsi que leur espèce ou leur nature." See also art. 5(2)(a) Collateral Act, implementing provisions of the Amending Directive; art. 19 Geneva Securities Convention.

25 See *Loi du 30 mai 2013 modifiant le Code civil en ce qui concerne les sûretés réelles mobilières et abrogeant diverses dispositions en cette matière*, 30 May 2013 (unpublished) [hereinafter *Movable Asset Security Act*]. This new regime reforming security rights over movable assets is expected to enter into force as determined by Royal Decree, but no later than by 1 December 2014.

are solved by classic protection of good faith in apparent authority,[26] including where a register or account is incomplete or inaccurate. These systems operate a deemed publicity of security rights which also addresses secrecy preferences of financial institutions without regulating access to information.

At the same time, many jurisdictions have abolished their fragmented systems of security rights and have regulated, or are in the process of regulating, their secured transactions regime in a comprehensive manner, covering every conceivable kind of personal property, not only in respect of collateral used in the securities and capital markets. They have done so, or are doing so, by establishing transparent public filing, registry and priority systems akin to UCC Article 9 and to the similar rules in the personal property security legislation of major Common law jurisdictions, in particular the PPSAs[27]. For example, these developments have taken place in the central and eastern European jurisdictions having implemented the EBRD Model Law on Secured Transactions to promote private sector development[28] and have been recommended by the UNCITRAL Guide. In order to make the secured transactions system more efficient, certain and transparent, France has similarly replaced delivery by a court based public filing maintained by its National Council of Commercial Court Registrars[29] and Belgium has voted to establish an electronic central registry for security rights over movable assets, such as inventory, receivables or intellectual property rights.[30] In these areas of secured lending, there appears to be more tolerance for differences in public policies addressing the secrecy and publicity of security rights, notably because the relevant markets are less integrated than the international securities and capital markets. Publicity of personal property security rights is the general rule in these cases, without public filing necessarily being the only means to achieve third party effectiveness. Thus, public registration or publicity requirements do not apply without exceptions, reflecting the type of collateral, the transactions, the particularities of the jurisdiction and specificities of the markets in which such collateral is used. Systemic differences concerning transparency and publicity for security rights on the one hand and the need for instant perfection rules on the other cannot subsist in a capital market spanning all continents, regardless of whether or not the relevant legal system is based on the Common law or on the Civil law.

5. FORM AND SUBSTANCE IN A FUNCTIONAL REALITY

The reduction of formalities for traditional security rights covering financial collateral (including title transfer devices) under current Luxembourg law would appear to blur the line between absolute security rights and quasi-security rights on the one hand and to do away with the traditional clear distinctions between absolute security rights and contractual set-off arrangements on the other. That is, all of the foregoing provide credit support and in substance secure payment or the performance of an obligation. Conceptually, the piecemeal process of regulating security rights, without considering all types of credit support in a comprehensive manner, has been an ongoing issue in many Civil law jurisdictions and leaves uncertainties that may lead to important application difficulties. The functional reality of credit support in today's markets has also diminished classical features of pledges such as their accessory or contingent nature. The foregoing aspects will be addressed subsequently.

26 The conceptually equivalent "*possession vaut titre*" is important to prevent a secured creditor from perpetually severing possession and real right. See art. 7 Collateral Act and art. 12 Securities Transfer Act, implementing provisions of the Geneva Securities Convention.

27 Some of their concepts have made impacts to the Civil Code of Québec (CCQ) which is based on the French Civil Code. The PPSAs also inspired the UNCITRAL *Convention on the Assignment of Receivables in International Trade*, 12 December 2001, G.A. doc A/Res/56/81, UNCITRAL, Vienna 2001, online: UNCITRAL <www.uncitral.org> (date accessed: 8 May 2013). See generally Cuming, Walsh & Wood, *supra* note 10 at 83ff. Given the existing benefits for institutional lenders in England, no such reform has proceeded in this jurisdiction. See, for example, M.G. Bridge, R.A. Macdonald, R.L. Simmonds & C. Walsh, "Formalism, Functionalism, and Understanding the Law of Secured Transactions," 44 *McGill L J* 1999, pp. 567 at 633 ff.; J. Ziegel, "The travails of the English Chattel Security Reform - a Transatlantic View," *Ll M C L Q* 2006, pp. 110.

28 European Bank for Reconstruction and Development, *Model Law on Secured Transactions*, London 1994, online: EBRD <www.ebrd.com/downloads/research/guides/secured.pdf> (date accessed: 29 April 2013).

29 See *Ordonnance n° 2006-346 du 23 mars 2006 relative aux sûretés*, J.O., 24 March 2006, p. 4475; *Décret n° 2006-1804 du 23 décembre 2006 pris pour l'application de l'article 2338 du code civil et relatif à la publicité du gage sans dépossession*, , J.O., 31 December 2006, p. 20368, in force since 1 March 2007 as well as art. 2348 Code civil (France) for out-of-court enforcement. For the troubling application difficulties caused by these (incomplete) reforms in the case of a parallel regime for a universality of business assets (inventory) requiring physical dispossession, see, for example, the judgment of Cass. com, 19 February 2013 (no. 11-21.763) which has caused widespread consternation in the legal community, amongst most legal academics and amongst investors. See Th. de Ravel d'Esclaponle, "Gage des stocks - exclusivité du régime," *Dalloz actualités*, 22 February 2013, online: Dalloz <http://www.dalloz-actualite.fr/essentiel/gage-des-stocks-exclusivite-du-regime>, with further references.

30 See Movable Asset Security Act, *supra* note 25. It is understood that data protection issues are being discussed and may limit the accessibility of the registry. Note that publicity is not sufficient to set up a security right against an account debtor under the CCQ or the PPSAs, see arts. 1638 ff CCQ and, for example, s 41(7) New Brunswick *Personal Property Security Act*, S.N.B. 1993, c. P-7.1 [hereinafter *NB PPSA*]. For Luxembourg, see *supra* note 16 and accompanying text.

5.1 Security Rights and Quasi-Security

Quasi-security rights typically encompass arrangements such as title reservation (for purposes of purchase money financing), repurchase agreements (whether or not based on transfer of title) or leasing agreements (for purposes of a financial lease) or certain cash collateral arrangements (including flawed asset arrangements discussed below or other arrangements). The Collateral Act addresses expressly the most critical quasi-security required for the operation of the financial sector, such as the repurchase agreement. From a traditional Civil law perspective, the transfer of title for security purposes would appear to also qualify as some sort of quasi-security.[31] It would not appear to matter in this context whether or not the arrangement is construed as accessory to the secured obligations and may be affected by defences affecting the validity or the enforceability of the secured obligations.

Unlike formal security agreements, a quasi-security would not necessarily contain explicit charging language such as "the debtor hereby grants a pledge" or, in terms of the Collateral Act, equivalent evidence in writing (at least in electronic form or on another durable support). It may merely convey the debtor's intention to create a security right which, in certain jurisdictions, may be sufficient to apply certain rules governing secured transactions.[32] In any event, such security agreement would not need to indicate the specific sum for which it is granted or the applicable interest rate in order to constitute a Collateral Act security right. The traditional example for a comprehensive approach to security interests and to arrangements having similar effects are the UCC, some of the modern Common law secured transactions regimes mentioned above or, more recently, the UNCITRAL Guide that in general[33] expressly provide that they apply to every transaction that in substance creates a security interest. In the case of specific agreements, such as an outright assignment, some of these jurisdictions go even further by deeming such arrangements a security interest even if they do not secure the payment of an obligation.

A flawed asset arrangement is one example for an unregulated quasi-security.[34] Under a flawed asset arrangement, the debtor's right to collect and dispose of a cash deposit for its own account in its ordinary course of business is limited until such time as it has satisfied certain obligations. If these obligations have not been satisfied, the creditor may use the deposit monies to exercise a right of set-off.[35] Further, a pledge over claims[36] may be validly granted, *a fortiori* it may be said, when the security provider has transferred effective control of a claim to a creditor by giving it the right to collect directly (without further approval from the security provider) upon the occurrence of an event of default, and where the agreement fulfils the conditions of an outright assignment of claims, in particular as regards debtor notification (to the extent required). Both examples resemble a transfer of title or an assignment with reduced effect because they convey control, although the parties neither expressed their wish to create a security right nor submitted the arrangement to the Collateral Act.

The functional similarity between formal security rights and quasi-security arrangements becomes even more apparent considering that Luxembourg pledges are enhanced by an automatic retention right created by statute. The title-based quasi-security right originating in a personal obligation, inherent in each retention right and vesting a secured creditor with possessory powers as against the legal asset owner, is the key driver for this conclusion. Even in light of this striking resemblance, the law would not appear to explicitly clarify the treatment of quasi-security within its existing secured transactions system, exception made for title-based repurchase agreements, or potentially other arrangements that partially fall within the scope of the Collateral Act.

31 Note that under the CCQ certain registration requirements for security rights (*hypothèque*) extend to instalment sales (*vente à tempérament*), art. 1745 CCQ, sales with redemption rights (*vente à réméré*), art. 1750 CCQ, leasing (*crédit-bail*), art. 1846 CCQ, and lease (*bail*), art. 1852 CCQ.

32 In the Civil law, characterization of a transaction is a function of form, not of substance, as a rudimentary means of debtor protection. This has been confirmed by judgments of the Supreme Court of Canada dealing with the publication for perfection purposes of leases, leasing contracts and instalment sales, being title security. See Supreme Court of Canada, 28 October 2004, *Lefebvre (Trustee of); Tremblay (Trustee of)*, [2004] 3 S.C.R. 326, 2004 SCC 63.

33 It is understood that each jurisdiction has operated adjustments to the common approach in light of local policy particularities in specific provinces or territories.

34 Flawed asset arrangements are used, for example, in certain ISDA Credit Support Annexes or ISDA Master Agreements and would appear to fall under some of the PPSAs.

35 Note that set-off clauses are dealt with at arts. 18 ff. Collateral Act. However, they have not been not included in the definition of financial collateral arrangement at art. 1(4) Collateral Act. The latter reads as follows (translation by author): ""financial collateral arrangement" means a pledge agreement, a transfer of title by way of security, a repurchase agreement or a fiduciary transfer governed by this Act." See below for further considerations in this context.

36 In Québec, a pledge over claims was held to consist in a movable hypothec with delivery (*dépossession*) and susceptible to be taken over a non-negotiable debt instrument in the form of a certificate of deposit. See Supreme Court of Canada, 5 June 2003, *Caisse populaire Desjardins de Val-Brillant* v. *Blouin*, [2003] 1 S.C.R. 666, 2003 SCC 31. Consequently, the CCQ was amended to require physical delivery of the collateral. See Cuming, Walsh & Wood, *supra* note 10 at 94 ff. with further references.

Secured creditors may well wonder whether or not, in light of the specific features of the Collateral Act, Luxembourg courts may assess certain quasi-security arrangements, such as the examples mentioned above, as security rights, regardless of where these arrangements originate. In light of the general requirement that the arrangement must at least "designate the collateral so as to be in the possession or under the control of the collateral taker",[37] there would appear to be good reasons to consider these types of arrangement as security rights governed by the Collateral Act.

5.2 Contractual Set-Off as a Quasi-Security perfected by Control

The simplified perfection regime for formal security rights, particularly the instant perfection in respect of claims and the general control requirement in the Collateral Act, as discussed above, inevitably raises the question of how credit support in cash in the form of a set-off arrangement (*compensation*) should be characterised.[38] Indeed, the current regime of cash collateral arrangements makes it difficult to distinguish formally created security rights operating automatic perfection from simple set-off arrangements resulting from a personal obligation. Traditionally, the distinguishing feature of a security right is the right to enforce upon assets (*avoirs*) or property (*biens*). Quasi-security as credit support based on a purely personal obligation, to the extent not based on title, by contrast, traditionally had a fundamentally different character.[39] As such, set-off is not an arrangement that gives a creditor a formal property right (*droit réel*) in the collateral but constitutes a right (contractual or legal) that enables a creditor to apply an amount owing to satisfy its own payment obligation. In practice, the automatic retention right included in a formal security right created would appear to be a typical prelude to set-off in that both relate to reciprocal debts that arose from the same contract or transaction.[40] In a nutshell, a set-off clause operates like a security right created by way of control, but not technically as a result of its legal form.

It is generally admitted, although not free of doubt, that quasi-security arrangements operate within a closed system (*numerus clausus*) of property rights, security rights and preferential liens (*privilèges*) in the Luxembourg Civil Code as a result of which it would not be possible to create security rights that are not enumerated or dealt with by statute.[41] In light of the practical effects of set-off described above, it may be asked whether or not the existence of any closed system may be assumed to continue under the current regime and continue to interpose artificial borders between set-off and formal security rights, both of which benefit from the same insolvency protection. What is more, the enforcement rules of the Collateral Act expressly refer to setting off the value of the collateral, in particular enforcement proceeds, against due and payable amounts outstanding under a secured claim in accordance with ordinary set-off rules.[42] The bottom line therefore appears to be that, in terms of practical effects on the secured obligations, differences can be traced no longer between credit support by way of contractual set-off and by way of security over cash held on deposit. The enforcement and priority regime of both forms of credit support, however, is emblematic of their continuing opposed characteristics. This makes it difficult to fully reconcile both in a unitary regime.

In addition, the Collateral Act does not set out an express rule governing the priority between set-off arrangements and formal security rights over

37 See *supra* note 14 and accompanying text.

38 For a Québec analysis of this point, see Supreme Court of Canada, 19 June 2009, *Caisse populaire Desjardins de l'Est de Drummond* v. *Canada*, 2009 SCC 29, [2009] 2 S.C.R. 94. This judgment held that an agreement between a lender and borrower with respect to set-off against a term deposit gave rise to a "security interest" within the meaning of the Canadian federal Income Tax Act. Consequently, the lender's right to set-off its term deposit obligation against the borrower's loan obligation was subject to a statutory priority of the federal government with respect to income tax deductions. The judgment caused consternation in the legal and business community because it extended the scope of perfection requirements to arrangements which parties may not have drafted so as to constitute security rights. Thus, art. 11.1 Québec Derivatives Act, RSQ, c I-14.01, was amended as follows: "An instrument under which a person is required to pay an amount of money to a party to a derivative, including as a margin or settlement deposit, and which allows that party, in all circumstances described in the instrument, to extinguish or reduce, by means of a set-off, its obligation to repay that amount to the person is enforceable against third persons without further formality. […]." See also Cuming, Walsh & Wood, *supra* note 10 at 666 f.

39 See Supreme Court of Canada, *ibid*., per Deschamps J. (dissenting).

40 See, for example, J. Ghestin, M. Billiau & G. Loiseau, *Le régime des créances et des dettes*, L.G.D.J., Paris 2005, at 1011, no 976.

41 See arts. 543 and 2094 Code civil (Luxembourg). The concept originates in the unitary notion of ownership in civil codes and the need to protect third party rights (typically by way of publicity) from the decisions of secured creditors. See *Motive zu dem Entwurfe eines Bürgerlichen Gesetzbuches für das Deutsche Reich*, vol. III 1888, pp. 1-3. For its origins and current discussions in this area, see, for example, T.H.D. Struycken, "The Numerus Clausus and Party Autonomy in the Law of Property," in: R. Westrik & J. van der Weide (eds), *Party Autonomy in International Property Law*, Sellier, Munich 2011, pp. 59. For similar discussions in Québec, see M. Cantin Cumyn, "De l'existence et du regime juridique des droits réels de jouissance innommés - essai sur l'énumération limitative des droits réels" 45 *R. du B.* 1986, pp. 3. From a comparative perspective, see J.M. Milo, "Property and real rights," in: J.M. Smits (ed), *Elgar Encyclopedia of Comparative Law*, 2nd ed. Edward Elgar Publishing, Inc., Cheltenham, Gloucester, UK & Northampton, Massachusetts, 2012, 726 at 733 ff.

42 See art. 11(1)(d) Collateral Act which refers to the ordinary set-off rules at arts. 18 ff Collateral Act.

cash collateral.[43] In a cross-border context, the priority among a set-off creditor and its competing secured creditor in respect of a pledgor of cash (as original counterparty), arising out of the terms of the contract or a related contract with such pledgor, would not appear to be governed by the law applying to its security arrangement but rather by the law governing the claim against the account debtor. Hence it could fall outside the scope of Luxembourg law where such debtor is located in another jurisdiction.[44] Third party publicity or the question of whether or not set-off may be set-up under the governing law of the security right would appear irrelevant in this context. Further, it is generally accepted that failure to exercise a right of set-off as such would not result in a subordination of those set-off rights of an unsecured creditor to the rights of a competing pledgee.[45] Instead, it obeys its own enforcement conditions existing as matter of law or agreed amongst the parties. In general terms, the rule in respect of priority is that set-off would prevail - as some sort of super priority - over other forms of security rights, such as pledges and preferential rights, whether perfected before or after the set-off arrangement has taken effect, as applicable.

In order to defeat the ordinary super priority effects that, as described above, would typically result from the freedom of an account debtor to set up, by way of defence against a competing secured party, all set-off rights, anti-assignment clauses or other defences available to it against the pledgor or assignor (as original counterparty), it is crucial to have such debtor (legally or contractually) disapply such defences multilaterally and therefore maintain the priority as created under the terms of the security arrangement with the pledgor or assignor.[46] Commercial considerations, particularly in case of ordinary trade receivables, may not always permit such waiver to take effect and the relevant security documentation may not necessarily comprise a waiver as standard feature. From a public policy perspective, however, the possibility to override set-off and other defences strengthens the independent proprietary character of such claims, limiting the impact of any events affecting the validity or the enforceability of the secured obligations and, in general, reduces the potential for collateral claims to be less liquid and further facilitates their circulation.[47] A waiver of set-off rights provides added benefit to the legislative limitations applying to contractual anti-assignment clauses and reduces the need for a secured creditor to due diligence the terms of the documentation evidencing credit claims. In addition, the Collateral Act which - unlike the Securitisation Act[48] or the PPSAs - does not contain an express statement prohibiting anti-assignment clauses,[49] would appear to implicitly restrict the effectiveness of such clauses through its automaticity of perfection in respect of cash claims and its protection of good faith in apparent authority of the grantor in respect of the collateral (*possession vaut titre*).[50] However, damages may need to be assessed against the pledgor or assignor following any violation of such clause.[51]

43 Art. 5(6) Collateral Act applies only to pledge agreements and reads as follows (translation by author): "The priority of pledges is determined by the date on which they become effective against third parties." It is understood that typical security arrangements would ensure that no competing set-off arrangements exist in respect of the collateral claim.

44 Under uniform conflict of laws rules at art. 14(1) and (2) of the EU, Council, *Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I)*, [2008] OJ L 177, p. 6 [hereinafter *Rome I*], the question of whether or not the law permits an account debtor to set up by way of defence against a competing secured party defences available to it against the pledgor arising out of the terms of the contract or a related contract or whether the law outrules any such set up of defences (even without express waiver) is governed by the law governing the collateral claim against such debtor. In an insolvency context, an additional test under art. 6 EIR requires that the law governing the account debtor's claim against the counterparty permit the set-off under the relevant set-off arrangement. In UCC and PPSA jurisdictions as well as under the Securitisation Act (art. 58(2)), the law of the location of the assignor determines the applicable rules in this context. For a discussion of these issues, see J. Krupski, "Cross-Border Receivables Financing at the Crossroads of Legal Traditions, Capital Markets, Uniform Law and Modernity" *Uniform L.R.* 2007, pp. 57.

45 Other rules apply where such unsecured creditors' own creditors are affected. See Ghestin, Billiau & Loiseau, *supra* note 40, p. 1051 ff., nos 1026 ff. with further references.

46 See art. 2(5) and (6) Collateral Act.

47 This would keep with the solutions retained in other jurisdictions implementing reformed securities transfer regulations, such as those implementing amendments resulting from the Canadian Securities Administrators Uniform Securities Transfer Act Task Force, *Uniform Securities Transfer Act*, 26 August 2004, online: Uniform Law Conference of Canada < http://www.ulcc.ca> (date accessed: 20 February 2013) [hereinafter *USTA*]. See, for example, s 40(1.1) Ontario Personal Property Security Act, S.O. 1989, c. 16, R.S.O. 1990, c-P-10 as am [hereinafter *OPPSA*] which reads as follows: "An account debtor who has not made an enforceable agreement not to assert defences arising out of the contract between the account debtor and the assignor may set up by way of defence against the assignee, (a) all defences available to the account debtor against the assignor arising out of the terms of the contract or a related contract, including equitable set-off and misrepresentation; and (b) the right to set off any debt owing to the account debtor by the assignor that was payable to the account debtor before the account debtor received notice of the assignment."

48 See art. 57 Securitisation Act.

49 See section 5.3 below.

50 See arts. 5(4) and 7 Collateral Act.

51 See, for example, s 40(4) OPPSA which reads as follows: "A term in the contract between the account debtor and the assignor that prohibits or restricts the assignment of, or the giving of a security interest in, the whole of the account or chattel paper for money due or to become due or that requires the account debtor's consent to such assignment or such giving of a security interest, (a) is binding on

The foregoing considerations demonstrate that constraints of the financial markets and the modern rules governing the relationship between security rights and set-off aim to reduce the practical differences resulting from the different forms of cash collateral arrangements. However, many of the features of real rights remain in effect for security rights created by mere contract while set-off continues to pertain, predominantly, to the law of obligations. These legal realities may not necessarily allow for every practical application of the existing rules to operate without frictions.

5.3 The Accessoriness of Security Rights

The nature of the support required for today's credit and securities transactions undertaken by financial markets participants required further fundamental adjustments as a subset of the more apparent modern changes to the usual classifications of security rights. In the Civil law, these adjustments relate to the accessory character of security rights which may be comparable to the equitable right of redemption in the Common law. The central design elements of both of the aforementioned features are the automatic transfer or extinction of the security right when the secured obligations are transferred or extinguished and the right to repay the debt and to reinstate security by redeeming the property encumbered by the security interest, respectively.[52] The morphing of the contingent nature of security rights can be perceived in several respects, even if accessoriness has never had any absolute character in the Civil law.

The first consideration, as already mentioned, is the possibility of waiving set-off rights, anti-assignment clauses or other defences rooted in collateral claims. It reflects the modern tendency to prohibit clauses that hinder the circulation of collateral in the ordinary course of business.[53] This feature is complemented by the taking of security relying in good faith on the apparent authority of the grantor and any reduction of the usage value of the collateral. The significance of the right to follow, where relevant, is therefore clearly reduced.

Secondly - unusual in a Civil law setting - the Collateral Act does not require that senior debt be due and payable and does not provide for any pre-requisite acceleration of senior debt prior to enforcement of the security right. Therefore, it is technically possible under the terms of the security right not only to enforce upon the occurrence of a payment default, but to enforce based on a financial covenant default, cross-default or events external to the parties[54] or to agree on the exercise of voting rights in specified circumstances. In addition, enforcement may depend on any agreed consent requirements or other contractual restrictions internal to the creditors (e.g. under intercreditor arrangements or, in a US context, resulting from hedging, intercompany loan or second lien arrangements). Considerations in this context have clearly moved away from aspects linked to payment obligations as such.[55]

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the assignor only to the extent of making the assignor liable to the account debtor for breach of their contract; and (b) is unenforceable against third parties." See also art. 9 of the UNCITRAL *Convention on the Assignment of Receivables in International Trade*, 12 December 2001, G.A. doc A/Res/56/81, UNCITRAL, Vienna 2001, online: UNCITRAL< www.uncitral.org> (date accessed: 15 February 2013) [hereinafter *Receivables Convention*]. See ss 9-406, 9-407, 9-408 and 9-409 UCC. Similarly, in other jurisdictions based on the Civil law, such right of set-off is, in certain circumstances, excluded as a matter of general policy. For example, art. 1680 CCQ reads as follows: "A debtor who has acquiesced unconditionally in the assignment or hypothecating of claims by his creditor to a third person may not afterwards set up against the third person any compensation that he could have set up against the original creditor before he acquiesced. […]" Similar rules apply under European civil codes.

52 For example, see the express explanations provided by arts. 2761 ff CCQ and s. 62 NB PPSA. According to the anecdotal statement in *Best Fertilizers of Arizona Inc* v *Burns*, 117 Ariz 178, 571 P 2d 675 (App 1977) "The note [i.e. personal obligation] is the cow and the mortgage the tail. The cow can survive without the tail, but the tail cannot survive without the cow." The German land charge (*Grundschuld*) has long been one of the traditional security rights lacking accessory character. However, to avoid misuse by secured creditors the land charge has been rendered accessory in that the chargor may set up against the assignee of the secured obligation any defences that it had against the assignor, such as the defence that the secured obligation has been discharged in whole or in part, see § 1192(1a) BGB.

53 See the relevant provisions of the Securitisation Act, the PPSAs, the UCC and the Receivables Convention, or of the Ottawa *Convention on International Factoring* of 28 May 1988, 27 ILM 1988, p. 943, in force as of 1 May 1995.

54 This applies regardless of whether these events are labelled "event of default", "enforcement event", "declared default", "dissolution event" or "acceleration event".

55 See also art. 11 of the Cape Town *Convention on International Interest in Mobile Equipment*, 16 November 2001, Unidroit, Rome 2001, online: Unidroit <www.unidroit.org> (date accessed. 28 May 2013) [hereinafter *Cape Town Convention*], implemented in Luxembourg by *Loi du 28 mai 2008 portant approbation de la Convention du Cap du 16 novembre 2001 relative aux garanties internationales portant sur des matériels d'équipement mobiles et de son Protocole portant sur les questions spécifiques aux matériels d'équipement aéronautiques*, Mém., 9 June 2008, p. 1102, which reads as follows: "1. The debtor and the creditor may at any time agree in writing as to the events that constitute a default or otherwise give rise to the rights and remedies specified in Articles 8 to 10 and 13. 2. Where the debtor and the creditor have not so agreed, "default" for the purposes of Articles 8 to 10 and 13 means a default which substantially deprives the creditor of what it is entitled to expect under the agreement." See H. Wagner & A. Djazayeri, "La réalisation du gage en temps de crise - aspects juridiques", 45 *ALJB Bulletin Droit et Banque* 2010, pp. 39 at 40 f; D. Boone & D. Maria, "Renforcer la sécurité juridique de la réalisation des garanties financières - l'appel à la loi", 9 ACE 2010, pp. 3 at 12 f. with further references, in particular to the opinion of the Conseil d'Etat, *supra* note 8, at 2. Given

Further, under the Collateral Act, like in other developed jurisdictions, a representative can be appointed as holder of the security right for the benefit of present or future secured creditors, to the extent that the beneficiaries of the relevant security right are identified or can be identified. As such, it is not necessary that all the secured creditors be direct holders of the security right over qualifying collateral in order to have them benefit therefrom or that the security representative be formally appointed to hold the security right on behalf of future, unknown members of a syndicate of lenders. It is not the purpose of this paper to dwell on settled practical considerations, such as parallel debt or agency arrangements, in this context.

Finally, the possibility to transfer title by way of security (*sûreté-propriété*) defeats the security grantor's right to redeem where a re-transfer of collateral has not been contractually agreed or where a total or partial non-performance of the secured obligations has occurred. The same analysis applies where the settlement of securities collateral for purposes of a securities lending transaction occurs by way of close-out netting between securities. The possibility given by the Collateral Act to a collateral taker to deal with credit claims or securities as if it were the owner of those claims and enabling it to substitute or rehypothecate collateral credit claims by way of a so-called "right of use" ("*droit d'utilisation*") reflects the substantial needs of participants in the financial markets infrastructure over traditional legal rules that may otherwise become a source of legal risk.[56] The foregoing rules follow the title transfer collateral mechanics created in England and developed further under the Collateral Directive.

Concluding on this part, the accessory nature of security rights has diminished in significance and cannot necessarily be considered as a core feature of a security right that would preclude arrangements without any contingent nature from being considered as being equivalent to formal security rights. In legal practice, careful drafting and transaction structuring should not normally raise characterisation problems in terms of quasi-security, set-off or accessoriness.

6. FOREIGN SECURITY ARRANGEMENTS IN A FORMAL DOMESTIC SYSTEM

Characterization questions arise where foreign security arrangements need to be assessed as to their effects within the domestic legal system. This is of particular relevance when considering whether or not such foreign arrangements, with or without express charging language, could be viewed as similar to a corresponding Luxembourg security right and could benefit from certain creditor-friendly features of Luxembourg law. Characterization is also of importance for the classification or priority treatment of such arrangements in Luxembourg insolvency or similar proceedings. Additional limits may be imposed by the *numerus clausus* of real rights and security rights (as rights *in rem*).

6.1 Foreign Rights in rem under the European Insolvency Regulation

Article 5 EIR is the relevant provision addressing questions related to foreign security rights in main insolvency proceedings in the European Union (except Denmark).[57] In a European insolvency context, the closed system of security rights must be understood on a cross-border basis. This means that a competent Luxembourg court or insolvency official appointed for a company would be required to give full effect to a foreign security arrangement, constituting a right *in rem*,[58] that does not have, in all respects, the legal nature of a domestic security right where it covers collateral located in an EIR Member State (other than Luxembourg). This rule applies even if such foreign right *in rem* (for

that the French term "*garantie*" ("security interest") is used to ensure neutral language across jurisdictions, detached from existing national concepts of security rights, it would seem rather doubtful that the choice of this term (i.e. "*garantie*" instead of "*sûreté*") could have any impact on the functional or non-accessory character of a security right. See, for example, the definitions of "security agreement" or "security right" in the UNCITRAL Guide that read as follows: “Security agreement” means an agreement, in whatever form or terminology, between a grantor and a creditor that creates a security right. […]" “Security right” means a property right in a movable asset that is created by agreement and secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right […]". Art. 1 Collateral Act does not contain any such clarification. See also the definition of "international interest" ("*garantie internationale*") in the Cape Town Convention.

56 See art. 10 Collateral Act; art. 34 Geneva Securities Convention; Ph. Dupont, "Le transfert de propriété à titre de garantie" 34 *ALJB Bulletin Droit et Banque* 2002, pp. 5.

57 For the equivalent rules applicable to Luxembourg credit institutions, see art. 61-10 of the Luxembourg Act of 5 April 1993 concerning the financial sector, as amended.

58 See M. Virgos, *Report on the Convention on Insolvency Proceedings* by M. Virgos & E. Schmit, Doc. 6500/96/EN (1996), online: University of Pittsburgh <http://aei.pitt.edu/952/1/insolvency_report_schmidt_1988.pdf> (date accessed: 8 May 2013) [hereinafter the *Report*], pp. 74, nos 102 ff., who flags two main characteristics of a right *in rem*: "(a) its direct and immediate relationship with the asset it covers, which remains linked to its satisfaction, without depending on the asset belonging to a person's estate or on the relationship between the holder of the right in rem and another person; and (b) the absolute nature of the allocation of the right to the holder. This means that the person who holds a right in rem can enforce it against anyone who breaches or harms his right without his assent (e.g. such rights are typically protected by actions to recover); that the right can resist the alienation of the asset to a third party (it can be claimed *erga omnes*, with the restrictions characteristic of the protection of the *bona fide* purchaser); and that the right can thus resist individual enforcement by third parties and in collective insolvency proceedings (by its separation or individual satisfaction).".

purposes of the EIR) grants either more extensive or other types of rights to a secured creditor than are known under domestic law.

To take a classical example, a competent court or insolvency official will give full effect to a floating charge or one of the quasi security arrangements mentioned above, where it is recognised as right *in rem* and covers collateral located (at the time of its creation or perfection) in such Member State,[59] regardless of whether or not it can be assimilated to a Luxembourg security right. However, Article 5 EIR does not explain how a right *in rem* must be characterized. And it does not explain whether or not a right *in rem* includes all types of security right and regulated or unregulated quasi-security arrangements (such as title retention, flawed asset arrangements or repurchase agreements mentioned above). Instead, read in conjunction with Article 2(g) EIR, it merely aims to locate the relevant asset.[60] Based on the official report on the predecessor convention to the EIR,[61] only the law of the jurisdiction where the relevant assets are located (*lex causae*) has the power to determine the question of whether a right is a right *in rem* and whether a quasi-security interest can prevail within a closed system of security rights.[62] However, the Report also states the following: "An unreasonably wide interpretation of the national concept of a right *in rem* to include, for instance, rights simply reinforced by a right to claim preferential payment, as is the case for a certain number of privileges, would make the Convention meaningless, and such a wide interpretation is not to be attributed to Article 5."[63] For example, where securities are transferred electronically to an account located outside Luxembourg, the foreign location constitutes the applicable connecting factor. Accordingly, foreign law decides on whether the security right attaches, is perfected for purposes of Article 5 EIR and can be recognised in domestic insolvency proceedings. Depending on the characteristics of the quasi-security in each case, the relevant arrangement may or may not constitute a right *in rem*. An assessment of its constituent elements would need to be undertaken in light of the guidance set out in the Report, namely in respect of any direct relationship with the collateral and the absolute nature of the right, including in insolvency proceedings. Control by the collateral taker may not necessarily be sufficient to fulfil these requirements.

In addition, Article 5 EIR has left unanswered questions about the effectiveness, classification and priority of creditor rights under foreign security arrangements within the insolvency regime applying to the estate of an insolvent security grantor under domestic law. For example, a right of retention entitles a secured creditor to assert its possession and to exercise a right of segregation of assets from the other assets composing the estate of the insolvent pledgor (*droit de revendication*). Such right of segregation typically, but subject to important variations in the relevant jurisdiction, extends beyond a creditor-driven enforcement process resulting in a separate settlement. It is not limited to the satisfaction of the creditor from the proceeds resulting from the sale of its assets composing the estate, whether or not such sale has been performed in the insolvency administration or by the creditor under the supervision of the competent insolvency official.

Traditionally, a secured creditor will not be entitled to assert more rights or remedies, such as a right of segregation of assets or a right of separate settlement, in a given jurisdiction than are available to it under the foreign security arrangement and available to a holder of a domestic security right that is at least equivalent to the foreign security arrangement. This approach is common practice in a majority of jurisdictions and originates in the *numerus clausus*, in the situs rule (*lex rei sitae*) for movable assets and in public policy limitations imposed by national insolvency law and affecting collateral. To some extent, it is also rooted in the choice of law rule that characterization of a foreign security arrangement is made autonomously according to the legal system of the court seized of the matter (*qualification lege fori*).[64] The purpose

59 Security rights taking the form of a floating charge continue to exist in jurisdictions based on the English Common law (England or, for example, Hong Kong or Tanzania) and some mixed jurisdictions (Québec, *hypothèque ouverte*), but are discontinued in PPSA jurisdictions (Canadian Common law provinces, Australia and New Zealand).

60 In case of registered private company shares (*parts sociales nominatives*), the corporate shareholder register (which is not a public register) held by the issuer at its registered office is the most likely connecting factor for purposes of locating these shares. See EU, Commission, *Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings*, 12 December 2012, COM(2012) 744 final [hereinafter *Insolvency Proposal*], art. 2(f)(iii).

61 See Virgos, *supra* note 58, p. 73, no 100.

62 In the absence of exhaustive rules for the location of asset classes at art. 2(g) EIR, it may be necessary to resort to conflict of laws principles. As a result of the discussions about a reform of the EIR, it has been suggested to add bank accounts as a new asset category and to locate such accounts at the branch where the relevant account is held. See INSOL Europe, *Revision of the European Insolvency Regulation*, Nottingham 2012, p. 36, items 2.18 ff. and art. 2(f)(iv) and (v) Insolvency Proposal.

63 Virgos, *supra* note 58, p. 74, no 102.

64 See art. 3078 CCQ; Cass. civ. 1re, 22 juin 1955, D (*Recueil Dalloz*) 1956, p. 73, Rev. crit. dr. int. pr. (*Revue critique de droit international privé*) 1955, p. 723; Seine, 12 janvier 1966, Rev. crit. dr. int. pr. (*Revue critique de droit international privé*) 1967, p. 120; Audit & d'Avout, *supra* note 8, at 188 ff., nos. 205 ff.; Cuming, Walsh & Wood, *supra* note 10 at 232 ff. Similar clarifications are under way for the PPSAs. In the context of movable assets, the characterization of property as movable or immovable is generally made according to the law of its location.

of this rule is to ensure that the choice of law rules are applied even when the governing law would not characterize the relevant arrangement or interest (or element) as a security right. Accordingly, a security right would only encompass such arrangement, interest and rights in insolvency or similar proceedings that would constitute a security right under domestic law, regardless of the enforcement conditions applying under the law governing the foreign security right.

An application of the above principles to foreign security arrangements in a European cross-border context and within the domestic legal system would appear to lead to the conclusion that neither Article 5 EIR nor domestic law would grant any right of segregation in main Luxembourg insolvency proceedings if the content and purpose of the foreign right *in rem*, as a matter of its own applicable secured transactions law, is not to grant such right. Such right *in rem* would therefore be limited by the *situs* rule (*lex rei sitae*) in relation to collateral in the relevant jurisdiction.[65] That being said, it shall not be the purpose of this paper to address in detail any other open issues that may arise under the EIR in this context. In order to ascertain the classification or priority of a foreign security right in national insolvency or similar proceedings, however, it seems clear that it will still be necessary to assess whether or not, and to what extent, the insolvency features originating in the legal system of the foreign security arrangement may claim effectiveness in Luxembourg law.

6.2 Foreign Security Arrangements under the Collateral Act

The open questions that exist under Article 5 EIR are also relevant under Article 20(4) in conjunction with Article 24 Collateral Act. Read together, the latter have the effect of placing a secured creditor (or its security representative) outside the body of creditors (*masse des créanciers*), so that the collateral is segregated in the insolvency of the security grantor or the defaulting party under a repo or set-off transaction. Article 24 Collateral Act further extends this protection to "any other similar collateral to which a foreign law applies." Given that Article 5 EIR encompasses security rights constituting rights *in rem* over collateral in the context of main insolvency proceedings, the Collateral Act is essentially relevant for non-EIR security arrangements, for secondary insolvency proceedings under the EIR and for cases of fraudulent preferences or hardening periods.[66] Admittedly, the legislative intention of Article 24 Collateral Act is to set Luxembourg security grantors and foreign security grantors on an equal footing. However, this provision leaves unanswered questions about forms of security rights or quasi-security that would not appear to technically exist under domestic law. Questions also remain over foreign security arrangements entitling a secured creditor to rights that would appear incompatible with the insolvency regime applying to the estate of an insolvent grantor of the relevant security right.

(a) Characterization

As mentioned above, the common technique of transposing a foreign security right into a closed domestic legal system of property and security rights is a conversion by way of autonomous characterization in accordance with the rules applied by the court seized of the matter. This rule interprets a foreign security right (or any of its constituent elements) in light of criteria employed by domestic law to constitute a security right (or any of its constituent elements). The rule would appear to apply generally, except where a functional approach, not looking to the legal technique of constituting a security right but rather to the content and purpose of the arrangement in respect of the relevant asset class, is expressly endorsed by law. This holds true for certain provisions of the Collateral Act that enact a functional approach to assimilate a foreign security right.

The continued existence of the closed system of property rights and security rights is currently being questioned in the context of international

By contrast, the comprehensive regulation by art. 14(3) Rome I of techniques conferring rights in receivables (including outright assignments and security arrangements with or without transfer), would appear to point towards a characterization in accordance with the law applicable to the security arrangement (*qualification lege causae*). This approach would be aligned with the regime under art. 5 EIR, see *supra* note 62 and accompanying text.

65 See Recital (25) EIR: "The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security." (emphasis added); BGH 3.2.2011 (V ZB 54/10) at p. 10f., online: BGH <www.bundesgerichtshof.de> (date accessed: 17 January 2013) [Germany]. For the different interpretations of the wording "shall not affect" at art. 5(1) EIR, see INSOL Europe, *supra* note 62, p. 51 f. point 5.4 with further references. For a "hard and fast rule" overprotecting the secured creditors in a cross-border context (similar to art. 20(4) Collateral Act), see D. Devos, "Legal Protection of Payment and Securities Settlement Systems and of Collateral Transactions in European Union Legislation," p. 11 ff, online: IMF <http://www.imf.org/external/np/seminars/eng/2006/mfl/dd.pdf> (date accessed: 17 January 2013), and M. Veder, The Future of the European Insolvency Regulation, 28 April 2011, Applicable law, in particular security rights, p. 83 ff, online: RESOR <http://www.eir-reform.eu/uploads/papers/PAPER%204-3.pdf> (date accessed: 17 January 2013). This view has been refused by the BGH and by INSOL Europe who suggest to limit the right only to the extent that the limitations of the situs rule match with those of national insolvency law, similar to arts. 8 and 10 EIR, see INSOL Europe, *supra* note 62, p. 53, item 5.9. The Insolvency Proposal currently does not address amendments to art. 5 EIR.

66 According to art. 4(2)(m) EIR, the latter are excluded from the scope of art. 5 EIR.

transactions. It has been suggested that the characterization exercise requiring to reinterpret the foreign security right in its entirety be replaced by a simple exercise assessing its functional equivalence that would allow the foreign security right to be tolerated in the domestic legal system. A step into this direction has been undertaken in the Netherlands and in Germany. In both of these jurisdiction it has become trite law that a security right acquired abroad will be recognised but cannot be exercised in manner inconsistent with the legal order of the jurisdiction in which the property is located.[67] In the Netherlands, it is sufficient for purposes of assimilation and enforcement of a foreign security that such security be merely in terms of content and purpose (*inhoud en strekking*) equivalent to a domestic security right.[68] Public policy exceptions (*ordre public*) appear to continue to impose certain limits to the conversion and enforcement of such foreign security rights in the domestic legal order. Similar doctrinal approaches exist in Belgium and in France in the case where the collateral moves into the enacting jurisdiction,[69] but the precise mechanics of such conversion and the question of whether or not such approach would overrule the general *numerus clausus* appear somewhat unclear.

Currently, the law would not appear to contain any explicit rule allowing it to suffice that a foreign security right be in terms of content and purpose equivalent to a domestic security right. The Collateral Act merely requires the foreign security to be "similar" - a difficult term given the international discussions in this area.[70] It gives no indication that it purports to overrule the traditional rules requiring to convert a foreign security arrangement into rights or prerogatives available under the *numerus clausus*.[71] In an enforcement context, it is unlikely that these rules would allow that a foreign security right be enforced at all times in accordance with its terms. As such, a right or obligation under foreign law that is incompatible with a right or prerogative available under domestic law will not normally be given legal effect to by a local court.

(b) Rights in the Insolvency of the Security Grantor

Bearing in mind that Article 20(4) Collateral Act entitles the beneficiary of a Luxembourg security right to segregate collateral from the estate of an insolvent debtor, the question arises as to the treatment of foreign security right. Again, a characterization keeping with domestic concepts would appear to lead to the conclusion that where the foreign security arrangement, under its own applicable law, may be enforced, as if no insolvency situation had occurred, outside the common pledge (*gage commun*) of creditors, such right should continue under the Collateral Act. By contrast, security arrangements whose home jurisdictions merely allow enforcement through separate settlement against the proceeds of the insolvency administration would not appear to be eligible "similar" security rights. The question may be asked, how such security rights should be dealt with in practice.

A similar situation arises where an enforcement by way of private sale of a foreign security right, in accordance with its own secured transactions or insolvency law, would not necessarily purge the collateral from the security right but instead have the purchaser take the collateral subject to any security rights of lower priority. In traditional Civil law jurisdictions, any security arrangement that would allow a purchaser of collateral to take the asset subject to the rights of creditor of lower priority would unlikely be considered as a security right that has characteristics similar to those of a domestic security right. Assuming that such security arrangement cannot be fully recognised in domestic law, the next question would be whether such security arrangement would not be recognised at all or if the safe harbour provisions of Article 20(4) Collateral Act would simply not apply. The latter would give way to ordinary insolvency rules as if the security arrangement was governed by rules of general application. It would appear unlikely, in line with the common approach for Article 5 EIR,[72]

67 See art. 10:130 BW and art. 43(2) EGBGB. See P.M. Veder, *Cross-Border Insolvency Proceedings and Security Rights*, Kluwer, Deventer 2004, at 275 ff; A. Flessner, "Choice of Law in International Property Law - New Encouragement from Europe" in: *Party Autonomy in International Property Law*, *supra* note 41, p. 11 at 23 ff.; G. Kegel, *Internationales Privatrecht*, 9th ed. by G. Kegel & K. Schurig, C.H. Beck, München 2004, at 772 f.

68 The Netherlands Supreme Court held that it was not decisive whether or not a foreign security interest is similar in all respects to a security right available under Netherlands law, but whether or not, with a view to the application of a specific Netherlands law provision, the foreign security interest can, in terms of its content and purpose, be considered equivalent to a related Netherlands security right. See Hoge Raad, 14 December 2001, NJ (*Nederlandse Jurisprudentie*) 2002, 241, JOR (*Jurisprudentie Onderneming & Recht*) 2002, 70 (Sisal II). In a German context, see also B. von Hoffmann & K. Thorn, *Internationales Privatrecht*, 9th ed., C.H. Beck, München 2007, at 469 and 526. German court precedent appears to predate art. 43(2) EGBGB and did not adopt any consistent approach when converting foreign security rights in accordance with the transposition theory (*Transpositionslehre*) prevailing at the time.

69 See F. Rigaux & M. Fallon, *Droit International Privé*, 3rd ed. Larcier, Bruxelles 2005, p. 678 ff.; Audit & d'Avout, *supra* note 8, p. 677.

70 See S. Jacoby, *Les garanties financières face aux procédures d'insolvabilité*, *Journal des Tribunaux* 2010, pp. 24 at 28, no 61.

71 See Audit & d'Avout, *supra* note 8, p. 676 no 778 with further references.

72 See *supra* note 65 and accompanying text.

that domestic law could grant a secured creditor more rights than it would have under the secured transactions law in which the foreign security right originates. The foreign security right would probably have to be exercised within the limits of foreign law.

(c) Assessment Factors

For the time being, therefore, the traditional Civil law rules of interpretation continue to require an assessment of the legal nature of a foreign security arrangement in light of the specific features given to security rights governed by the Collateral Act. Except as expressly otherwise stated, an assessment of such legal nature does not permit a comparison of the factual prerogatives arising out of, or the mere functional similarities between, the relevant foreign security and a Luxembourg security right under the Collateral Act. Nor should such assessment overlook Civil law aspects of private property as opposed to the relativity of property in the Common law. Rather, the relevant legal characteristics and design factors must be scrutinised and compared to one another. It is understood that Luxembourg courts have not had the occasion to examine any related practical matter.

As a general underpinning of such assessment, a characterization of the legal terms or constituent elements of a security arrangement in a cross-border context would appear to be made autonomously according to the legal system binding upon domestic courts, regardless of the characterization under the law governing the security right.[73] The assessment may depend on the relevant elements in the specific circumstances of each transaction and involve multiple complexities that may not always allow the foregoing rule to be applied in a consistent manner. For example, the right to secure a specific type of obligation is fundamentally a matter of the validity and existence of the security arrangement.[74] Therefore, the law applicable to the security arrangement should decide this question - derogating from an autonomous characterisation. The law governing the underlying obligation may also determine the nature of the obligation, although it would have no bearing on the validity and existence of the security right. That said, it is a different question how the validly existing foreign security right would be assessed by a Luxembourg court.

Thus, in case of a Luxembourg security right securing payment obligations under a loan agreement governed by a foreign law, the question of whether or not the obligations to be secured constitute eligible "relevant" financial obligations would be decided by domestic concepts. This is particularly relevant for the eligibility of obligations for the payment of money or of certain types of future obligations. In case of a foreign security right securing obligations under a foreign law, the question if such security right can be fully assimilated in Luxembourg would not only be a matter of the law applicable to the foreign security right, but would also be a matter of domestic law. Where a foreign security agreement is making inroads under Article 5 EIR, such security arrangement would also determine the eligibility of the obligations to be secured. There is no room for a domestic court to make an autonomous assessment in this case. It may be difficult to justify why the approach to characterization in this respect should depend on whether or not the security arrangement originates geographically in an EIR jurisdiction because the same question should not be answered in different ways.

In general, in order to determine whether or not a foreign security can be considered similar, in all respects, to a Collateral Act security right, certain elements would seem to constitute fundamental design factors. Therefore, these characteristics are likely of importance when extracting the relevant assessment factors for foreign security arrangements that secure a claim for the payment of money. Considering the foregoing, a foreign security arrangement must, without limitation,

(i) cover eligible claims for the payment of money[75] and/or eligible financial instruments,[76]

(ii) designate collateral so as to be in the possession or under the control of the collateral taker (immune against statutory preferences),[77]

(iii) entitle a secured creditor to a segregated enforcement upon the collateral against the insolvent estate, and

73 See *supra* note 64 and accompanying text.

74 See Cuming, Walsh & Wood, *supra* note 10 at 90 ff., 190 ff. and 291 ff.; Article 2687 CCQ ("any obligation whatever"). The point is of particular relevance in respect of those jurisdictions which, when implementing the Collateral Directive, have given a wider meaning (such as the United Kingdom) or a narrower meaning (such as Germany) to the term "relevant financial obligations" as set out at Article 2(1)(f) Collateral Directive. Similar issues may arise in the context of non-EU jurisdictions, for example, as to the question whether interest or other charges have been properly included in the secured obligations.

75 In light of the earlier considerations, eligibility in this case would appear to be determined by the applicable foreign secured transactions law and by Luxembourg law.

76 Eligibility would appear to be determined under the Collateral Act or the law applicable under art. 5 EIR, as applicable.

77 This design factor should be deemed met where such arrangement features a right of retention, title security or at least an equivalent priority right (regardless of its contractual or proprietary nature) at the time of creation and, in any event, prior the fulfilment of any enforcement conditions.

(iv) allow a purchaser (in an enforcement sale) to take the asset free and clear from all security rights of lower priority.

The tentative character of these factors shall be highlighted as this area of secured transactions law is all but static and other arguments may be equally persuasive.

Finally, it should be borne in mind that the law requires to transpose and interpret domestic law in a manner consistent with existing European Union law[78] and that courts should endeavour to apply laws from a perspective of jurisdictional harmony where State legislatures cooperate in the same manner. Thus, it may be useful to verify whether or not the relevant foreign security right falls within the type of arrangements that are meant to benefit from the implementation of the Collateral Directive and can therefore be deemed to be an approximating legal concept. Where security rights are rooted in the same legal tradition, the level of similarity is likely high, for example in case of a transfer of title for security purposes. In this context, it should generally be borne in mind that many legal systems outside the geographical scope of the European Union are based on European Civil law or Common law traditions, as the case may be. Therefore, solely their geographical location should not preclude a comparison exercise for security rights that would be mandatory if the security right originated in the European Union.

(d) Practical Impact

In practical terms, individual or several of the tentative assessment factors mentioned above may not necessarily apply in all circumstances. As such, in the absence of a general rule assimilating foreign elements that are constituent of security rights, the Collateral Act, particularly in the area of financial assets (such as negotiable collateral or cash collateral), provides for certain express rules taking a functional approach and recognising the equivalence of such elements in terms of content and purpose. However, even where this route is taken, not all apparent functional similarities will lead to an assimilation if the effects of the foreign security right under its own secured transactions law are diametrically opposed to the effect such security right would have had it been created in accordance with domestic law.

(1) Negotiable Collateral

A current example for a functional approach is the case of a foreign security arrangement covering negotiable collateral held through the intermediated system. In the intermediated holding system, an intermediary (depository) is the legal owner of the security in the books of the issuer (or in the books of its transfer agent) ("upper tier") and in turn holds accounts for its own intermediary participants who hold accounts for their own clients in the chain. There is no direct relationship between the ultimate investor and the issuer. The legal nature of the rights of a securities depositor ("entitlement" or "*titre intermédié*"[79]) against a securities intermediary, where such rights are given as collateral, is irrelevant for the characterization exercise regardless of whether or not these rights may be characterised as a property right, as a contract right, as an equitable interest or as any other right combining any of them under any applicable law. Given the broad meaning given to the term "financial instruments" in the Collateral Act, all of these variations qualify as eligible financial instruments for purposes of the relevant (foreign) security arrangement.[80] This functional rule aligns Luxembourg with uniform international law and is relevant for the assimilation of foreign arrangements covering negotiable collateral. It would not appear relevant for domestic rules governing rights against intermediaries.

Similarly, although not expressly mentioned, the question of whether or not the foreign security arrangement features an accessory character and may be affected by defences originating in the latter, would appear irrelevant given the possibility under Luxembourg law to transfer title to qualifying collateral by way of security. Hence, the foregoing elements of a security right would appear to be excluded from any assessment of their legal nature.

Further, the assessment of other elements of security rights over negotiable collateral is done by reference to foreign law. For example, the legal nature, the proprietary effects and the subordination among competing creditors in relation to paperless securities collateral are determined in accordance with the law that applies at the location of the relevant securities account.[81] The legal nature of

78 See, for example, Court of Justice of the European Union, 5 October 2004, Cases C-397-403/01 *Pfeiffer and Others* v *Deutsches Rotes Kreuz*, [2004] ECR I-8835, no. 113 with further references.

79 The notion is understood functionally as an interest in a securities account that comprises a bundle of rights associated with the financial instruments or assets credited to the relevant account, such as the right to vote or receive dividends and rights against an intermediary. See art. 1(b) Geneva Securities Convention.

80 See the reference to "claims relating to or rights in or in respect of any of the foregoing" under art. 1(8)(f) Collateral Act and art. 2(1)(e) Collateral Directive, as well as art. 1 Securities Transfer Act, which is similar to the functional approach under s 8-102 UCC for uncertificated investment securities.

81 See art. 23 Collateral Act and art. 9 Collateral Directive, as opposed to art. 2(1) Hague Securities Convention and art. 8 UCC (which primarily refer to the agreement between intermediary and account holder rather than the location of the account). The account was first used as reference by the *Regulation of 17 February 1971on the circulation*

these securities certainly includes the question whether or not the rights of the holder of the security or the security entitlement as against the intermediary are of a personal or proprietary nature according to the relevant legal tradition. It may also include questions of legislative terminology used to describe such collateral, including terms such as "(financial) instrument"[82], "security"[83], "security entitlement", "investment property"[84] or "financial assets"[85], their statutory definitions and features (including the possibility to opt into a statutory rule that would not otherwise apply), the technique of their creation[86] and classification or the nature of the underlying. The reference to proprietary effects and to subordination essentially looks to the perfection and the priority of security rights over paperless securities collateral in the secured transactions system. The use of the account as connecting factor is based on a uniform international conflicts of laws rule and facilitates the assessment of the domestic effects of a foreign security arrangement. Thus, foreign law will determine whether or not a dematerialised security for its own purposes also constitutes a dematerialised security for purposes of domestic law or whether a futures contract qualifies as collateral for the purpose of assimilating the related foreign security arrangement. In general, the features of many foreign securities are likely to be characterised as similar to the features of Luxembourg financial instruments provided that legal technicalities employed by the foreign governing law are deemed irrelevant.

In the context of the effectiveness or perfection as against third parties, the law of the location of the account will necessarily determine the validity against any competing title or interest and the enforceability of the collateral.[87] The account jurisdiction will also govern the effects of

of securities, as am. (Règlement grand-ducal du 17 février 1971 concernant la circulation de valeurs mobilières), Mém. 25 February 1971, p. 255. From the perspective of comprehensive and holistic regulation, one may well wonder why the legislator has not included explicit conflict of laws rules (such as the *situs* rule) addressing questions relating to other forms of securities in the Collateral Act.

82 See the definition of that term at art. 2(1)(e) Collateral Directive whose implementation in the Member States has been inconsistent. In terms of the USTA, an "instrument" is, amongst others, defined as a writing evidencing a transferable claim to payment of money and does not include "investment property" (or "security"), probably akin to the term "payment instrument" in the Collateral Directive.

83 The term "securities" in a foreign legal system may include other elements than under domestic law. Art 1(a) Geneva Securities Convention defines this term as "any shares, bonds or other financial instruments or financial assets (other than cash) which are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of this Convention," but does not define the terms "financial instruments" or "financial assets". Further, the term "security" or "financial asset" may or may not include a futures contract, whereas the term "financial instrument" or "investment property" may include such contract, depending on the relevant legislation.

84 For example, in terms of the USTA, "investment property" (which includes a "security") "[…], means an obligation of an issuer or a share, participation or other interest in an issuer or in property or an enterprise of an issuer (a) that is represented by a security certificate in bearer form or registered form, or the transfer of which may be registered on books maintained for that purpose by or on behalf of the issuer, (b) that is one of a class or series, or by its terms is divisible into a class or series, of shares, participations, interests or obligations, and (c) that (i) is, or is of a type, dealt in or traded on securities exchanges or securities markets, or (ii) is a medium for investment and by its terms expressly provides that it is a security for the purposes of this Act. (*valeur mobilière*)."

85 In Luxembourg, the term "financial asset" is only used by the Act of 17 December 2010 on undertakings for collective investment, as amended, (*Loi du 17 décembre 2010 concernant les organismes de placement collectif*) Mém., 24 December 2010, p. 3928, and by the Act of 11 May 2007 on wealth management companies (*Loi du 11 mai 2007 relative à la création d'une société de gestion de patrimoine familial*), Mém., 14 May 2007, p. 1608 (which includes cash deposits in its scope), but not by the Dematerialisation Act or the Collateral Act. In terms of the USTA, "Financial asset" means, "[…], (a) a security, (b) an obligation of a person that, (i) is, or is of a type, dealt in or traded on financial markets, or (ii) is recognized in any other market or area in which it is issued or dealt in as a medium for investment, (c) a share, participation or other interest in a person, or in property or an enterprise of a person, that, (i) is, or is of a type, dealt in or traded on financial markets, or (ii) is recognized in any other market or area in which it is issued or dealt in as a medium for investment, (d) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Act, or (e) a credit balance in a securities account, unless the securities intermediary has expressly agreed with the person for whom the account is maintained that the credit balance is not to be treated as a financial asset under this Act; ("*actif financier*")."

86 For example, such collateral may result from legislative enactment or come into existence contractually through party autonomy, through registration, immobilisation (above all in the United States and the United Kingdom) or collective deposit with a custodian or "at source" through inscription in an issue account held by specific authorised entities. Party autonomy and the free creation of securities in content and form has been a matter of debate in some Civil law jurisdictions. Hence, the issuance of dematerialised securities was regulated through express enactment, amongst others, in France and Belgium, by the Act of 30 December 1981 (*Loi n° 81-1160 du 30 décembre 1981 des finances pour 1982*), J.O., 31 December 1981, p. 648 (arts. L.211-3 ff *Code monétaire et financier*), the Act of 7 April 1995 (*Loi modifiant les lois sur les sociétés commerciales, coordonnées le 30 novembre 1935, et modifiant l'arrêté royal no. 62 du 10 novembre 1967 favorisant la circulation de valeurs mobilières*), Moniteur Belge, 18 May 1995, p. 13541, the Act of 14 December 2005 (*Loi du 14 décembre 2005 portant suppression des titres au porteur*), Moniteur Belge, 23 December 2005, p. 55488, respectively. Except for State bonds, no similar regulation exists in Germany, and the need for any such regulation has remained unclear in light of the collective safekeeping possibility under § 9(a) Securities Deposit Act (*Depotgesetz*). In a US context, see ss 8-102(18), 8-108(b), (c) and (e), 8-202(a) UCC.

87 See Recital (8) Collateral Directive.

perfection, either through registration or through control.[88] These effects may vary as a result of policy choices made in different jurisdictions. Typically, these policies include, without limitation, the confidentiality and efficiency of collateral agreements as opposed to the promotion of the publicity of security interests, the reduction of transaction costs and of burdens associated with registry searches or with a subordination of priority, or the facilitation of financing for brokers and other intermediaries.

In particular, certain jurisdictions have enacted automatic super priority or super perfection mechanisms in respect of property rights in indirectly held securities.[89] These mechanisms operate regardless of any other competing prior security right or statutory creditor preferences over enforcement proceeds, either as a result of registration (where security is granted in favour of an intermediary) or as a result of control (where security is granted in favour of the control creditor).[90] The foregoing effects of control differ from similar legal techniques in domestic law. Luxembourg law employs the general rule that creditors rank, subject to statutory or contractual subordination, in order of their priority according to the first-in-time rule. The scope of the first-in-time rule is generally not limited by any automatic super seniority effected by control.[91] One exception applies in certain securities transactions undertaken by an intermediary where similar effects are achieved through non-consensual statutory transfer of title over transaction proceeds ("broker's lien")[92] or where set-off rights effect control. Particularly in cases where the control creditor is a depository institution, such creditor will not normally trump all creditors who perfected their security right prior to the control agreement.[93] Finally, no priority is given in Luxembourg to one control creditor over the other when obtaining control by virtue of becoming the account holder.[94]

Given that the location of an account merely aims at providing a uniform connecting factor for the matters stated in the Collateral Act, the law does not contain any rule in respect of the effects of the laws of the account jurisdiction in insolvency proceedings taking place in another jurisdiction.[95] Hence, "any question" relating to a foreign legal nature should not necessarily eliminate the need for a characterisation of such legal nature with regard to its effects in domestic insolvency or similar proceedings. Again, this would appear to refer to the approach rehearsed above that where the foreign security right over a foreign securities account, under its own applicable law (including insolvency law), may be enforced as if no insolvency situation had occurred, such right should continue under the Collateral Act.

(2) Cash Collateral

In the area of security over monies held on account with a depository institution, it is admitted that Luxembourg law, as many other Civil law and Common law jurisdictions, characterizes the rights of a holder of a deposit account against

88 See art. 23(2)(c) Collateral Act.

89 This applies to States and provinces having implemented art. 8 UCC and the USTA, respectively.

90 See ss 8-106(d)-(f), 8-510(d) and 9-106(c), 9-328(3) UCC as opposed to art. 19(4) Geneva Securities Convention (in respect of the intermediary).

91 See, by contrast, art. 2714.2 CCQ, to give just one example, which reads as follows: "From the time a creditor secured by a movable hypothec with delivery obtains control of the securities or security entitlements, that hypothec ranks ahead of any other movable hypothec on the same securities or security entitlements, regardless of when that other hypothec is published. […]".

92 See art. 16 Securities Transfer Act and, for example, s. 11.1(2) OPPSA and s. 12.1(3) NB PPSA. See also art. 22-1(4) of the Luxembourg Act dated 23 December 1998 on the monetary statute and the Luxembourg Central Bank, as am., Mém., 24 December 1998, p. 2980, Mém., 16 July 2007 p. 2076, and Mém., 29 October 2008, p. 2250 [hereinafter *Central Bank Act*] which enables the Luxembourg Central Bank to take security over claims as credit support. The security right is registered in special register held by the Central Bank and takes, on the basis of the traditional first-in-time rule, priority over any pledge created after registration. In addition, under art. 27-1(1) Central Bank Act, claims of central banks within the European System of Central Banks, arising within the framework of common monetary policies, are secured by a preferential lien (*privilège*) over all assets held by the debtor, either with the Luxembourg Central Bank or with a clearing system or any other counterparty in Luxembourg. This preferential lien ranks in the same manner as an ordinary pledge.

93 The Geneva Securities Convention has left this issue to national law because it has proven too controversial internationally. Luxembourg law operates an automatic super priority of the beneficiary of securities collateral, except where the securities depositary objects or agrees to different arrangements; see art. 5(2)(a) last sentence Collateral Act.

94 That being said, the basic concept of control by becoming the account holder exists per art. 5(2)(a)(iii) Collateral Act.

95 This conclusion derives from a comparison of art. 23 Collateral Act with arts. 2(1) and 8 of the Hague Conference on Private International Law, *Hague Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary* of 13 December 2002, The Hague 2002, online: HCCH <ww.hcch.net> (date accessed: 31 January 2013) [hereinafter *Hague Securities Convention*] and art. 9.2 of *Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements*, 27.6.2002, [2001] OJ L 168, p. 43. Art. 8 of the Hague Securities Convention reads as follows: "1. Notwithstanding the opening of an insolvency proceeding, the law applicable under this Convention governs all the issues specified in Article 2(1) with respect to any event that has occurred before the opening of that insolvency proceeding. 2. Nothing in this Convention affects the application of any substantive or procedural insolvency rules, including any rules relating to a) the ranking of categories of claim or the avoidance of a disposition as a preference or a transfer in fraud of creditors; or b) the enforcement of rights after the opening of an insolvency proceeding."

the depository institution largely as a claim for the payment of a monetary sum.[96] Therefore, Luxembourg law does not contemplate that security rights in cash on deposit be perfected by control. Instead, they are rendered effective in accordance with the general rules governing perfection.[97] As mentioned earlier, these rules (still) require either registration or some other act of (deemed) publicity in many developed jurisdictions,[98] while Luxembourg law, in line with the Amending Directive, provides for security rights over cash claims to be perfected by mere agreement without any actual publicity towards third parties generally or specifically. It is common understanding today that such a regime contributes to legal certainty and stability in the derivatives markets. And instant perfection would have the benefit of reducing any differences between the creation of the pledge which encompasses instruction rights of the pledgee, on the one hand and any additional need for true control over the collateral by the pledgee on the other. It gives secured parties holding cash collateral the same degree of legal certainty as to their priority as secured parties holding securities collateral.

It goes without saying that an absence of disclosure may expose the counterparty using cash as credit support to the risk of subordination to prior concluded agreements, unless the relevant statutory effects of control, particularly as to priority, provide for safeguards in this respect. The legal effects of the perfected security right over a deposit account may be fundamentally different amongst jurisdictions, even where they have commonalities in their secured transactions system. For example, UCC Article 9 deposit account security, despite being perfected by way of control without any act of publicity,[99] grants an automatic super priority where a depository institution is the control creditor. It has been given to understand that the reason for this statutory difference is that, under the UCC, such account does not qualify as intangible despite the clearly existing debtor-creditor relationship between the depository institution and the depositor.

96 See *supra* note 16 and accompanying text.

97 That being said, accounts may be opened and maintained in the name of the secured creditor either exclusively or jointly with the debtor under a lock box agreement, similar to a traditional pledge with delivery. This allows creditors to block access to "lock box accounts". The general rule allowing a designation effecting possession or control, *supra* note 14 and accompanying text, would seem to apply regardless of the type of financial instrument given as collateral.

98 See the relevant provisions of the PPSAs and the CCQ. For the Québec Registry of Personal and Movable Real Rights, see *Règlement sur le registre des droits personnels et réels mobiliers*, Décret 1594-93, 17 November 1993, 125 G.O. II 1993, p. 8058.

99 See ss 9-314(a) and 9-312(b)(1) UCC (except where security traces proceeds of other collateral).

Similar approaches may exist in other jurisdictions, regardless of their legal tradition. Market realities and the increasing cash collateral needs of lenders, swap counterparties or central counterparties[100] may well induce legislators to introduce a perfection by control regime for cash collateral into publicity-based secured lending regimes in order to make it easier for businesses and financial institutions to provide or obtain first-priority security rights.[101]

In sum, similarities between foreign security rights over cash on deposit and security rights under the Collateral Act may be restricted to specific legal relationships and do not necessarily imply identical policy choices or desired similar results in all respects. Rather, it would probably be closer to reality to work on the understanding that many foreign secured transactions regimes, especially those outside the European Union, operate fundamental conceptual differences. Similar conceptual differences are also reflected in the incompatible conflicts of laws regimes for receivables transactions under Rome I on the one hand and in developed Common law jurisdictions outside Europe on the other.

(3) Universality of Collateral

In order to come within the closed system, any universality of assets subject to a foreign law governed security right must relate exclusively to claims for the payment of money and/or to financial instruments within the meaning of the Collateral Act. This means that the security right does not need to specify the collateral individually but may instead employ a generic description, such as a reference to all the grantor's present and after-acquired claims for the payment of money and financial instruments. The sole criterion is that third parties must be able to identify the collateral, similar to the regime existing under the UCC or the PPSAs.

A common example involving the characterization of a foreign security right over a universality of assets in the Civil law is the equitable floating charge granted by companies under English law. The floating charge can be described as a registered security right over existing or future property under which no encumbrance covers business assets (i.e. "crystallises" and becomes possessory) until certain events occur, so that the debtor may continue to control the collateral and to deal with it. A conventional English law floating charge has no real equivalent under Luxembourg law. This may make it difficult to assimilate this form of security right to a Luxembourg security right.

100 See EMIR and the Dodd-Frank Act, *supra* notes 22 f.

101 See, for example, Ontario, *2013 Ontario Budget: Budget Papers* online: <*www.fin.gov.on.ca/en/budget/ontariobudgets/2013/papers_all.pdf*>; OBA, *supra* note 20.

The characterization of a floating charge has been discussed over decades by authoritative legal scholars and courts in a number of Civil law jurisdictions, many of which would appear to allow, in certain circumstances, its assimilation, in form and in substance. It cannot be excluded that the most approximating concept under Luxembourg law is that of a general preferential lien (*privilège*), even though this comparison will unlikely apply where the latter grants statutory priority and cannot be created by contract.[102] Under the Collateral Act, the absence of any public filing system, the possibility given to a pledgor to substitute such collateral through a right of disposal (*droit de disposition*) and the understanding that ownership of the collateral may vest with the pledgor would appear to be compatible with the core functionalities of a floating charge. Hence, the flexible regime of the Collateral Act would appear to play in favour of an assimilation of the floating charge in respect of financial assets, provided that the contractual rights in respect of the collateral are limited to the substitution with equivalent[103] collateral or to the withdrawal of any excess collateral.[104] This solution is even more likely where the floating charge also falls under the English Financial Collateral Arrangements (No. 2) Regulations 2003, as am., that implement the Collateral Directive.[105] Even beyond the confinements of the right of disposal of a pledgor under the Collateral Act, an equitable floating charge covering qualifying collateral located abroad would, upon crystallisation, also appear assimilable to a transfer of title by way of security (*transfert à titre de garantie*)[106] over a universality of qualifying collateral.

That being said, in light of the principle that a secured creditor is not entitled to assert more rights or remedies under domestic law than are available to it under the foreign security right, it appears unlikely that an assimilated equitable floating charge, upon crystallisation, would hold any other right, including without limitation any right of segregation or of separate settlement, or priority than would be available to it under English law or the law of another applicable jurisdiction.[107] Similarly, a crystallised floating charge would unlikely rank senior to any specific fixed charge or any Luxembourg pledge perfected prior to crystallisation and would also be subject to any applicable preferential creditor deduction. In sum, it would seem that related characterisation considerations are of limited practical relevance given the weak position that a creditor typically acquires under this form of universal security.

7. CONCLUDING OBSERVATIONS

Secured transactions infrastructures require a comprehensive regulation of security rights and of similar security arrangements both in a national and cross-border context, as well as a resolution of critical priority competitions. Luxembourg is at the crossroads of many legal systems and is therefore put in an important position for secured financing transactions. Given the amount of moving parts and of complex problems in collateral transactions in this area, any short term rule-making addressing selective issues in any jurisdiction may strike an external observer as a missed opportunity to increase legal certainty and predictability through comprehensive and holistic regulation. The ongoing challenge of establishing an efficient, transparent

102 See Hoge Raad, *supra* note 68. Any similarities with a pledge over a universality of business assets under the Grand-Ducal Decree dated 27 May 1937 on the pledge of a universality of business assets (*Arrêté grand-ducal du 27 mai 1937 portant réglementation de la mise en gage du fonds de commerce*), (Mém A no. 39 du 31.05.1937 p. 386 as am., shall not be discussed here because this form of security encompasses a much wider asset category than the Collateral Act. Considering the planned abolition of the pledge over a universality of business assets (*pand op handelszaak/gage sur fonds de commerce*) in Belgium by the Movable Asset Security Act, *supra* note 25, the equivalent Luxembourg regime may be expecting a similar fate.

103 See English Financial Collateral Arrangements (No. 2) Regulations 2003, as am. Regulation 3(2) clarified the term "equivalent" as meaning "of same or greater value."

104 See art. 2(3) second sentence in conjunction with art. 11(4) Collateral Act and the definition of the term "possession" in the Financial Collateral Arrangements (No. 2) Regulations 2003, as am. In traditional Civil law, this would operate as real subrogation, see arts. 2674 and 2477 CCQ and, for comparative purposes, the tracing provisions in the PPSAs.

105 The consideration that the publicity of the floating charge following its registration at the relevant public commercial register, such as Companies House, is a validity requirement (see s 860(7)(f) in conjunction with s 874 of the Companies Act 2006) would appear to not play any role in this context because such publicity unlikely produces effects beyond the borders of the relevant Common law jurisdiction. However, as regards perfection effected abroad, it may be necessary to renew any required publicity where the collateral relocates ("re-perfection").

106 See M. Ille, "Die Sicherungsübereignung in Fällen mit Auslandberührung," online: Universität Leipzig <www.uni-leipzig.de/bankinstitut/dokumente/2000-07-13-01.pdf>, Leipzig 2000, at 9 ff, referring to P. von Wilmowsky, *Europäisches Kreditsicherungsrecht - Sachenrecht und Insolvenzrecht unter dem EG-Vertrag*, Tübingen 1996, p. 109, U. Huebner, Internationalprivatrechtliche Probleme der Anerkennung und Substitution bei globalen Sicherungsrechten an Unternehmen, in: P. Hofmann, U. Meyer-Cording & H. Wiedemann (eds), *Festschrift für Klemens Pleyer zum 65. Geburtstag*, pp. 41 at 55 Köln Berlin Bonn München 1986. In any event, such an agreement can be characterised as a promise to pledge (*promesse de gage*). See also Debroise, *supra* note 8, at 45 ff.

107 The floating charges continues to exist in Québec. Neither the UCC nor the PPSAs have retained a floating charge. All PPSAs provide that a security interest can be taken in all of a debtor's present and after-acquired personal property which results in a specific fixed charge. It is understood that an English fixed charge, in general terms, grants the secured creditor a right to appoint a receiver to sell assets and to obtain separate settlement of the outstanding secured claims in the insolvency estate.

and reliable secured transactions law is directly linked to the interaction between international markets and the widening perimeter of financial market and securities regulation. Particularly in the aftermath of the financial meltdown, the global regulatory agenda is moving from freeing-up barriers between financial markets and reducing individual business risks to addressing regulatory risk related to the financial markets infrastructure, financial stability and systemic risks in a comprehensive manner. The foregoing necessarily includes the instant satisfaction of the collateral needs of secured parties.

An important number of regulatory risks and other risks have been addressed by the Collateral Directive and by its generous implementation through the Collateral Act, by way of a substance "through" form rather than a substance "over" form approach. But with many questions that may be raised in this context and in the context of laws of general application in secured transactions, some answers remain far from clear. Providing answers that are conducive to uniform rules requires not only efforts by the national legislator. It also requires a "back to basics" mentality amongst diverse legal systems, because the national legislator, in many instances, is relegated to the back bench of international fora devising modern rules through consensus amongst States, international organisations, legal experts, industry specialists, market participants and stakeholders in international commercial law instruments that aim to coordinate essentially, but not exclusively, the Common law, the Civil law and the realities in international financial markets by pragmatic concepts expressed in everyday no-nonsense language.

For the time being, any consideration or assimilation, in part or in full, of a foreign security right or of a security arrangement that may be considered similar to a domestic security right requires a pre-requisite thorough examination of the legal technique of the creation of such right or arrangement, of the effects of perfection and of the priority regime required by the relevant arrangement, because fundamental policy choices are mirrored in the details of the legal regime. The performance of this task may require enlisting specialists from the relevant jurisdictions and cannot necessarily be expected from the ordinary transaction lawyer. It may also involve substantial costs in the context of a financing or capital markets transaction and will likely be excluded from standard legal opinion practice. In the absence of a more detailed regulation recognising foreign security arrangements, akin, for example, to specific lists of foreign instruments (such as insolvency proceedings under the EIR), or of a principle-based regulation looking to the consistency with the legal order of the jurisdiction where the collateral is located, the current regime unlikely opens the floodgates to foreign security rights. For the time being, characterisation remains a valuable risk management tool where a functional approach is not clearly enshrined in law.

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