Luxembourg: Cross border banking and finance guide

A Lexis®PSL Restructuring & Insolvency document produced in partnership with **Jad Nader** and **Josée Weydert** at **NautaDutilh**

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Loan market and developments

Please provide a brief overview of the current state of the loan markets in your jurisdiction and any significant recent market developments.

The Grand Duchy of Luxembourg (Luxembourg) has a well established reputation as a financial and business centre. Luxembourg's geographic position, political stability, competent and well trained workforce together with a solid legal and tax framework has contributed to this reputation as a financial and business centre and as being a hub for international trade and financing. The loan markets, be it those provided by banks or private loan financing, play a major role in Luxembourg and in the considerable volume of debt financing structured through Luxembourg.

At this stage, no significant market developments have occurred which would affect the existing framework for the loan markets sectors and the general trend confirmed throughout Europe that private non-banking financing is favoured to bank loans and that loan transactions tend to be secured rather than unsecured loan transactions also applies in Luxembourg.

Please provide a brief overview of forthcoming changes to the law or other matters that may affect the loan markets or the responses to the questions below.

With the exception of the below, no major legislative initiatives are expected to directly affect the Luxembourg loan market in the foreseeable future.

The Luxembourg Act of 8 January 2013 on over-indebtedness (*surendettement*) (the Over-indebtedness Act) came into force on 1 February 2014. The new law replaces the previous act of 8 December 2000 on over-indebtedness and amends, among others, article 2016 of the Luxembourg Civil Code (**LCC**) with respect to the validity of a guarantee (*cautionnement*) granted by a natural person.

On 6 April 2013, the Luxembourg Parliament adopted the law on dematerialised securities which was published on memorial A and entered into force on 18 April 2013.

On 1 February 2013, a draft Act amending and restating Luxembourg insolvency proceedings was presented to the Parliament (draft act no. 6539 related to the protection against corporate insolvency). The adoption of such law will result in substantial Luxembourg modifications to the legal framework for insolvency proceedings in Luxembourg.

With respect of EU laws, Directive 2014/17/EU on mortgage and credit was adopted on 4 February 2014. This Directive aims to create a union-wide mortgage credit market with a high level of consumer protection and will be implemented by 21 March 2016 at the latest.

On 13 May 2014, the Council adopted a Regulation establishing a European Account Preservation Order procedure to facilitate cross border debt recovery in civil and commercial matters. This Regulation aims at facilitating cross-border debt recovery by creating a european procedure leading to the issue of a european account preservation order. The european procedure will be an alternative to national procedures in the case of cross-border debt recovery.

Luxembourg is often used as an intermediary jurisdiction for finance transactions, and once the term and content of the regulations on shadow banking have been defined, these could impact on some of the comments below.

Lending

Is it necessary to obtain any consents or licenses in order to lend in your jurisdiction or enforce rights under a loan agreement and if so what is the process for obtaining the consent or license? Are there any other restrictions on lending that foreign lenders should be aware of?

The granting of loans to the public can be made solely by a duly authorized credit institution or a duly authorized professional of the financial sector carrying on lending operations, within the meaning of the Luxembourg Act of 5 April 1993 on the Financial Sector, as amended (the **Financial Sector Act**).

A credit institution is authorized by the Minister of Finance and may act as a 'universal bank' (*banque universelle*), meaning it can perform all activities provided for and governed by the Financial Sector Act, including the granting of loans. However, a professional carrying on lending operations may engage in the business of granting loans to the public for their own account but may only act within the limits of its authorization.

In any case, such authorization only concerns Luxembourg and foreign entities (which have no establishment in the EU) as EU based entities may provide cross-border services in Luxembourg by means of a branch or under the freedom to provide services to the limit of the activities under their own authorization, to the extent granted by their home Member State authority and covering lending activities which can be passported. As a consequence, if an EU credit institution or a professional carrying on lending operations exercises its activities in Luxembourg through a branch or under the freedom to provide services, it will have to be authorized in its home Member State for the activities it intends to provide in Luxembourg (eg to offer loans).

To obtain an authorization to operate in Luxembourg, a credit institution or a professional carrying on lending operations has to submit an application to the Luxembourg Financial Sector Supervisory Authority (CSSF), which complies with all requirements of the Financial Sector Act, including various requirements as regards capital structure, shareholders' structure, transparency or management. The authorization is granted by the Minister of Finance after a process of review of the application by the CSSF.

It is worth noting that the Council of the European Union adopted Regulation (EU) 1024/2013 of 15 October 2013, conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions which introduces a new system of supervision according to which the European Central Bank will directly supervise significant credit institutions. The new system of supervision will be effective as from 1 November 2014.

There are as such no particular legal restrictions specific to the granting of loans to foreign borrowers, except as regards mandatory local public policy provisions (eg local mandatory consumer's protection provisions may have to be complied with by lenders even acting from Luxembourg).

The term of what is to be meant by 'granting loans to the public' remains however uncertain and in specific cases, it might be recommended to get a clearance from the CSSF that the loan to be granted is not considered as being granted to the public, to ensure that no license requirement is triggered.

Are there any taxes, duties or other charges associated with making loans to entities that are incorporated in your jurisdiction?

As a matter of principle, under Luxembourg tax laws as at January 2014 and administrative practice as at January 2014, it is not necessary to file, record or enrol with any court or other authority in Luxembourg or that any stamp duty, transfer, capital, registration, issue or similar duties or taxes or governmental fees and charges be paid on or in relation to the provision of loans to Luxembourg entities.

Are there any restrictions, controls, fees, taxes or charges on foreign exchange in your jurisdiction?

No specific exchange control provisions exist as a matter of Luxembourg law. However, foreign exchange control provisions should be respected when performing contracts and a party may be bound by anti-money laundering/terrorism financing regulations and by any restriction imposed by Luxembourg authorities in any given circumstance.

In addition, pursuant to the EU Directive 2007/64/EC on payment services (the **Payment Services Directive**), in the case of currency conversion, the payment services provider shall disclose to the payment service user, the actual or reference exchange rate to be applied to the payment transaction. In case the exchange rate used is different from the exchange rate previously disclosed, the payment services provider shall disclose the exchange rate used in the payment transaction by the payer's payment service provider and the amount of the payment transaction after that currency conversion.

No specific taxes apply on currency conversion. Foreign exchange gains realized by Luxembourg resident corporations are subject to corporate income tax and municipal business tax at a combined rate of 29.22%, whilst conversion losses should be tax-deductible.

How is debt normally transferred in your jurisdiction?

In general, a debt can be transferred under Luxembourg law by way of assignment (*cession de créance*) or by way of a novation agreement (*novation*).

An assignment will in principle transfer the debt without the extinction of the security right attached to the secured obligation. In this case, the assigned debtor is however entitled to invoke every exception arising out of the secured obligation as against the assignee as if it was the original creditor. As a result of the accessory character of security rights under Luxembourg law, security rights given as collateral to secure the debt will in principle remain to the benefit of the assignee as new creditor.

By contrast, if the debt is traded by way of a novation, the existing obligation disappears and a new contract is created. Even though the amount and the content of the original debt and the new debt are identical (except for the parties), any security right granted to secure the original debt will be extinguished by the novation, unless specific provisions plan the preservation of security rights in accordance with Articles 1278 and 1281 of the LCC.

Security and guarantees

Is it possible to take security over each of the following types of assets in your jurisdiction (including future assets) and what form does that security usually take?

Under Luxembourg law, several types of security rights may be granted, governed by specific provisions of the LCC, general law principles, or specific laws such as the Luxembourg Act of 5 August 2005 on financial collateral arrangements, as amended, implementing the Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements and Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems (the **Collateral Act**).

On 29 January 2014, the Luxembourg District Court sitting in commercial matters held that a secured creditor's right to enforce a pledge on default payment at maturity is of the very essence of the pledge irrespective of whether non-payment at maturity was expressly defined as an enforcement event and that any clause depriving a creditor of such right must be considered null and void.

- *Civil law security rights*
  The considerations on civil law security rights apply to Luxembourg security arrangements that are governed by the LCC and, as such, relate primarily to property rights over tangible and/or moveable assets (ie pledges), or immovable real property (ie mortgages), as well as to pledges over intangible intellectual property rights (**IP Rights**) and that are not subject to the specific regime of the Collateral Act or to special rules such as for instance those relating to international interests in aircraft or other high value mobile equipment.
  It is possible to grant a security covering both present and future assets requiring the debtor to cover all its commitments on its present and future assets. Given that physical transfer is required to perfect a mere civil law security right, a security right with respect to future assets will in principle be considered as a promise to pledge (promesse de gage), ie to deliver the after-acquired collateral for the purpose of a security right and such promise will become an actual and effective security right once the physical transfer of the collateral is effected.
- *Security rights governed by the Collateral Act*
  Only security rights (i) over qualifying collateral that take the form of financial instruments (shares/securities) or claims and (ii) securing monetary claims may enter into the scope of the Collateral Act. As a consequence, these security rights are often used in financial transactions to secure the various financing agreements.

The Collateral Act can be considered as a creditor-friendly legislation: by contrast to civil law security rights, the Collateral Act aims to offer to creditors the utmost protection against nearly any type of impairment, including Luxembourg and foreign insolvency proceedings affecting rights of creditors generally (by application of article 20(4) of the Collateral Act), while offering possibilities to appoint, without having to use the mechanism of parallel debt, a security representative or trustee to manage and hold the security rights for the benefit of secured creditors. Under the Collateral Act, collateral may be given under the form of a pledge or a transfer of property for security purpose.

Land (immoveable property)

Immoveable property (real property) is secured either by a mortgage (*hypothèque*), ie a non-possessory registered security right or an 'antichresis' (*antichrèse*), the latter being rarely used in Luxembourg as such registered pledge requires the transfer of possession of the real estate to the secured creditor including the fruits or rent income in lieu of payments on the secured obligation (we will not enter into further details as regards antichresis).

A mortgage is created in principle by notarial deed (*acte authentique*) and rendered effective as against third parties by registration with the mortgage register of the judicial district where the property is located. The registration is valid and enforceable against third parties for 10 (ten) years and is renewable for unlimited 10 (ten)-year periods, provided that the underlying debt for which the mortgage was created is not extinguished and the 10-year term has not expired. In the absence of such renewal in due time, the security will no longer be enforceable and the secured creditor will lose its preferential rank over such immoveable property.

In the case of mortgages, the specificity principle requires the document to clearly identify the immoveable property and to clearly specify the amount which the mortgage secures in the constituting deed. In addition, the secured obligation must be certain and liquid, otherwise no registration of the mortgage will be authorized. Therefore, it is impossible to grant a mortgage (*hypothèque*) or an 'antichresis' (*antichrèse*) over future property, because both require a clear and precise identification of the property in order to effect a valid registration.

Shares and other securities

- *Shares and equity securities*
  Security rights over financial instruments (shares/securities) and over claims are in principle governed by the Collateral Act, if these assets are located or deemed to be located in Luxembourg.
  As such, any security right over registered shares (actions nominatives) or another form of equity interest is normally taken in the form of a pledge (*gage*) governed by the Collateral Act, if such company is governed by Luxembourg law. It is also possible to take a security right in the form of a transfer of title for security purposes (*transfert de propriété à titre de garantie*).
  The terms of a pledge are governed by written agreement executed between the pledgor and the pledgee and the pledge is perfected and rendered enforceable against third parties by the dispossession or deemed dispossession of the pledged assets. In the case of registered shares/equity securities, a pledge is indeed perfected as against the issuer and third parties only by registration (*inscription*) of the pledge in the shareholders' register (or the register for the relevant equity interest in question) held by the issuer of the relevant security at its registered office in Luxembourg. If these shares (or equity instruments) are materialized through a bearer certificate (bearer securities), the rights attached to such instrument vest with the bearer once it physically acquires its bearer certificate and lose such rights by physically transferring the bearer certificate as well. Accordingly, the perfection of a pledge over bearer shares/equity securities is effective by physical delivery (*tradition manuelle*) to the pledgee (or its security representative) or to an agreed third party custodian (*tiers convenu*). A collateral agreement taking the form of a transfer of title for security purposes is enforceable as against third parties as of the date of execution of the agreement evidencing the transfer of title for security purposes.
  A pledge or a transfer of title for security purposes may extend to both present and future collateral without any need to specifically designate such collateral and may secure present and future obligations of the debtor towards the pledgee/transferee or towards a third party thereby constituting a third party security. The legal ownership of the collateral remains with the pledgor during the lifetime of the pledge in the case of a pledge, whereas a transfer of title for security purposes includes an undertaking of the transferee to re-transfer the transferred collateral (or equivalent collateral as agreed by the parties), upon expiry of the security period (in the absence of course of an enforcement event).

- *Bonds, notes and other forms of transferable debt securities*
  Bonds, notes and other forms of transferable debt instruments may be secured but the formalities required will depend on the type and form of such debt instruments and a security right is perfected, in the same manner as set out under item (i) above, depending on their form in accordance with the Collateral Act.
  For some bearer debt instruments, a transfer by way of endorsement (*titres à ordre*) (such as promissory notes or commercial paper (*billet de trésorerie*)) can be made. The mechanism of endorsement (*endossement*), used for the transfer of ownership or for the perfection of security rights over these bearer debt instruments does not apply to the transfer or the creation of security rights over equity instruments. Under Luxembourg law, the endorsement consists of the inscription of the name of the bearer onto the bearer debt instrument. Endorsing such certificate is not a condition of its transfer, but any future bearer of the certificated debt instrument may, in principle, request the payment of the underlying debt from any person having endorsed the certificate prior to its acquisition. An acquisition without endorsement will constitute a 'transfer in blank' (made through physical delivery of the debt instrument (*tradition manuelle*)) and such bearer will therefore not appear in the chain of possession as evidenced by any endorsement on the bearer debt instrument. Security rights granted over certificated debt instruments transferable by way of endorsement are perfected through a specific form of endorsement, for the purpose of granting such security right (*endossement à titre pignoratif*) and which indicates the name of the pledgee (or its security representative) on the certificate

Cash deposits in bank accounts

Security rights over cash claims as well as over accounts are governed by the Collateral Act. Security rights can take the form of an account pledge or of a transfer of title for security purposes (please refer to Shares and other securities above). A security interest to be taken under the form of a pledge over a cash deposit account may either be considered as a security interest under the form of a pledge taken over a cash claim held against the bank or a security interest over an account (to the extent the cash can be assimilated to financial instruments) held by that bank. In practice however the differences in the drafting of the pledge agreements are minor as both pledges take the form of a pledge over account and it is commonly agreed to notify such pledges to the account bank to ensure perfection.

Receivables (non-contractual and contractual rights, including rights under insurance policies)

- *Receivables*
  Security rights over rights to claim payment of a monetary sum (*créances de sommes d'argent*) are governed by the Collateral Act. Security rights can take the form of a pledge or of a transfer of title for security purposes (please refer to Shares and other securities above). The receivables pledge takes effect between the parties, and is automatically perfected as against the relevant debtor and against third parties (debtor and competing creditors) as of the date of execution of the pledge agreement. However, until it receives a notice of such pledge, the debtor will, in principle, validly discharge its obligations towards the pledgor.
  In an international context, the perfection requirements as against the debtor are determined by the law of the debtor's domicile, in accordance with Article 14(2) of EU Regulation of 17 June 2008 on the law applicable to contractual obligations (the **Rome I Regulation**). In addition, in the case of assigned debtors that are located outside Luxembourg, it may be necessary to ensure that any relevant foreign perfection requirements under the laws of the location of the relevant debtor (registered office or place of central administration, as the case may be), be complied with following the execution of the pledge agreement. Similarly, it may be necessary that foreign law security rights over receivables whose debtor is located in Luxembourg be perfected in Luxembourg, as a result of the traditional conflicts of laws rule according to which the proprietary effect on third parties of the security right is governed by the law of the debtor's domicile (as a *situs* of the receivable).
- *Contractual rights*
  Contractual rights have to be considered either as financial instruments or as claims (*créances*) depending on the type of rights concerned, to benefit from the Collateral Act. A security right over the relevant contractual right is created and perfected by written agreement between the pledgor and the pledgee, as further explained above.

Intellectual property

IP rights are intangible personal property and are normally subject to security rights in the form of a civil law pledge governed by LCC.

Given that physical transfer is required to perfect a civil law pledge, a pledge with respect to future assets will in principle be considered as a promise to pledge (*promesse de gage*), ie to deliver the subsequently-acquired collateral for the purpose of a security right and such promise will become an actual and effective security right once the physical transfer of the collateral is effected. Therefore, any security right with respect to future IP rights will in principle be considered as a promise to pledge.

In order to be enforceable against third parties, pledges over registered IP Rights must be registered with IP registers such as the Benelux Office of Intellectual Property (for trade marks and designs) at The Hague (Netherlands), or the Intellectual Property Department of the Luxembourg Ministry of Economy, in Luxembourg, or the European Patent Office (for patents) in Alicante (Spain) and respectively, in accordance with the law where the register is held. Security rights over unregistered IP Rights (such as copyrights) are created by private agreement and perfected through notification to the debtor in accordance with civil law. No mandatory public registration is as such required for unregistered IP Rights.

A security right over registered IP rights may also be granted by way of title transfer for security purposes to a licensed fiduciary (*fiduciaire*) under a fiduciary contract, under the Act of 27 July 2003 on trusts and fiduciary contracts, as amended (implementing the Hague Convention of 1 July 1985 regarding the law applicable to the trust and its recognition, the **Hague Convention**) (the **Trusts and Fiduciary Contracts Act**). Perfection as against third parties is effected by registration with the relevant register (either to the Benelux Office of Intellectual Property (for trade marks and designs), the Intellectual Property Department of the Luxembourg Ministry of Economy, or the European Patent Office, or such other IP registers). In the case of unregistered IP Rights (such as copyrights), the title transfer for security purposes to a licensed fiduciary can be made by private agreement without any third party notification or any mandatory public registration which allows the fiduciary security right to remain entirely undisclosed.

Tangible assets such as ships, aircraft, machinery, etc.

- *Aircrafts and ships*
  Security rights over aircraft may be granted in accordance with the Convention on International Interests in Mobile Equipment (the **Cape Town Convention**) in conjunction with the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment of 16 November 2001 (the **Aircraft Protocol**), as ratified by the Luxembourg Act of 28 May 2008, in force as of 1 October 2008 (similar to the regime under the Collateral Act). An international security interest over aircraft constituted under the Cape Town Convention and the Aircraft Protocol prevails over any aircraft mortgage under internal Luxembourg law, even if the latter was registered earlier. Such internal Luxembourg security right over aircraft may be created under the Luxembourg Act of 29 March 1978 on the recognition of rights in aircraft (the **Aircraft Mortgages Act**), either in the form of a mortgage or by way of title transfer for security purposes (*transfert de propriété à titre de garantie*) in application of the Trusts and Fiduciary Contracts Act. Title to an aircraft can be transferred for security purposes only to a licensed fiduciary or to a (foreign) trustee, in which case such quality of licensed fiduciary or trustee must be inscribed in the aircraft mortgage register (*Bureau de la conservation des hypothèques aériennes*) in addition to registration with the Luxembourg Administration of Registrations and Domains (*Administration de l'Enregistrement et des Domaines*). Registration is valid for a renewable 10 (ten)-year period. If the security interest is an international interest over aircraft governed by the Cape Town Convention and the Aircraft Protocol, such interest is perfected (and its priority established on a first-to-file basis) upon the registration with the International Registry of Mobile Assets in Dublin (Ireland). In the case of mortgages, the civil law rules on mortgages are applicable.
  Security rights over vessels may be granted by way of ship mortgage, either under the Luxembourg Act of 14 July 1966 on the registration of inland navigation vessels and on the mortgage on inland navigation (for inland ships with a weight of more than 20 tons or a length of more than 20 metres, the **Inland Vessel Mortgages Act**) or under the Luxembourg Act of 9 November 1990 as amended on the register of international navigation vessels (such as container ships, the **Maritime Mortgages Act**, which implements the Brussels Convention of 27 May 1967 for the unification of certain rules relating to maritime liens and mortgages in Luxembourg), or by way of title transfer for security purposes in application of the Trusts and Fiduciary Contracts Act. Inland ship mortgages and maritime mortgages are in principle constituted and perfected in accordance with the civil law rules on mortgages, except where otherwise provided by the Inland Vessel Mortgages Act or the Maritime Mortgages Act. Accordingly, registration with the inland ship mortgage register (*Bureau de la conservation des hypothèques fluviales*) or the maritime mortgage register (*Bureau de la conservation des hypothèques maritimes*), as applicable, is required following constitution of the mortgage (either by notarial deed or by written agreement with the declaration or certification set out under Land above). The registration is valid for a renewable 10 (ten)-year period. If the ship loses its Luxembourg nationality because it is not registered with the relevant Luxembourg register and/or is not authorized

to sail under the Luxembourg flag, the mortgage will continue to exist until it expires, but no additional Luxembourg mortgage may be created over such asset.
In any case, a security right granted over an aircraft, an inland ship (with a weight of more than 20 tons or a length of more than 20 metres) and/or an international vessel (such as container ships) shall require a notarial deed or a written agreement unless governed by the Cape Town Convention and Aircraft Protocol, as applicable.

- *Moveable property (including machinery)*
Security rights over moveable personal property are created by a civil law pledge under the LCC. Civil law pledges can be granted over most categories of moveable property, either tangible or intangible, on present and future assets, and also on fungible goods, such as agricultural products. A civil law pledge may be created by a private written agreement.
Civil law pledges with respect to plant and machinery are uncommon in practice, because they necessarily imply the delivery of the property by, and the dispossession of, the debtor.
Given that moveables can be transferred from one jurisdiction to another, the legislation of their situation (*lex rei sitae*) may be replaced by the legislation applicable to the contractual relationship that they derive from. Parties to a contractual relationship may choose to submit their contract to a foreign law in accordance with Rome I Regulation, within its scope of application. A Luxembourg court could thus decide to apply the law chosen by the parties rather than the *lex rei sitae*, although there is no court precedent on this point and we do not express any final view hereon, particularly in respect of mandatory publicity of possession (or false wealth) aspects in a perfection context which would need to be evaluated by a Luxembourg court.

Inventory or stock

In this context, a civil law pledge with respect to assets such as inventory or stocks may be excluded in practice because such pledge necessarily implies a delivery (*dispossession*) of the collateral from the pledgor to the pledgee. Inventory or stock may be the subject matter of a pledge over a going concern/business universality (*gage sur fonds de commerce*).

A pledge over a going concern/business universality usually includes all the assets of the pledgor (in a broad meaning) such as customers, tools, equipment and part of a stock, unless otherwise agreed between the parties. The pledgor who pledges its business as a going concern acts as custodian (gardien) of the business collateral over the time of the existence of the secured obligations. A pledge over a going concern/business universality is subject to specific requirements set out in the Grand-Ducal Decree of 27 May 1937 (as amended), and can only be granted to authorized credit institutions and breweries. A valid pledge over the business universality of the security provider requires that the beneficiary of such pledge is a Luxembourg or foreign credit institution specifically authorized by the government (sitting in council) to enter into a pledge over a going concern/business universality. To be valid, a written agreement is required, which is enforceable against third parties after registration at the mortgage register of the judicial district in which the business is run or the stock or goods are located. In light of the latter and given that an authorization has to be obtained from the government, the perfection of a pledge over a going concern/business universality is a lengthy and costly process that may take several months to complete (unless the relevant credit institution is already authorized). In addition, the pledge may cover only 50 % of the stock (if any) of the pledgor, and will be valid for a renewable 10 (ten)-year period. Where there are no specific provisions (including under the Luxembourg Commercial Code), the civil law rules on pledges over moveable personal property remain applicable. Under Article 119(2) of the Luxembourg Commercial Code, the rights of the pledgee under such pledge are suspended neither by the opening of insolvency proceedings in respect of the pledgor nor by the death of the pledgor.

In relation to each type of asset listed above: What formalities are necessary or desirable to perfect the security and what is the effect of the formalities not being carried out?

Depending on the type of security right, specific perfection requirements must be met to ensure that the security right is valid and enforceable as against third parties, or remains valid and enforceable as against third parties. Luxembourg law does not require information concerning the existence of a non-possessory security right over assets located in Luxembourg (other than mortgages and antichresises) (*antichrèse*)) to be made publicly accessible in a public filing, recording or registration system. As such, public searches are generally not available in the area of Luxembourg-based

secured transactions, except in respect of mortgages, where secured creditors may request from the relevant register in writing information concerning any security right of record attaching to the collateral (real property, pledge over a going concern, ship or aircraft) in question.

In the case of a personal property security (other than mortgages or antichresises) (*antichrèse*), the pledgor will usually be required to perform the perfection requirements, on a first-in-time basis. In the case of a mortgage or an antichresis (*antichrèse*), the secured creditor will perform the perfection requirements on a first-to-file basis.

The perfection of a security right over qualifying collateral under the Collateral Act does not prevent a competing creditor from bringing an action to obtain attachment or seizure of the collateral for the purposes of a forced sale, but the priority of the secured creditor under the security right over the proceeds of such sale will not be impaired. Similarly, pledges under the Collateral Act are protected against any criminal attachment order, whose effects are suspended until the release of the pledge by the pledgee.

Depending on the type of security right, the following perfection steps are required:

- civil law pledges: dispossession through physical delivery of the collateral from the pledgor to secured creditor as pledgee.
- mortgage and antichresis (*antichrèse*): inscription in the mortgage register on a first-to-file basis by or on behalf of the secured party (please refer to our explanations under Land above).
- ship mortgage: for inland vessels, the registration with the inland vessel mortgage register in Luxembourg. If the mortgage was constituted by written agreement under private form (instead of a notarial deed), the required information on the parties and the vessel may be replaced by a written declaration at the end of the agreement or by a certification of the shipping court for the Mosel (*Tribunal de navigation pour la Moselle*) in Luxembourg that is annexed to the deed. The perfection of the maritime mortgage constituted by a notarial deed will be made by the inscription at the maritime mortgage register (*Bureau de la conservation des hypothèques maritimes*). If the mortgage was constituted by written agreement, it will have to be notified to the registrar (conservateur).
- security rights over registered IP Rights: registration with the relevant IP register. Security rights over unregistered IP Rights are perfected as against the debtor through notification to the debtor in accordance with civil law.
- pledge over claims: perfection as between the parties, automatically against the debtor and third parties as of the date of execution of the pledge agreement.
- pledge agreement over registered shares/notes: registration of the pledge in the shareholder/noteholder register of the company whose shares/notes are pledged (please refer to Shares and other securities above).
- pledge agreement over financial instruments (securities) held in an account: perfection occurs (including through the concept of control) as follows:
  - the mere execution of a pledge agreement by the depositary if the depositary is also the secured creditor (automatic perfection/control by status);
  - a control agreement between the pledgor, the pledgee and the depositary bank, or an agreement between the pledgor and the pledgee, notified to the depositary bank, according to which the latter will comply with instructions by the pledgee without further consent of the pledgor;
  - the registration of the financial instruments in the account of the pledgee (control by becoming the account holder); this rule also applies in the case of a security assignment;
  - registration in an account opened with a depositary in the name of the pledgor or in the name of an agreed third party (*tiers convenu*), the financial instruments being designated as pledged individually or collectively by reference to the relevant account in which they are recorded (book-entry perfection or earmarking), this rule also applies in case of a security assignment.
  - The means of perfection under (B), (C) and (D) above imply an automatic waiver by the depositary of its priority over the financial instruments except where agreed otherwise or in the case of a notification made under (B) above where the depositary has not expressly accepted such waiver of its priority.

There are no ongoing requirements in relation to the maintenance of the security outside the obligation to renew registration with the mortgage register, IP registers or ships and aircraft registers (please refer to our explanation above).

If perfection requirements have not been validly performed, the pledgee may not obtain the benefit of a valid security right over such asset, may have no preferential rank and/or may be unable to enforce its security right as against third parties benefiting from a validly perfected security right, even if it was more recent. The pledgee may also be in competition with other unsecured creditors of the debtor over the same asset and be paid on a first-to-file basis or at the prorate of the claim it has against the debtor.

What costs are involved in taking security over each asset, including notarial fees, registration fees and taxes and are there any ways to minimize these costs?

In general, security rights require a private written agreement but not necessarily a notarial deed (*acte notarié*), therefore no public registration is required and the costs of such documents are rather limited. However, mortgages, antichresis (*antichrèse*), IP Rights, pledges over a going concern and security rights over real estate, aircrafts, inland ships or international vessels may require a notarial deed, a registration in a public register and the renewal of such registration for the continuation of the security right. Proportional registration duties may apply on the registration of these notarial deeds. The registration of a mortgage on real estate, aircrafts, inland ships or international vessels is subject to proportionate registration duties.

Does your jurisdiction recognize the concept of a trust? If not, is there an accepted method of ensuring all lenders get the benefit of security? Are there any limits on action a security agent could take on behalf of the secured parties?

In general, the legal concepts of 'trust', 'trustee' and 'security trustee' and related legal concepts do not exist in Luxembourg law. However, Luxembourg law allows for two main exceptions:

- Foreign trusts may be recognised under certain circumstances under the Trusts and Fiduciary Contracts Act. A trust is therefore considered a foreign legal institution which may be granted effect in Luxembourg through recognition. The Hague Convention merely regulates the conditions for such recognition, including the requirement of a valid trust in accordance with its own governing law, the ability of the trustee to manage the collateral and represent the beneficiaries (eg, in the case of judicial proceedings) and the segregation of the trustee's assets from the beneficiaries' assets. Once recognized, the trust remains subject to its own governing law, chosen by the parties, subject to certain exceptions (including the non-recognition of the chosen governing law in the case of a closer connection with another jurisdiction which does not recognise trusts, the application of mandatory provisions and the general exception of public order).In light of the above, the use of a foreign law trust may be recognized in Luxembourg. As a consequence, any asset eligible to be managed in Luxembourg under a trust in accordance with the law chosen to govern such trust, may be subject to the trust that is to be recognized in Luxembourg (eg real estate, properties)
- Article 2(4) of the Collateral Act provides that financial collateral may be granted by a person acting on behalf of the beneficiaries of the financial collateral, a fiduciary or a trustee to secure the claims of third party beneficiaries, present or future provided that such third party beneficiaries are identified or can be identified. The persons acting on behalf of third party beneficiaries, the fiduciary or the trustee enjoy the same rights as those granted to direct beneficiaries of the financial collateral arrangement by virtue of the Collateral Act, without prejudice to their obligations towards the third party beneficiaries of the collateral.

Will changes to the group of lenders adversely affect the security or require any steps to be taken as regards the security package in your jurisdiction?

In general, a debt can be transferred under Luxembourg law by way of assignment (*cession de créance*) or by way of novation agreement (*novation*) (please refer to our explanations above).

As a result, it is necessary to provide, in the security documentation, a specific provision to allow the transfer of such security rights with a power for the transferee to exercise all rights and powers which were available to the former pledgee.

In addition, it is possible to appoint a security representative or trustee to act on behalf of a group of secured creditors, and such creditors do not have to be listed in the security documentation: a mere reference to the intercreditor agreement or the document by which the creditors have appointed the security representative or trustee (which is to be amended in the case of a change in the group of creditors) will suffice to have a valid pledge granted to the security representative or trustee, regardless of any change that may occur within the group of creditors.

How is security commonly released in your jurisdiction?

In general, a security right is released in the reverse manner as it is created and perfected (the principle of parallelism of forms).

In the case of a civil law pledge or a pledge requiring physical delivery under the Collateral Act, the restitution of the asset to the debtor will be operated by a release of the security from the collateral (*mainlevée*). The release will be documented by a release agreement. In the case of a mortgage, the registration will be deleted from the mortgage register, in accordance with a specific procedure applicable to such register.

Under the Collateral Act, where the security concerned is an account pledge, the release of the security over the account will require the information of the account bank, to ensure it has knowledge of such release and is properly instructed as to whom any payments may be directed following the release. In the case of a share pledge agreement over registered shares, the release of the pledge will be mentioned in the share register of the relevant company.

What forms of quasi-security are common in your jurisdiction?

In general, Luxembourg law distinguishes between personal guarantees (*sûretés personnelles*) and personal property security rights (*sûretés réelles*).

Personal guarantees can be of several types. The most common are (a) the suretyship (*cautionnement*), (b) the autonomous (or demand) guarantee (*garantie autonome/à première demande*) or (c) the letter of comfort (or letter of patronage).

A suretyship (*cautionnement*) is ancillary to the principal secured obligation and is subject to all the defences that apply to the principal secured obligation, as a result of which the guarantor may invoke all remedies that are available to the principal debtor in respect of the execution of its obligation, unless previously waived, which may threaten its efficiency. In order to be valid and enforceable, a suretyship requires certain hand-written annotations, but neither a notarial deed nor the consent of the principal debtor are required.

It is worth mentioning that the Over-indebtedness Act introduces amendments to certain types of suretyships provided by natural persons (introduction of an annual information obligation and a sanction against disproportionate suretyships).

An autonomous/demand guarantee is a type of guarantee created by international commercial practice and not by law, contrary to the suretyship. It is a stronger commitment, characterized by its autonomous nature. An autonomous/demand guarantee expressly stipulates that (i) it is a demand guarantee (*garantie à première demande*) and not a suretyship (*cautionnement*), (ii) the obligations of the guarantor constitute an autonomous guarantee (*garantie autonome*) that is not an accessory (*accessoire*) to the principal secured obligations and (iii) the guarantor acknowledges that any invalidity or unenforceability relating to the principal secured obligations for any reason would not invalidate or render unenforceable the obligations of the guarantor under an autonomous/demand guarantee. Typically, the guarantor engages itself irrevocably to pay a specific amount, either at the first demand or following the presentation of specific documents. In general, the autonomous/demand guarantee offers a better security than the suretyship and, like the suretyship, requires written evidence (even though any means of evidence are admissible in the area of commercial matters (*actes de commerce*)), but without all hand-written annotations as required in the case of a suretyship. In the area of group financings, particularly in respect of guarantees granted in favour of a parent or sister company, certain corporate benefit and guarantee limitation considerations apply, as further set out below.

Can entities in your jurisdiction give guarantees? If so are there any restrictions or limitations on an entity incorporated in your jurisdiction granting such guarantees and are there any common ways of minimizing the impact of these?

Ultra vires

A company is limited by its corporate object as defined in its articles of association, as well as its corporate interest and benefit. Therefore, any guarantee must be provided in accordance with the scope of such corporate object as determined by the articles of association of such guarantee provider.

If the guarantee was granted in excess of the corporate object and corporate interest, it also means that the physical persons which had power to sign the guarantee have exceeded their mandate, necessarily limited by the powers of the company itself. In such case, a Luxembourg court may consider that the person acting in excess of power has acted in its own name and not in the name and on behalf of the company, in application of article 1994 LCC and the transaction may be declared null and void based on the concept of illicit cause (*cause illicite*). The risk of such requalification is higher where such guarantee hinders considerably the credit of the company or appears to be obviously disproportionate as regards the financial capacity of the company and not to the benefit of the company. In addition, directors of a company may even incur criminal penalties for misappropriation of corporate assets (*abus de biens sociaux*, Article 171-1 of the amended Luxembourg Act of 10 August 1915 on commercial companies (the Companies Act)) if they derive a personal benefit (not necessarily pecuniary) from the granting of such guarantee.

Difficulties and limitations may therefore apply in the case of upstream or cross-stream guarantees.

Financial assistance

Currently, financial assistance prohibitions do not apply to a Luxembourg private limited liability company (*société à responsabilité limitée*), but they are specified to apply to public limited liability companies (*société anonyme*). Article 49-6 of the Companies Act provides a whitewash procedure under which a public limited liability company may, under certain conditions, directly or indirectly, advance funds, grant loans or provide guarantees or security with a view to the acquisition of its own shares by a third party. It is possible that similar rules will be introduced with respect to the private limited liability company. Financial assistance must also be given in accordance with the corporate object of the company and meet the corporate/group interest of the company (please refer to our explanations under the Ultra vires section, above and Conflict of interest section, below). On 8 June 2007, a bill of law (bill no.5730) relating to the modernisation of the Luxembourg company legal framework and amending the Companies Act was deposited with the Luxembourg Chamber of Deputies. The bill is currently pending. Among other measures, the bill provides for the extension of the scope of the financial assistance prohibition to private limited liability companies (*société à responsabilité limitée*).

Corporate interest

The concept of corporate interest as such is not expressly mentioned in Luxembourg law, neither in the Companies Act nor in the LCC. The concept of corporate interest is distinct from the individual interest of each shareholder as well as from the particular interests of a majority group of shareholders, but it is to be considered specific to the company.

The directors/managers of a company have a duty to act in the best interests of their company and must ensure that the granting of guarantees and security by their company meets a 'corporate interest test'.

- Corporate benefit is in the first instance a problem for the company's directors. They may incur personal liability if their actions do not pass the corporate benefit test, and may even incur criminal penalties for misappropriation of corporate assets (*abus de biens sociaux*) if they derive a personal benefit (not necessarily pecuniary) from the transaction.
- Lenders/creditors also have an interest, but if the transaction does not benefit the company, then it may be set aside if the lenders/creditors were aware that in entering into such transaction, the directors were acting in breach of their duties; there is even the risk that the lenders may incur joint liability with the directors for such breach and the transaction becomes unenforceable.
- The granting of third party security is, in principle, not in the interests of the company, as it hinders its credit for the benefit of someone else. However, in the context of affiliates or group companies, it is under certain conditions accepted that it may be in the interest of such company, when it is in the interest of affiliated or group companies and to the own benefit (either directly or indirectly) of the company. The interest of the company granting such guarantee/security right may however require demonstration that the company received adequate consideration. The question of whether adequate consideration is given to the security provider is a question of fact.

- In addition, the directors/managers should avoid committing the company beyond its financial means.
- Moreover, third party creditors of the company may claim that fraudulent acts made to their detriment shall not be effective against them. Court precedent has confirmed that fraud/evasion of law (*fraude à la loi*) can be demonstrated by the abnormal character of a transaction or payment when the company should have known that it was to the detriment of such creditors. Again, this is a question of fact.
- In practice, it is for the directors to consider whether granting the guarantee or other security is justified by the interest of their company and, if they decide it is, they should record the reasons for their decision in the minutes of the board meeting which approves the guarantee or such other security.
- Corporate interest is not a defined term under Luxembourg law and its concrete interpretation is left to the courts and legal authors. Consequently, there are many visions on the meaning of "corporate interest", ranging from a narrow view according to which only the collective interest of the shareholders is to be taken into account, to a broad view, which has also regard to the interests of the employees, the suppliers, the creditors, etc. of the company providing the guarantee/security right.

Works council

Under Luxembourg law, a works council (*comité mixte d'entreprise*) is required for any industrial, commercial or craft undertaking which had at least one hundred and fifty (150) regular employees over the past 3 years. The functioning of the works council is governed by articles L-421-1 ff. of the Luxembourg labour code (*Code du travail*).

If there is no specific provision requiring the entity's directors/managers to inform or consult the works council prior to granting a guarantee or security rights, a general provision requires the mandatory information and consultation of the works council as regards any economic or financial decision which may have a determining impact on the structure or the employment within the undertaking. Therefore, it may be possible that a transaction with an impact on the structure of the undertaking itself, requires the consultation of the works council, prior to any decision being taken. In case of consultation, the works council will provide advice (or several pieces of advice in the absence of agreement within the council) to the director or the board of managers/directors of the undertaking. The proceeding is not applicable should the company not be a stock company (*société par actions*) and the director/manager has been present during the discussions. Then, such recipient shall make an informed decision as regards the works council's advice(s) and record its decision in the minutes.

Would there be any concerns in terms of validity or enforceability for an entity in your jurisdiction to grant an English law guarantee as typically included in syndicated loan agreements governed by English law?

In principle, an English law guarantee will be recognized and enforceable in Luxembourg under its terms, in accordance with the principles of the Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the Brussels I Regulation) and the Rome I Convention, unless such foreign law provisions are contrary to the Luxembourg overriding mandatory provisions (*lois de police*) or manifestly incompatible with Luxembourg public order (*ordre public*).

As such, the expressly agreed terms of such English law document may not be enforceable under Luxembourg law or before a court of competent jurisdiction in Luxembourg if and to the extent that their performance would be unlawful, unenforceable or contrary to public policy. In general, it will be required that the relevant provisions are contrary to a matter of Luxembourg international public policy, ie embody the essentials of the country's moral, political or economic order, such as certain consumer code provisions (that cannot be waived or overridden by express contractual agreement), the appointment of a Luxembourg insolvency receiver or official in relation to the assets of a debtor located in Luxembourg, the use of a Luxembourg enforcement official for civil law security rights (ie, no self-help enforcement), provisions on usury or contractual penalties or, subject to important exceptions, the equal treatment of creditors.

Enforcement

When in your jurisdiction would a lender be entitled to enforce its security or guarantees?

A valid security right agreement or a guarantee governed by its own terms is enforceable under its own terms, therefore the time of enforcement shall depend on the terms of the agreement itself, as well as on the definition of enforcement event.

In brief, for each type of asset referred to above, what are the procedures for enforcing security and guarantees in your jurisdiction:

Inside insolvency

Luxembourg civil law security rights may be affected by the opening of insolvency proceedings against the pledgor. However, all security rights governed by the Collateral Act benefit from the utmost protection against Luxembourg or foreign insolvency proceedings, by application of Article 20(4) of the Collateral Act.

- Civil law rights:
  - Immoveable property
    Given that such security right is registered in a public register, a sole first ranking mortgagee may enforce by way of fast track based on the notarial deed (which constitutes an enforceable title (*titre exécutoire*)), if the notarial deed provides that the mortgagee is authorised to sell the real property through a notary public without having to follow the statutory attachment procedure (*clause de voie parée*). In this case, the public auction may occur thirty (30) days after the summons to pay. If there is a dispute, the notary suspends all actions and brings the parties before the president of the competent court who will make a ruling in an urgent procedure (*procédure de référé*).
    Under the statutory attachment procedure, a writ to attach (*exploit de saisie*) must be served by a process server/bailiff on the mortgagor fifteen (15) days after the summons to pay and must be registered where the mortgage was initially registered. Thereafter, the mortgagee must file an application for a hearing with the clerk of the competent court and have it served (through a process server/bailiff) on the mortgagor. The court assesses the validity of the attachment and appoints a notary public to organise and conduct a public auction. Following adjudication at the highest bid the proceeds are first paid to the notary up to the amount of its fee, then to other preferred creditors (such as preferred creditors by operation of law, eg the Luxembourg Treasury...) and then the mortgagee.
    Moreover, a Luxembourg bankruptcy receiver (*curateur*) may ask the court (with the intervention of the mortgagee and notification of the company and any other creditors) for authorisation to (i) proceed to foreclosure proceedings if no such proceedings were initiated by the mortgagee or (ii) order an end to any foreclosure proceedings already initiated by the mortgagee if that would be more beneficial to the estate (e.g. to avoid depreciation or to maximise the price), and to sell the property itself by public auction or private sale, distributing the proceeds to secured creditors in the order of their priority.
    It should be noted that Luxembourg courts recently held that a mortgage validly constituted may be enforced in good faith notwithstanding a *saisie pénale* which would have occurred subsequently.
  - Contractual rights, Plants and machinery, IP Rights
    There is no need for lenders/creditors to act on their own behalf if a pledgee has been appointed. As a general rule, civil law security rights or mortgages may only be enforced after a prior summons to pay (*mise en demeure*) has been served on the debtor of the secured obligation (in the case of a mortgage, served by a process server/bailiff (*huissier de justice*)). Civil and commercial pledges over moveables, including pledges in respect of intellectual property rights, that have been perfected by delivery of collateral to the pledgee are enforced either by judicial attribution (following valuation by a court-appointed independent expert) or, more typically, through public auction in accordance with Articles 116 to 119 of the Luxembourg commercial code and, in the case of mortgages, Articles 809 ff of the Luxembourg new code of civil procedure, and satisfaction from the proceeds of sale, but not through self-help appropriation, which would constitute a forbidden *pacte commissoire* or *clause de voie parée*.
    A public auction of collateral subject to a civil law pledge may be made at a stock exchange (in the case of unlisted financial instruments, eg commercial papers...) or outside the stock exchange, in each case under the supervision of a public officer (such as a notary, a bailiff or a clerk) designated by the competent court. Sales have to be made in cash, therefore it is not possible, for example, for lenders to bid their credit. A public auction at and by the Luxembourg Stock Exchange (**LxSE**) is made at a date and time published by the LxSE.

- Security rights governed by the Collateral Act
  - Shares and debt securities
    The Collateral Act provides a number of enforcement remedies that may be varied by agreement. As such, the Pledgee may, unless otherwise agreed, without prior summons to pay:
    - *appropriate the collateral (without court intervention)*
      The appropriation method allows the pledgee to enforce the pledge without court intervention, subject to the existence of an agreed evaluation method. Contrary to the judicial attribution under civil law, the expert or financial advisor who values the collateral in accordance with the agreed evaluation method, may not be approved by a Luxembourg court but is designated by the parties in accordance with the terms of the security agreement. Subject to any delays due to the need for a valuation (which will depend on the existence of an agreed evaluation method and on the diligence of the appointed expert) and assuming no provisional measures will be permitted by a competent court, appropriation can happen relatively quickly in accordance with the terms of the pledge agreement.
      Further to the appropriation, the pledgee (or any other person designated by it, such as a special purpose vehicle) will become the direct owner of the shares of the company. It should be verified whether such appropriation cause(s) any tax, accounting or regulatory issues for the pledgee.
    - *sell at a private sale*
      The only requirement for a private sale is that it must be made on 'normal commercial terms' (*conditions commerciales normales*), meaning in a commercially reasonable manner (without which any aggrieved party is limited to a claim for damages), in a sale organised by a stock exchange (to be chosen by the pledgee) or in a public sale (organised at the discretion of the pledgee and which, for the avoidance of doubt, does not need to be made by or within a stock exchange), subject only to an ex-post control by the courts in relation to the assessment of the 'commercially reasonable' realisation or valuation of the collateral.
      There is little guidance as to what the expression 'normal commercial terms' means. It is common practice to refer to the fair market value of the collateral at the time of the sale. The purpose of the rule is the protection of the pledgor against an arbitrary sale by the pledgee. Once an enforcement strategy has been decided, a detailed analysis should be undertaken in order to verify if the private sale can be characterised as occurring on normal commercial terms. For the avoidance of doubt, it is normally recommended to carry out a sale by cash consideration, as opposed to credit bidding or giving in payment, because the law requires a 'sale'.
    - *sell at a public auction*
      In general, if the parties have agreed on a public auction of the collateral, unless provided otherwise, the auction shall be effective at and by the LxSE at a date and time published by the LxSE. According to the regulations of the LxSE, all sales have to be made in cash. A public auction may also be made outside a stock exchange under the supervision of a public officer.
    - *sell on stock exchange*
      In the case of collateral admitted to the official list of a stock exchange located in Luxembourg or abroad, or if it is traded on a regulated market functioning regularly, recognised and open to the public, appropriate the collateral at its list price.
    - *judicial attribution*
      Request a judicial decision attributing the collateral to the pledgee in discharge of the secured liabilities following a valuation of the collateral made by a court appointed expert (*attribution judiciaire*).
  - Bank accounts
    Upon the occurrence of an enforcement event, the account pledge will, unless agreed to the contrary, become immediately enforceable and the pledgee may thereupon immediately exercise any or all of its rights and powers of execution, realisation and foreclosure under the pledge agreement or otherwise provided by law. In particular, it may give instruction to the account bank with which the cash account is maintained to pay to the pledgee the amount it has indicated for setting-off purposes against the secured obligations.
  - Receivables
    If the collateral is a receivable, the pledgee may provide notification upon an enforcement event and instruct the debtor of the receivable to make payment directly to the pledgee (whether or not the pledgor was making collections on the receivable before such notification and instruction) to apply any money paid to the pledgee to its satisfaction and set-off against all or any part of the secured obligations.

Outside insolvency

Outside insolvency, security rights will usually be enforceable in accordance with their terms, depending on the definition given to an enforcement event, justifying the enforcement of the security right. It is however necessary to ensure that the provisions allowing enforcement do not give an arbitrary power to one of the parties that is disproportionate, otherwise a Luxembourg court may consider such provision to be abusive and therefore inapplicable.

Intercreditor issues

In brief, how will security interests over the same asset (where the priority is not contractually regulated) rank as against each other in your jurisdiction?

Luxembourg law grants certain preferential liens on moveable assets of debtors in favour of Luxembourg tax authorities and social security institutions, as well as employees in respect of their claims (if any); they may take precedence over the rights of other secured or unsecured creditors. The priority of competing secured creditors in respect of the same collateral will be determined by the type of asset and type of security right.

Unsecured creditors rank pari passu.

- **Civil law Security Rights**
  Although not explicitly recognised in the LCC, rules similar to the priority rules under the Collateral Act are used in practice for civil law security rights such as pledges over IP rights or over moveable assets.
  If the security is a civil law pledge, then the time of delivery, registration or notification of the debtor, as applicable, will determine the priority of the secured creditor priority ('first-to-file' or 'first-in-time'). If there is no possibility to determine the date on which the security has attached, then the competing creditors will be considered as equally secured. If competing creditors that are equally secured enforce simultaneously, the proceeds of realisation will be distributed proportionally to the amount of each secured creditor's outstanding claim.
- **Security Rights under the Collateral Act**
  Under the Collateral Act, only pledges will be affected by ranking issues, given that a transfer of title for security purposes precludes any conflict between competing secured creditors.
  Under a share pledge agreement, the time of registration in the share register of the issuer determines the priority of the pledge over the issuer's shares without the need to involve any competing creditors.
  In respect of collateral consisting of claims resulting from a receivable, the mere execution of the security agreement perfects the pledge as against the debtor under the receivable, as applicable, but priority is contingent on the acknowledgement of the security by any existing competing creditor.
  Under a pledge over financial instruments, the priority of a secured creditor will be determined in accordance with the perfection steps set out above. The priority of a competing pledgee in respect of the same financial instruments is determined in accordance with the following perfection steps, which depend on the type of financial instruments:
  - in the case of a pledge over book entry securities:
    - by the approval of the pledgee of higher priority, if the relevant bank account is held in the name of the pledgor;
    - if the relevant account is held in the name of a pledgee of higher priority, by the approval of such pledgee and of any other pledgee of a higher priority;
    - if the relevant account is held in the name of a third party (*tierce personne*), by the agreement of such third party to act as an agreed third party custodian (*tiers convenu*) and the approval of every pledgee with a higher priority.
  - in the case of a pledge over securities in bearer form:
    - if the relevant securities were delivered to a pledgee, by its approval to act as an agreed third party and the approval of any other pledgee of a higher priority;
    - if the relevant securities were delivered to an agreed third party, by its approval and the approval of every pledgee with a higher priority.
  - in the case of a pledge over registered financial instruments (*instruments financiers nominatifs*), by the time of registration in the relevant register of the issuer.

- in the case of a pledge over order instruments (*instruments à ordre*), by a regular endorsement with the indication that the qualifying collateral was pledged in favour of a pledgee with a lower priority.
- in the case of a pledge over other financial instruments, by the express approval or notification to the issuer of the relevant financial instruments, or any third party depositary and the approval of every pledgee of a higher priority.
- in the case of a pledge over receivables, by the approval of every pledgee of higher priority; the debtor of the secured claim may validly discharge its obligations towards the pledgor or any existing pledgee if it was not aware of the constitution of a new security right.

In the case of enforcement, the priority of competing pledgees is implemented as follows (subject to the terms of any relevant intercreditor agreement):

- Where the most senior pledgee(s) realize(s) upon the collateral, any surplus will be held by an agreed third party custodian, acting for the account of pledgee(s) of lower priority. Where the most senior pledgee acted as the agreed third party custodian, it may continue to do so or else remit the surplus to the other pledgees in order of their agreed priority. In the absence of an agreed priority, the most senior pledgee will appoint a Luxembourg credit institution as receiver (*séquestre*) and remit the surplus to it for the benefit of the secured creditors of lower priority.
- Where a junior pledgee realizes upon the collateral, enforcement must occur in accordance with the agreed enforcement method and the proceeds must be applied in accordance with the agreed order of priority. In the absence of an intercreditor agreement, the most diligent pledgee (in practice, the first to act) may request provisional measures (*référé*) from the president of the Luxembourg district court to settle the issue. The competing pledgees are entitled to apply for appeal against the provisional measure. A junior pledgee acting in good faith who ignores the existence of a competing pledgee with higher priority is entitled (i) to retain the enforcement proceeds up to the amount of its secured obligation and (ii) to remit any surplus to the pledgor, in each case without incurring any liability.

What method(s) of subordination are commonly used in your jurisdiction?

Except as between securitization companies and its creditors and investors, Luxembourg law does not regulate contractual subordination. There exists very limited case law in Luxembourg in relation to the recognition of contractual subordination provisions.

Investors using Luxembourg securitization vehicles and requiring the benefit of security rights may also need to appoint a security representative. Under the Luxembourg Act of 22 March 2004 on securitization, as amended (the **Securitization Act**), a Luxembourg securitization vehicle may grant a security right over its own assets exclusively to secure its obligations under the issued securities for the benefit of the investors, their fiduciary security representatives (*représentants-fiduciaires*) or the issuing vehicle (if assets are held by an acquisition vehicle).

Under the Securitization Act, investors in a securitization vehicle acting as secured creditors may appoint a security representative as a fiduciary (*fiduciaire*) under the Trust and Fiduciary Contracts Act, to represent their interests in security rights or receive payments. The powers, rights and duties of such fiduciary are normally determined by the investors as secured creditors at the time of its appointment, in accordance with the provisions of the Trust and Fiduciary Contracts Act. A fiduciary security representative for the purposes of the Securitization Act, whose statutory seat is in Luxembourg, must be approved by the Minister of Finance and is subject to specific requirements (including without limitation its share capital and its shareholder structure). An appointment may also result from the subscription to additional securities issued by the securitization vehicle, where contemplated by the terms and conditions of the securities. For a security representative whose statutory seat is located outside Luxembourg, a general distinction must be made between security rights covering qualifying collateral under the Collateral Act and civil law security rights (please refer to our explanations above).

Subject to any statutory claims of preferential rights (see above), subordinated creditors rank in accordance with the priority agreed in the relevant subordination agreement. Subordination clauses can be specific (for example, limited to a defined operation) or general. In general subordination clauses, the subordinated creditor accepts that, if the debtor becomes insolvent, or is liquidated, its claim is paid after all other creditors have been paid. Such a clause does not prevent the creditor from being paid when the debt becomes due and payable.

The Luxembourg Court of Appeal recently emphasised the main principles applicable to the validity and enforceability of subordination clauses.

Subordination clauses must comply with the general law on validity of contracts. There is very limited case law in Luxembourg in relation to the recognition of voluntary subordination provisions. If a Luxembourg court were to analyse the validity and enforceability of voluntary subordination provisions, it is in our view likely that it would consider the position taken by Belgian legal scholars and more recently by Luxembourg legal scholars based on (limited) Luxembourg court precedent, according to which voluntary subordination provisions are legal, valid and enforceable against the parties thereto, including in case of bankruptcy of such parties, but may not be enforceable against third parties which are not party to the relevant agreement.

Will local courts in your jurisdiction give effect to the contractual terms of an English law governed intercreditor agreement (which may include limitations on enforcement, rights to receive payment and turnover clauses). Would an English law governed intercreditor agreement survive the insolvency of a borrower incorporated in your jurisdiction?

A court of competent jurisdiction in Luxembourg may not apply the chosen English law if such choice is abusive and/or if such foreign law provisions would be manifestly incompatible with the public policy (*ordre public*) of Luxembourg (eg consumer protection matters).

Generally however, in the case of bankruptcy, the bankruptcy receiver does terminate all existing agreements.

Governing law and disputes

Will a choice of English law as the governing law of the documents and the English courts as the jurisdiction for disputes be upheld in your jurisdiction? Would a judgment given by the courts of England and Wales be enforceable in your jurisdiction without a retrial of the merits of the case?

As a matter of Luxembourg law, there is no obligation to submit the security agency/intercreditor agreement to Luxembourg law.

In application of Article 3 of the Rome I Regulation, the choice of a foreign law as the governing law of the security agency agreement is legal, valid, binding and enforceable against the debtor, and will be recognized and given effect to by a court of competent jurisdiction in Luxembourg, except where Luxembourg courts consider the choice of the foreign law to be contrary to Luxembourg international public policy (please refer to our explanations above).

As regards the choice of jurisdiction, the submission in the agreements to the jurisdiction of the courts of England is legal, valid, binding and enforceable against the parties thereto (if one of them is domiciled in an EU Member State) and will be recognized and given effect to by a court of competent jurisdiction in Luxembourg in accordance with Article 23 of the Brussels I Regulation and in accordance with Article 18 of the Luxembourg New Code of Civil Procedure.

Final and conclusive judgments of the courts within the territorial jurisdiction of the United Kingdom will be recognized and enforced in Luxembourg in accordance with the Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters, as amended from time to time (the **Jurisdiction Regulation**).

A court of competent jurisdiction in Luxembourg may stay proceedings if concurrent proceedings involving the same parties and the same cause of action have been brought in another court of competent jurisdiction (whether or not covered by the Jurisdiction Regulation) and will decline jurisdiction in favour of that court if its jurisdiction is established.

The recognition and the enforcement in Luxembourg of final and conclusive judgments of a court within the territorial jurisdiction of England (based on legal proceedings commenced by valid service of process) is subject to the applicable enforcement (*exequatur*) procedure of the Jurisdiction Regulation or the Council Regulation (EC) No 805/2004 of 21 April 2004 creating a European enforcement order for uncontested claims, as the case may be, both as construed and applied by Luxembourg courts, and provided the recognition of the judgement may not be refused on the grounds specified at Articles 34 and 35 of the Brussels I Regulation.

The formal enforcement of a foreign decision may be obtained by submitting a motion for *exequatur* to the president of the competent Luxembourg district court. The following evidence must be attached to the motion:

- the original or certified true copy of the court decision, translated into French;
- the original or certified true copy of the formal service of process to the parties involved, translated into French;
- a certificate from the court, establishing that no recourse or appeal lies from the court decision (i.e. a certificate demonstrating that the decision is final and conclusive), translated into French.

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Jad Nader is counsel in our banking & finance practice. He assists clients on all kinds of financial and regulatory matters including capital markets, securitization, financial products, international credit structures, funds structures, AIFM license requirements, Emir, MiFID and listing regulations.

Josée Weydert is the managing partner of NautaDutilh Avocats Luxembourg and leads the banking and finance practice. She has extensive experience in finance and corporate law, in particular in capital markets, structured finance, securitisation, financial products, securities laws, international finance structures, insolvency and restructuring. She also deals with the setting up of debt and real estate funds.

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Eleanor Stephens
LexisNexis
Lexis House
30 Farringdon Street
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eleanor.stephens@lexisnexis.co.uk
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