

Change of legislation

Luxembourg as a single point of enforcement jurisdiction is further strengthened

The recently passed law of 20 July 2022 (the **New Law**) introduces several important amendments to the well-known Luxembourg financial collateral law of 5 August 2005 (the **Collateral Law**).

The New Law modernises and further clarifies the Luxembourg financial collateral arrangement's regime and integrates into legislation current market trends and realities (1). It also further clarifies the regime of transfers of title for security purposes and nettings (2). Finally, the New Law extends the material scope of the Collateral Law (3).

We have limited the points covered herein to what we consider and experience as having a direct impact on security enforcement practices and the below is thus not meant to be exhaustive.

1. Modernisation and clarification of the pledge enforcement regime

As part of the modernisation and clarification amendments envisaged by the New Law, a new public auction regime was put in place (1.1), enforcement processes over certain types of collateral were updated to be in line with current market practices and allow more flexibility (1.2). Finally, the regime regarding the application of proceeds in an enforcement scenario which is not based on a payment default or acceleration was confirmed (1.3).

These improvements aim to strengthen Luxembourg's already strong position as a creditor friendly and robust security jurisdiction and preferred place for a single point of enforcement in international financing structures or debt restructurings.

1.1 New public auction regime

Under the previous regime, the enforcement of pledged collateral by public auction was conducted at and by the Luxembourg Stock Exchange (the **LSE**), unless provided otherwise¹. This enforcement remedy, which is now outdated², was very rarely used in practice due to its many drawbacks, including:

- the slow and cumbersome procedure, which made it ill-suited to the needs for speed and flexibility of market players;
- the right for the LSE to refuse to admit to the auction financial instruments, without any justification³;

¹ Article 11(1)(b) and 11(2) of the Collateral Law; Part 4 of the LSE Rules & Regulations.

² The State concession based on which the LSE carried out public auctions was abolished further to the law of 3 July 2007 on markets in financial instruments, as amended.

³ Article 4, Part 4 of the LSE Rules & Regulations.

- the fact that only members of the LSE were entitled to sell or buy during a public auction⁴; and
- the relative uncertainty of its outcome.

Key changes

Further to the New Law, the LSE will no longer oversee public auctions. A Luxembourg bailiff (*huissin*) or notary (appointed at the sole discretion of the pledgee)⁵ will lead the auction, whose regime will be aligned with Luxembourg standard auction procedures.

The main features of public auctions under the New Law are the following:

- an extensive contractual freedom, as the new auction regime and procedure only apply if nothing is otherwise contractually provided;
- an announcement by the bailiff or notary of the public auction must be made at least:
 - eight business days before the auction date;
 - in one or more Luxembourg newspapers, containing mandatory information (announcements in foreign newspapers remain possible if requested by the pledgee)⁶;
- the collateral may be sold either piece by piece or by batch/category, provided that the pledged collateral have the same features;
- neither the debtor, nor any person which is known to be insolvent or unknown to the bailiff/notary is allowed to bid;
- the sale can be conditioned to the approval or absence of objection from a public authority⁷ within a certain time period;⁸
- the highest bidder must pay the auction price in cash or as agreed in the auction announcement; and
- no overbidding is allowed post auction.

1.2 Enforcement remedies over certain types of collateral aligned with existing market trends

1.2.1 Financial instruments admitted to trading

Under the previous regime, the pledgee could (unless agreed otherwise) *inter alia*:

- sell the pledged financial instruments on a stock exchange⁹; or
- appropriate the pledged financial instruments at their market price¹⁰, if such instruments were listed on an *official Luxembourg or foreign stock market or traded on a recognised regulated market which operated regularly and was open to the public*.¹¹

⁴ Article 8, Part 4 of the LSE Rules & Regulations.

⁵ Bailiffs/notaries are public officers whose fees and rates are fixed by Luxembourg laws and regulations. The Luxembourg Council of State (*Conseil d'Etat*) strictly objected that such fees be freely agreed between the pledgee and the bailiff/notary (Report of the Finance and Budget Commission (*Rapport de la Commission des Finances et du Budget*) dated 1 July 2022, Chapter 3, Article 11, paragraphs 22 and 23, p. 16).

⁶ Publications on the Internet were suggested by the Luxembourg Council of State but the Finance and Budget Commission finally decided otherwise as it would have raised practical issues (i.e., determination of the webpage, date of publication ...) (Report of the Finance and Budget Commission dated 1 July 2022, Chapter 3, Article 11, paragraphs 24 and 25, p. 16-17).

⁷ The Finance and Budget Commission clarifies that this applies to Luxembourg or foreign public authorities, in particular if the sale involves a participation in a regulated entity (such as an entity of the financial sector) or for antitrust or national security purposes. The auction sale's announcement (*avis d'adjudication*) published by the bailiff/notary will contain the requirement to obtain such an approval or absence of objection from the relevant public authority (Report of the Finance and Budget Commission dated 1 July 2022, Chapter 3, Article 11, paragraph 20, p. 16).

⁸ The pledgee may freely decide to extend such period. In the absence of such an extension or if the last extension expires without the condition being fulfilled, or in the case of an objection or refusal by the public authority, the pledgee can enforce the pledge again.

⁹ Article 11(1)(b) of the Collateral Law.

¹⁰ Parties could agree to a different valuation method and set out the conditions to determine the price in the security agreement or in a separate document (*Exposé des motifs*, p. 17; Report of the Finance and Budget Commission dated 1 July 2022, Chapter 3, Article 11, p. 14.)

¹¹ Article 11(1)(e) of the Collateral Law.

Key Changes

- The New Law specifies the type of trading venues where the pledgee may sell the pledged financial instruments. The pledgee will from now on be able to enforce its pledge by carrying out a sale over any trading venue where the financial instruments are listed, i.e., any Luxembourg, European or third country regulated market, multilateral trading facility (MTF) or organised trading facility (OTF).¹²
- The pledgee is now entitled to appropriate the pledged financial instruments at their market price on the trading venue on which they are admitted to trading.

1.2.2 Units or shares of undertakings for collective investment (UCIs)

Previously, the pledgee could (unless agreed otherwise) appropriate units or shares of an UCI, either:

- at their market price, if listed “on an official Luxembourg or foreign stock market or traded on a recognised regulated market which operated regularly and was open to the public”;¹³ or
- at the price of the latest published net asset value (for UCIs which determine and publish a net asset value – NAV – on a regular basis).

Key changes

- *Adjustments to the appropriation regime*

The New Law maintains the above option for the pledgee, while making the following adjustments.

The pledgee may now appropriate, at their market price, pledged units or shares of UCIs listed on any trading venue (as broadly defined in the New Law).¹⁴

The pledgee may also choose to appropriate the units or shares of an UCI at the price of the latest published NAV, which must not be older than one year. Under the previous regime, such appropriation was only possible for UCIs which published their NAV on a “regular” basis.

- *Additional enforcement remedy*

The pledgee will be able to request the redemption of the pledged units or shares of an UCI at the redemption price, in accordance with the constitutive documents of that UCI.¹⁵

1.2.3 Pledged insurance contracts

Confirming the current practice, the New Law expressly allows the pledgee to exercise all rights arising from the pledged insurance contract, including for life insurance contracts or capital redemption operations, the right of redemption, or to request the insurance undertaking to pay any amounts due under the insurance contract.¹⁶

1.3 Application of enforcement proceeds in the absence of acceleration

The Collateral Law always expressly allowed the enforcement of financial collateral arrangements based on any trigger event contractually agreed between the parties, i.e., even in the absence of payment default.¹⁷

¹² Draft Law n° 7933, Exposé des motifs, p. 17.

¹³ Article 11(1)(e) of the Collateral Law. See footnote 10.

¹⁴ See section 1.2.1 above

¹⁵ The units or shares redemption may be staggered over several days (Draft law n° 7933, Exposé des motifs, p. 17).

¹⁶ Pledges over a Luxembourg life insurance contract are also subject to articles 116 and 117 of the law of 27 July 1997 on the insurance contract, as amended (which provide *inter alia*, that the insurance contract may only be pledged further to an amendment thereto executed by the policyholder, the pledgee and the insurer).

¹⁷ Article 1(6) of the Collateral Law.

The Collateral Law was however silent on how to handle, in practice, the application of the enforcement proceeds in the absence of a payment default and acceleration of the debt, leading to some uncertainty as to whether it was practicable or not.

Key Changes

The New Law brings more legal certainty as it expressly allows the pledgee to apply the enforcement proceeds against the secured obligations, even when the latter are not yet due and payable at the time of enforcement (unless agreed otherwise).

This clarification thus confirms the key role the enforcement of a Luxembourg equity security (in particular) may play in a restructuring or distressed financing context.

1.4 Immediate benefit from the improvements

No change to the existing security documentation will be needed to enable pledgees to benefit from the modernisation of the enforcement remedies introduced by the New Law, as most Luxembourg pledge agreements provide that the pledgee may enforce the collateral in any other manner permitted by the Collateral Law, as amended. The pledgee will however not necessarily benefit from the new enforcement options or alternatives if the existing pledge agreement is drafted restrictively in this respect (i.e., public sale via the Luxembourg Stock Exchange).

2. Targeted amendments to strengthen the attractiveness of the Collateral Law

2.1 Transfers of title for security purposes

Under the previous version of the Collateral Law, pursuant to a transfer of title for security purposes, the transferor transferred title of assets to a beneficiary to secure financial obligations of the transferor or a third party towards the transferee, with an undertaking from the transferee to retransfer the assets or equivalent assets (as agreed by the parties) back to the transferor at a later stage, except in the event of total or partial non-performance of the relevant financial obligations.

Key changes

- The New Law removes the requirement that the transfer of title be carried out to secure the transferee's financial obligations and confirms that such security can be also granted to a person acting on behalf of the beneficiaries (e.g., security agent), a fiduciary or a trustee.
- If the transfer of title for security purposes is carried out on a fiduciary basis, the transferee must be a financial sector professional. The New Law clarifies that payment institutions and electronic money institutions are considered as financial sector professionals for this purpose.

2.2 Netting and insolvency proceedings

Under the current regime, netting provisions are enforceable notwithstanding reorganisation measures, winding-up proceedings, or similar proceedings.¹⁸

Key Changes

The New Law strengthens the protection of netting provisions in the case of insolvency proceedings: it specifies that not only Luxembourg, but also foreign reorganisation measures, winding-up proceedings, or similar proceedings (in the widest sense) have no impact on nettings.¹⁹

3. Extension of the scope of the Collateral Law to fungible precious metals

The New Law finally clarifies that pledges over fungible precious metals are also governed by the Collateral Law,²⁰ thus increasing the legal certainty around this type of security interest.

Precious metals of the same kind, form and standard quality, deposited without indication of identification, with credit institutions and other professional depositories of precious metals authorised in Luxembourg, are deemed fungible. This would typically cover gold, silver, platinum etc.

Conclusion

With the new improvements to the Collateral Law and its clear recognition of certain existing market practices or views, our legislator has further strengthened the legal certainty around the enforcement of Luxembourg security interests and settles some of the issues that parties were still struggling with in practice. This will mean continued flourishing days for security enforcements in Luxembourg, double Luxco structures but also restructurings using the Luxembourg “pre-pack”, which is obviously very good news for the Luxembourg market especially with a possible looming recession.

¹⁸ Article 18 of the Collateral Law.

¹⁹ Including, but not limited to, Luxembourg and foreign proceedings subject to Regulation (EU) 2015/848 on insolvency proceedings; Draft Law n° 7933, *Exposé des motifs*, p. 19.

²⁰ Unless the Grand-ducal regulation of 18 December 1981, as amended, provides for a specific regime or when the nature of the precious metals does not allow it - Draft Law n° 7933, *Exposé des motifs*, p. 21.

Contact Information

Anne-Marie Nicolas

Partner - Luxembourg

T +352 466 230 314

E anne-marie.nicolas@loyensloeff.com



Elie-Raphaël Soudry

Counsel - Luxembourg

T +352 466 230 320

E elie-raphael.soudry@loyensloeff.com



Vanessa Freed

Professional Support Lawyer - Luxembourg

T +352 466 230 432

E vanessa.freed@loyensloeff.com

