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FINANCE

Lending and taking security in Luxembourg: overview

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OVERVIEW OF THE LENDING MARKET

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

In the last twelve months, there have been two main trends in the lending market in Luxembourg:

- There has been a re-emergence of real estate-oriented lending that purports to raise funds in order to acquire real estate. In general, one or several banks lend to Luxembourg special purpose vehicle(s) (SPV) that will then acquire the real estate. The SPV usually has only one asset and grants to the local bank(s) security interests over:
  - the real estate;
  - its shares;
  - its bank accounts; and/or
  - the receivables.
- There is also the option of portfolio-oriented lending that purports to raise funds in order to acquire shares in holding companies and/or operational companies. The funds will be on-lent by a syndicate of banks to a SPV, depending on the size of the portfolio to be acquired. As the SPV often has various holdings in Luxembourg and/or foreign companies that are either operational or mere holding companies, one of its subsidiaries will be able to acquire the targeted portfolio. In such a case, the syndicate of banks will require security interests over any intercompany loan between the SPV and its subsidiary acquiring the portfolio assets as well as over the SPV's shares or bank accounts. Usually the incurred bank debt is refinanced by the issuance of high yield bonds, either senior secured or unsecured (see *Financing M&A deals and other business needs through high yield bonds issue structured via Luxembourg*).

The above-listed lending types benefit from the provisions of the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended (Collateral Law) which allow the fast enforcement of financial collateral arrangements.

FORMS OF SECURITY OVER ASSETS

Real estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

"Real estate" is considered as property comprised of land and anything that is attached directly to the land, such as buildings. It also includes rights and interests in connection to this land or the immovable property on such land.

Common forms of security

The most common forms of security granted over real estate are the following:

- Pledge over real estate (*antichrèse*).
- Contractual mortgage (*hypothèque*).
- Seller's lien (*privilège du vendeur*), provided by law to secure payment of the real estate's purchase price. This lien benefits the seller.
- Lender's lien (*privilège du prêteur de deniers*), provided by law to secure the bank debt incurred in order to finance the acquisition of the real estate. This lien benefits the lender.

Formalities

Several formalities must be fulfilled in order to ensure the creation of valid and enforceable security interests over real estate. These formalities prevent any security interests from being taken over the identical real estate without prior notification to the first beneficiary of a security interest and to the owner of the real estate. It also prevents any sale of real estate without the acknowledgment of the existing encumbrances. The validity and enforceability formalities differ depending on the form of the security interests:

- **Mortgage.** A mortgage in Luxembourg takes the form of a written notarial deed and is registered with the administration registry (*administration de l'enregistrement et des domaines*) (Administration Registry). In order to be enforceable towards third parties, the original notarial deed must be registered with the mortgage registry (*bureau de conservation des hypothèques*) (Mortgage Registry) of the judicial district in which the real estate is located. The registration of the mortgage has to be renewed within the first ten years of its registration with the Mortgage Registry and in order to remain enforceable towards third parties for a further ten years.

- **Real estate pledge.** Real estate pledges must be in writing and registered with the Administration Registry. The security is perfected by the dispossession of the pledgor. The pledgee will:
  - have full possession of the real estate;
  - be able to collect the rent deriving from it;
  - reduce its claim by way of netting with the collected rents; and
  - have a right of retention on the real estate.
- This type of pledge is not commonly used in Luxembourg as banks usually prefer the mortgage as security interest over real estate.
- The pledge agreement must also be registered with the Mortgage Registry.
- **Lender's lien.** The Luxembourg Civil Code provides for a lien granted to the lenders that lend funds to finance the real estate's acquisition. The lien must be recorded in a notarial deed stating that the funds were on-lent for the purpose of financing the purchase of real estate and were not used for any other purpose. The notarial deed must be registered with the Administration Registry. To render the lien enforceable against third parties it must also be registered with the Mortgage Registry. Within the first ten years of its registration with the Mortgage Registry and to continue to be enforceable against third parties for a further ten years, the registration must be renewed.
- **Seller's lien.** The Luxembourg Civil Code also provides the seller of real estate with a lien on the sold real estate until receipt of payment of the agreed purchase price in full. Within the first ten years of its registration with the Mortgage Registry and to continue to be enforceable against third parties for a further ten years, the registration of the notarial deed must be renewed.

TANGIBLE MOVABLE PROPERTY

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

Tangible movable property are assets that have physical substance and can be moved from one place to another including but not limited to financial instruments, machinery, trading stock, aircraft and ships.

For aircraft and ships (weighing more than 20 tonnes), the laws of 19 June 1966 and 29 March 1978 provide a specific kind of mortgage that may be granted over such assets, although mortgages are usually restricted to immovable assets.

Common forms of security

The most common form of security over movable property is the pledge. It can secure most categories of assets, including financial instruments and future assets. Two types of pledge can be distinguished:

- Civil pledge (*gage civil*), which is governed by the Luxembourg Civil Code.
- Commercial pledge (*gage commercial*), which is governed by the Luxembourg Commercial Code and, if the latter does not provide, the Luxembourg Civil Code. Under Luxembourg law, a pledge over a going concern is also recognised. This type of pledge is by nature a commercial pledge but is governed by specific laws (such as the Grand Ducal Decree of 27 May 1937, as amended, in addition to the relevant section of the Luxembourg Commercial Code. The latter can only be granted to authorised credit institutions and breweries).

Another common form of security interest over movable property is the transfer of ownership for collateral purposes, where either the:

- Legal title to the collateral is transferred to the lender in order to secure the bank debt incurred. In the event of default of the payment of the debt, the lender offsets the value of the transferred assets with the outstanding debt and, as the case may be, retransfers to the defaulting debtor, the remaining assets after netting.
- Ownership rights in relation to the assets are transferred to the lender by way of a fiduciary contract (*contrat fiduciaire*) and the exercise of these rights is limited to the terms agreed between the parties to the fiduciary contract.

Formalities

The common feature of the commercial and civil pledges lies in the dispossession of the grantor of the pledge validly creates the security interest. It is important to note that for any pledge, either civil or commercial, the lien deriving from the pledge agreement only subsists where the pledged assets are held by the pledgee or by a third party designated as security agent or holder by the pledgee and the pledgor. However, the enforceability and validity formalities may differ:

- **Civil pledges (*gages civils*).** A civil pledge must be kept in writing (either in notarised form or under private seal) and contain a detailed description of the pledged assets such as their nature and features. Its enforceability against third parties is subject to its notification. The debtor of a pledged claim or receivable must be notified or accept the pledge. The notification or acceptance can take the form of a notice or acceptance letter (either authentic form or under private seal) to be countersigned or signed by the debtor, as the case may be, or the debtor can countersign the pledge agreement for acknowledgment and acceptance purposes.
- **Commercial pledges (*gages commercials*).** A commercial pledge does not have to be in writing and can be proved by any means permitted by the Luxembourg Commercial Code. The enforceability of the pledge against third parties is also subject to notification or acceptance of the debtor as in the case of civil pledge above.
- **Pledges over a going concern.** A pledge over a going concern must be in writing (authentic form or under private seal). The term "a going concern" under Luxembourg law includes, among other things, the customers, the sign or logo, the concession, the brands, the patents, the lease, the machinery and materials required to exploit the concern. The agreement or notarial deed is subject to stamp duty. To be enforceable against third parties the pledge must be filed with the Mortgage Registry.

FINANCIAL INSTRUMENTS

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments

The most common types of "financial instruments", as defined in the Collateral Law, are (*see Question 1*):

- Shares.
- Units.
- Bonds.
- Debt instruments.

- Certificates of deposit.
- Loan notes.
- Payment instruments.
- Claims.
- Any other instruments evidencing ownership rights.
- Claim rights or securities related to financial underlyings, indices, commodities, precious metals, produce, metals, merchandise, goods or risks.

The Collateral Law implemented Directive 2002/47/EC on financial collateral arrangements, as amended, as regards linked systems and credit claims into Luxembourg law.

Common forms of security

Three different types of security interests can be granted over financial instruments under the Collateral Law:

- Pledge.
- Transfer of ownership for collateral purposes.
- Repurchase agreement.

However, the most common form in Luxembourg is the pledge.

Formalities

The rules governing the creation and enforceability of a security interest over financial instruments depend on the financial instruments, which compose the collateral:

Pledges over financial instruments under the Collateral Law. These pledges can be created by private deed and are perfected by a transfer of possession of the pledged assets from the pledgor to the pledgee or to a designated third party. Depending on the category of financial instruments, the dispossession of the pledgor for the purpose of perfection of the security interest can take on different forms, including but not limited to:

- Entry into the pledge agreement provided the pledgee is also depository of the book-entry securities.
- Entry into the pledge agreement made between the pledgor, the pledgee and the depository or between the pledgor and pledgee with notification to the depository provided the latter follows the pledgee's instructions relating to the book-entry securities.
- Registration of the book-entry securities with an account opened in the name of the pledgee, provided the book-entry securities are held on an account opened in the name of the pledgor with the depository and are marked as pledged.
- Entry of the parties into the pledge agreement, provided receivables are pledged.
- Transfer of the collateral purposes by material delivery to the pledgee or a designated third party (for bearer shares).

The pledgor can also be dispossessed by notification of the creation of the pledge to the issuer (if different to the pledgor) or a third party holding the pledge (if different to the pledgor), or that issuer or third party's acceptance of the pledge. Notification and acceptance must be made in notarised form or under private seal.

Transfer of ownership for collateral purposes. This consists of the transfer of title to the financial instruments by the transferor to the transferee in order to secure the financial obligations of the transferor or a third party. The transferee undertakes to retransfer the transferred titles or equivalent collateral as agreed between the parties, except in the event of total or partial non-performance of the secured financial obligations.

The transfer of ownership for collateral purposes takes effect between the respective parties and becomes enforceable against third parties in case of:

- Book entry financial instruments, at the latest at the time of recording of the financial instruments in an account opened in the name of the transferee or of an agreed custodian or by their designation, in an account opened in the name of the transferor, as being owned by the transferee.
- Financial instruments not in book entry form or of claims, from the time of the agreement between the parties. It is important to note that in the event of total or partial non-performance of the secured financial obligations, the transferee is discharged from its obligation of retransfer up to the amount of its claim against the transferor or the third party debtor in accordance with the termination or netting provisions agreed between the parties and, unless otherwise provided, without notice. If the transfer of ownership for collateral purposes is entered into by way of a fiduciary agreement, the fiduciary must be a professional of the financial sector within the meaning of the Collateral Law.

Repurchase agreements. The Collateral Law applies to repurchase agreements of assets. This includes transfers of assets made during the term of the contract that are intended to secure the balance agreed between the obligations of the parties, either for a specific repurchase transaction, or globally for all or part of the transactions between the contracting parties.

A repurchase transaction of book entry financial instruments takes effect between the parties and becomes enforceable against third parties when the financial instruments are recorded either in an account opened in the name of the:

- Transferee or an agreed third party custodian acting on behalf of the transferee.
- Transferor and designated as being owned by the transferee.

At the maturity of the repurchase transaction, the transferor must accept redelivery of the transferred assets or of equivalent assets. The transferee has, depending on the conditions laid down by the parties, either the obligation or option to reassign the transferred asset or an equivalent asset. If the transferee has the:

- Obligation to reassign the asset, the repurchase transaction constitutes a committed purchase and resale agreement.
- Option to reassign the asset, the repurchase transaction constitutes a committed purchase agreement with resale option.

The assignment and reassignment of an asset in the context of a repurchase transaction constitute an effective property transfer. If the parties so agree, the same rule applies to assets substituted for initial assets transferred or transferred as margin cover during the term of the contract. The reassignment does not retroactively affect the proprietary rights of the transferee in the transferred asset during the term of the repurchase transaction.

CLAIMS AND RECEIVABLES

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and receivables

In Luxembourg, debts are usually incurred to finance new acquisitions of either real estate or assets and to refinance corporate debt. Either way, the proceeds of the initial loans are usually on-lent to the subsidiaries of the borrower by way of intercompany loans. In general, the creditor of the borrower must

ask for security interests over these intercompany loans to track down the proceeds of the initial loans and secure the payment by the borrower of the initial loans. The same mechanism applies with regard to high yield bonds issuances where the proceeds of the notes are on-lent to the issuer's subsidiaries. The loan receivables constitute the most common type of receivables over which security is granted in Luxembourg.

Common forms of security

Pledges and transfers of ownership for collateral purposes are the most common forms of security granted over claims and receivables.

Formalities

Pledges can be created by an agreement under private seal and perfected by the dispossession of the pledgor for the benefit of the pledgee or a designated third party. Their enforceability against third parties is subject to notification or acceptance of the pledged claim by the debtor (*see Question 3*). The transfer of ownership for collateral purposes and the pledge over receivables can both be perfected by entry into the related security document by the parties (*Collateral Law*) (*see Question 1*). The transfer of ownership for collateral purposes becomes enforceable against third parties by the time of the agreement between the parties.

CASH DEPOSITS

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Common forms of security

Typically, the balance standing in a cash account will be pledged by the obligor for the benefit of the lender.

Formalities

In addition to the formalities mentioned in *Question 5*, a pledge over a bank account is enforceable against third parties as well as towards the account bank once the account bank has been notified of and confirmed its acknowledgment of the pledge. Indeed, the pledge over a bank account incurs a renunciation by the account bank of its contractual first ranking privilege as well as the account bank's undertaking to block the account in the event of total or partial non-performance of the secured obligations. It is common practice to attach the following to such a pledge agreement:

- A notice of pledge for the attention of the account bank.
- An acknowledgment notice to be signed by the account bank.
- A blocking notice to be signed by the account bank and sent to the account holder in the event of partial or total non-performance of the secured obligations.

It is also common practice to agree specific forms with the account bank, to the extent possible, to comply with its internal policy.

INTELLECTUAL PROPERTY

7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual property

IP rights are considered to be intangible assets, including patents (*brevets*), trade marks (*marques*), designs (*dessins et modèles*) and copyrights (*droits d'auteur*).

Common forms of security

Generally, the most common forms of security interests over IP rights are pledges and transfers of title by way of security.

Formalities

To be enforceable against third parties, specific pledges over registered IP rights must be registered with the relevant IP registry:

- The Benelux Office of Intellectual Property (for trade marks and designs).
- The Patent Registry of the National Intellectual Property Service (for patents).

Registration fees apply.

If the IP rights are not registered, the pledge must be made by private agreement, without need of a mandatory public registration.

Pledges over a going concern (which can include IP rights or consist only of IP rights) are made by private agreement or notarial deed. They are enforceable against third parties after registration at the Administration Registry and at the Mortgage Registry of the judicial district, in which the business is run or the stock or goods are located. Pledges over going concerns can only be granted to credit institutions and breweries authorised by the Luxembourg government.

Security granted by transfer of title of registered IP rights is perfected by the mere agreement between the parties and is enforceable against third party debtors (for example, licensees or parties owing royalties arising from the IP right) on registration with the Benelux Office of Intellectual Property (for trade marks and designs) or with the Patent Registry of the National Intellectual Property Service (for patents).

PROBLEM ASSETS

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Future assets

Mortgages cannot be granted over future assets. However, any kind of pledge can be granted over future assets.

Fungible assets

Fungible goods, such as agricultural products, can be pledged (*warrant agricole*) as a commercial pledge governed by the Collateral Law (*see Questions 1 and 4*).

Other assets

Intangible assets can be secured by pledges or by transfer of ownership.

RELEASE OF SECURITY OVER ASSETS

9. How are common forms of security released? Are any formalities required?

The release formalities depend on the nature of the pledged assets. However, when a security interest is recorded in the company's register, filed with a public register or notified to become enforceable against third parties, the release of such security interest must be followed by one of the following formalities:

- Recorded in the company's register.

- Filed with the relevant public register (such as the Mortgage Registry for mortgages and pledges over immovable assets).
- Notified to the relevant third party as applicable.

SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

Borrowers in Luxembourg are usually holding companies (Holdco). Their only asset is the shareholding in their subsidiaries which are usually operational companies. It is common practice for the lenders to take security over the borrower's shares as well as over the shares of a SPV that was set up to hold certain of the borrower's assets rather than security over the borrower's assets. The security interest usually takes the form of a pledge over shares governed by the Collateral Law (*see Question 1*). The enforcement of the pledge differs depending on the SPV's legal form. If the SPV has the form of a private limited liability company (*société à responsabilité limitée*), having an *intuitu personae* feature, the total or partial realisation of the pledge over less than 100% of the shares of the SPV in favour of one or more persons or groups (whether identified or not) requires the prior approval of the shareholders. If the shares are assigned to an unidentified person approved in the course of the realisation of the pledge and if the realisation of the pledge is not effected through public auction notified in advance in writing to the SPV, its members (excluding the assignor and the assignee) may, within one month after the notification of the assignment to the SPV, either buy the shares at the realisation price or cause the SPV to buy the shares at the realisation price.

QUASI-SECURITY

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

The following legal structures are most commonly used. If they are put in place in compliance with the criteria described below, the risk of recharacterisation is remote. In practice, lenders prefer to be granted a security interest in addition to one of these structures.

Sale and leaseback

In a sale and leaseback structure an undertaking sells an asset to the creditor (usually a credit institution) and leases it back. The undertaking makes periodic payments equal to the selling price and interest. The credit institution is secured by the property right it acquires over the asset.

Factoring

To ensure the payment of receivables, it is possible to use the factoring mechanism where a financial sector professional purchases commercial debts and proceeds to collect them for his own account when he makes the funds available to the transferor before maturity or before payment of the transferred debts.

Hire purchase

Hire purchase is often used to acquire plant, machinery or immovable property. Usually, a leasing company or a credit institution acquires the item and enters into a leasing contract with an undertaking. After termination of the leasing contract, the undertaking can choose to purchase the item for a residual price. There are different forms of hire purchase (such as financial or operational leasing).

Retention of title

A secured creditor who is in possession of the secured asset (for example, the holder of a pledge) has the right to retain possession of these assets until its claims have been fully paid. This right continues even against other, higher ranked creditors. A right of retention can also exist without a pledge. A seller who is still in possession of the sold goods will not be required to deliver them as long as the purchase price has not been paid (*Article 1612, Luxembourg Civil Code*). The right of retention prevails and can be exercised, even if there are other secured creditors (for example, creditors secured by pledges, mortgages and privileges). A sale or purchase agreement can also include a retention clause where the seller has the right until full payment of the purchase price to claim the possession and ownership of the sold fungible asset (*Article 567-1, Luxembourg Commercial Code*).

Delegation of payment

This is when a creditor obtains an additional debtor to secure payment of the debt.

Comfort letter

A parent company issues a statement about the value and standing of one of its subsidiaries. Although it indicates solidarity between the companies, the parent is not automatically legally bound to back the subsidiary's debts. The value of a comfort letter depends on its exact wording. The obligations contained in the comfort letter can be either reinforced by a guarantee or be only of moral value.

Letter of patronage

In a letter of patronage a parent company commits itself to back the debts of its direct or indirect subsidiary. The letter is not necessarily legally binding and its value depends on the exact wording. The obligations contained in the letter of patronage can either be reinforced by a guarantee or be only of moral value.

Set-off

A creditor may set-off any amount owed to the debtor against any amount owed by the debtor to the creditor.

GUARANTEES

12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees granted by a Luxembourg company are often used in secured lending transactions involving a Luxembourg company and are typically created by an agreement in writing made between the parties. In order to avoid the liability of any manager or director, a guarantee (whether governed by foreign law or Luxembourg law) should be limited to a certain percentage of the net assets of the guarantor.

Under Luxembourg law a "guarantee" can take one of the following two forms:

- First demand guarantees (*garanties à première demande*). This form of guarantee is also defined as being "self-sufficient", that is, the guarantor cannot oppose to the lenders any exceptions or exemptions derived from the initial loan agreement nor can the guarantee be automatically transferred with the initial loan agreement. The first demand guarantee as self-sufficient security can re-qualify as a suretyship (*cautionnement*) if it appears from the guarantee agreement that the guarantee is an accessory to the initial loan agreement and its related obligations. The guarantee may take on the form of a letter or an agreement under private seal. The guarantee is not subject to any filing and can be enforceable towards third parties at the time of the letter or the agreement, as applicable.

- Suretyship (*cautionnement*). As opposed to the first demand guarantee, the suretyship is an accessory to a principal obligation, that is, the guarantor can oppose to the lenders any exceptions or exemptions deriving from the initial loan agreement and the security interest will be automatically transferred with the initial loan agreement as its accessory. The suretyship takes on the form of an agreement under private seal and becomes enforceable against third parties at the time of the agreement. The suretyship is not subject to any filing requirements.

RISK AREAS FOR LENDERS

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial assistance

A Luxembourg public limited liability company (*société anonyme*) may for the purpose of acquiring its own shares (*Law of 10 June 2009, as amended*):

- Advance funds.
- Make loans.
- Grant security.
- Provide guarantees.

However, this may only be done if the following conditions are fulfilled:

- The board of directors of the company has responsibility for the operation, and verifies before the operation is carried out that it will be concluded at "fair market conditions" in relation to all parties involved.
- The board of directors of the company must submit the operation, by way of a written report, for the prior approval of the company's shareholders.
- The financial assistance must at no time result in the reduction of the company's net assets below the amount of the subscribed capital plus the non-distributable reserves.

This only applies to transactions entered into by a company with a view to acquiring its own shares (not the shares of third parties, including group companies). In general, companies cannot encumber their assets or provide guarantees in favour of third parties (including group companies) without any direct consideration.

Unlawful financial assistance results in the guarantee or security being void and the directors of the company can be held liable.

The conditions to be satisfied by the granting of guarantees or security interests relate to corporate power, authority and benefit. The following rules are derived from general principles and must be applied to specific circumstances on a case-by-case basis.

Corporate power. Limits on corporate power can either be imposed by:

- **Law.** A company is incorporated with a view to participating in a company's profits (and losses) (*Luxembourg Civil Code*). Profit-sharing is an essential element of every company's objective. A purely free or gratuitous act, without consideration, may be outside the scope of the activities of a company as contemplated by law. A company may however carry out gratuitous acts whenever these acts are carried out with a view to the direct or indirect realisation of the company's corporate objective. Unless there are exceptional circumstances, an intragroup security usually falls within this objective.
- Thus, it occurs only in exceptional circumstances without any reasonable indirect potential benefit of, or a motivated interest for, a proposed guarantee/security to be given by a company, that the validity of such a guarantee/security interest could be challenged for lack of any interest by the guarantor in providing the guarantee/security interest.
- In addition to this general legal restriction, further limitations are imposed by specific laws, such as the prohibition to exercise a financial activity without specific authorisation (which in the case of a Luxembourg company, does not apply to financial activities within a group of companies) or the limitation on financial assistance to shareholders in the case of subscription or purchase of shares of the guarantor.
- **The articles of association of the company.** The provision of guarantees or security interest by a company must be within the limits of the object clause of its articles of association. If the provision of a guarantee or security by a Luxembourg company exceeds the corporate objective as expressed in the articles of association, the company is still bound by the action, unless there is evidence that the beneficiary of such acts knew that the acts exceeded the corporate objective or that the beneficiary could not, in light of the circumstances, have been unaware of that fact.

Corporate authority. When a Luxembourg company grants guarantees or security interests, corporate procedures usually require that the decision is approved by a board resolution or a decision of delegates that have been appointed for such purpose.

Corporate benefit. The third condition for a guarantee/security interest to be granted by a Luxembourg company is that the proposed action by the company must be "in the corporate interest of the company". This is a translation of the French *intérêt social*, an equivalent term to the English legal concept of corporate benefit. The concept of corporate interest is not defined by law, but has been developed by doctrine and court precedents and may be described as being "the limit of acceptable corporate behaviour". Rather than the objective criteria of the provisions of law and the articles of association above, the concept of corporate benefit requires a subjective judgment. This may involve the interests of the relevant group of companies. The interests of the group may justify the issue of a guarantee or the granting of security in favour of a parent company (upstream guarantee) or a sister company (cross stream guarantee), in circumstances where the:

- Proposed action must be justified on the basis of a common economic, social, or financial policy applicable throughout the whole group.
- Existence of a group should be evidenced through capital links.
- Proposed action must not:
  - be without any consideration; or
  - break up the balance between the undertakings of the various group companies.

The limit of reasonable corporate behaviour is reached when the transaction is exclusively in the corporate interest of the parent company or the other companies of the group, without any benefit, direct or indirect, for the company granting the guarantee.

Failure to comply with the corporate benefit requirement typically results in liability for the directors or managers of the guarantor.

There is a limited risk that the directors or managers of the Luxembourg company will be held liable if, for example, the:

- Guarantee or security interest provided materially exceeds the (direct or indirect) benefit derived from the secured obligations for the Luxembourg company.

- Luxembourg company derives no personal benefit or obtains no direct or indirect consideration for the guarantee/security interest granted.
- Commitment of the Luxembourg company exceeds its financial means.

In addition to any criminal and civil liability incurred by the directors or managers, the guarantee or security interest could be held unenforceable if contrary to public policy (*ordre public*).

The above analysis is slightly different within a group of companies where a group interest (*intérêt du groupe*) exists. The existence of a group interest would prevent the guarantee or security interest from falling foul of the above constraints. For a group interest to be recognised, the following cumulative criteria must be met and proved:

- The "assisting" company must receive some benefit, or there must be a balance between the respective commitments of all the affiliates.
- The guarantee must not exceed the assisting company's financial means.
- The companies involved must form part of a genuine group operating under a common strategy aimed at a common objective.
- Assistance must be granted for the purpose of promoting a common economic, social and financial interest determined in accordance with policies applicable to the entire group.

These criteria must be applied on a case-by-case basis and a subjective fact-based judgment must be made by the directors or managers of the Luxembourg guarantor.

The guarantees (upstream and cross stream) granted by a Luxembourg company are subject to certain limitations, which usually take the form of general limitation language inserted in the relevant transaction document(s) and which covers the aggregate obligations and exposure of the relevant Luxembourg assisting company under the transaction documents. The obligations of the borrower are limited at any time to an aggregate amount not exceeding the aggregate amount of the outstanding intercompany loans made to the guarantor by the borrower that have been funded directly or indirectly with a borrowing under the initial loan agreement increased by the greater of an agreed percentage (usually between 85% and 95%) of the guarantor's own funds, subordinated debt or net assets. Such wording provides for unlawful financial assistance.

Loans to directors

Loans to directors are in principle valid, with the following restrictions:

- Public limited liability companies (*sociétés anonymes*), may not grant loans to finance the acquisition of their own shares.
- A director having an interest opposite to the corporate interest of a public limited liability company in a given transaction must disclose that interest to the board convened to decide on the transaction and abstain from taking part in the deliberation of the board.

Usury

Pursuant to the provisions of the Luxembourg Civil Code, a Luxembourg court (if competent) could reduce the rate of interest to the level of legal interest, if, in the view of the court, the interest rate was manifestly excessive.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

There are several statutory provisions that impose liability for damage caused by pollution of the environment or the neighbourhood. Liability usually derives from the property right in the polluted land. The lender can potentially become liable for damage if it enforces a mortgage on a polluted or polluting property, as it will become the owner of the land.

STRUCTURING THE PRIORITY OF DEBTS

15. What methods of subordination are there?

Contractual subordination

In a contractual subordination, several banks lend to a company, but certain banks (junior lenders) are subordinated to other banks (senior lenders) through inter-creditor arrangements. Contractual subordination is not common in European jurisdictions including the rules in Luxembourg. However, structural subordination (*see below*) and contractual subordination are often combined.

Structural subordination

Structural subordination is often used to subordinate a bank debt to the debt incurred by the issuance of high yield bonds:

- A holding company (TopCo) issues the high yield bonds.
- The group holding company (HoldCo) borrows from banks at a level below the bond issuing TopCo.

The incurred bank debt is secured by guarantees and securities granted by the operating subsidiaries of the HoldCo. In the event of the HoldCo group's insolvency, the TopCo, whose only asset is its shareholding in the HoldCo (and probably a downstream loan with respect to the proceeds of the issuance), ranks as a mere shareholder of the HoldCo and therefore junior to bank lenders of the HoldCo.

It is important to ensure that any downstream lending of the proceeds of the high yield bonds issuance is contractually subordinated to a bank debt.

Structural subordination has been used by Luxembourg issuers to facilitate the combination of the bonds issuance and bank lending to finance an acquisition, which in turn helps to reduce the interest rate payable on bonds and to limit the inclusion of non-flexible covenants.

Structural subordination can also be used where both the HoldCo and the TopCo issue high yield bonds or both borrow from banks to provide a structural subordination of the TopCo high yield bonds to the HoldCo high yield bonds and respectively the TopCo bank debt and the HoldCo bank debt.

Inter-creditor arrangements

Inter-creditor agreements establishing the order of priority of the creditors and the security available to them are common in Luxembourg and are, in practice, mostly governed by foreign law.

DEBT TRADING AND TRANSFER MECHANISMS

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Debts can be traded or assigned. These transactions generally include the debt and its accessories, such as pledges, privileges, liens, suretyships and mortgages (*Article 1692, Luxembourg Civil Code*). A first demand guarantee being self-sufficient and not accessory is not automatically transferred with the debt (*see Question 12*).

For enforcement purposes, the transfer of the debt must be notified to, or accepted by, the debtor.

Debts secured by a pledge over a going concern can only be transferred to an authorised brewery or credit institution.

AGENT AND TRUST CONCEPTS

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The principle of the agent concept (*mandat*) is recognised by the Luxembourg Civil Code as a contract under which a principal grants to an agent power to act in the principal's name and on its behalf.

In the context of secured lending, the Collateral Law (*see Question 1*) expressly provides that financial collateral may be held by a person designated by the beneficiaries.

Financial collateral may thus be granted to security agents acting for the lender(s) who do not own any of the debt secured by the collateral.

18. Is the trust concept recognised in your jurisdiction?

The determination of the governing law and the recognition of trusts by Luxembourg courts is in accordance with the HCCH Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trusts Convention) (ratified by a law dated 27 July 2003 on trusts and fiduciary contracts, as amended).

The law chosen by the parties is, in principle, recognised as the governing law. The effects of the trust are recognised in accordance with the Hague Trust Convention, subject to its established exceptions, including the:

- Non-recognition of chosen governing law if the situation has a closer link to another jurisdiction that does not recognise trusts.
- Application of mandatory laws of Luxembourg and other jurisdictions (*Article 15, Hague Trusts Convention*).
- General public order exception.

The following rules apply (*Law of 23 July 2003, as amended*):

- Trusts are not required to be registered (except for specific publishing requirements relating to the transfer of certain goods such as movable property or registered shares).
- When completed, a trust is enforceable against third parties without further publishing requirements (except relating to the transfer of certain items such as movable property or registered shares).
- Limitations of trustee powers are enforceable against third parties that have notice of these limitations.
- When completed, a transfer of debt to a trust is enforceable against third parties.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

Generally, secured creditors are entitled to enforce their security if the secured debt has become due and payable, and the debtor has failed to repay the debt.

In relation to pledges over financial instruments and claims governed by the Collateral Law (*see Question 1*) the lender has the right, upon the occurrence of an event of default, without prior notice, to enforce the pledge by appropriation, sale or compensation of the assets, unless the parties agree otherwise. The lender can also apply to a court to obtain a decision ordering the appropriation of the secured assets after their valuation by an expert.

The beneficiary of a pledge over a going concern or a mortgage, whose claim has become due and payable, can serve a summons to pay and, without a judicial order, seize the pledged assets. Enforcement, however, is a court driven process: a court order is required for realisation by public auction or appropriation.

Regarding a transfer of ownership for collateral purposes, the creditor may, without prior notice, set off the remaining debt due against the transferred assets, if the secured debt is not repaid in full. If there is a remainder in relation to the collateral, the creditor must return the remaining assets to the debtor.

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

Mortgages and civil and commercial pledges are usually enforced by public auction sale of the secured assets.

Pledges on financial instruments and claims governed by the Collateral Law (*see Question 1*) can be enforced by:

- Appropriating, directly or through a third party, the pledged assets at a price determined before or after such appropriation by a valuation method agreed between the parties.
- Selling the pledged assets or having them sold at arm's length commercial terms in a private sale organised by a stock exchange or in a public auction sale.
- Obtaining a court order that the pledged assets are assigned to the pledgee, according to a valuation made by an expert.
- Setting off the pledged assets against the secured obligations.

As a result, a creditor can directly appropriate pledged financial instruments or claims out of court. The parties can directly agree on a valuation method for the pledged assets, which may include the appointment of an independent auditor or reputable bank to determine the appropriation value of the pledged assets.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

Company reorganisation procedures are available, but rarely used. A court may grant a moratorium (*sursis de paiement*) to a company that either (*Articles 593 to 614, Luxembourg Commercial Code*):

- Is temporarily in arrears but has sufficient means to pay off all its creditors.
- Is in a situation where re-establishment of a proper balance between assets and liabilities appears likely.

The moratorium grants a stay on enforcement of security interests (*Article 604, Luxembourg Commercial Code*).

There is a controlled management procedure (*gestion contrôlée*), if the debtor's credit is weakened or the full execution of its obligations is compromised. The judgment, ordering a controlled management procedure, includes an initial stay on the enforcement of any mortgages, liens and pledges (*Luxembourg Grand-Ducal Decree of 24 May 1935*).

In winding-up arrangements (*concordat*) companies in financial difficulties may also benefit from stays on security enforcement. In the context of such arrangements, secured creditors will be required to waive their mortgages, liens and pledges, should they want to take part in the decision-making process relating to the debtor company (*Article 513, Luxembourg Commercial Code*).

Luxembourg law does not provide for specific rules regarding the voting requirements applying in the above procedures. Therefore, if they are not otherwise set out in the articles of incorporation, the board of directors or managers can take decisions with respect to such procedures.

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

Insolvency proceedings impose an order of priority for repayment (*see Question 24*) and might affect certain transactions (*see Question 23*). However the start of insolvency proceedings does not prevent the enforcement of security interests governed by the Collateral Law (*see Question 1*).

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

In general, a company's transactions, including security agreements, can be affected by insolvency procedures if they were concluded during the:

- Hardening period (*période suspecte*).
- Ten days preceding the hardening period.

The hardening period starts from the moment the company stopped paying its debts (*cessation de paiements*), though the exact date is fixed by the court (a maximum of six months before the start of insolvency procedures).

The following transactions are automatically void, if concluded during the hardening period:

- Contracts entered into by the insolvent company, if its obligations are significantly more onerous than the obligations of the other party.
- Any payment made by the insolvent company in respect of debts that are not yet due.
- Any payment made by the insolvent company in respect of debts that are due, unless it was paid in cash or made by bills of exchange.
- Any security granted over an asset of the insolvent company to secure obligations contracted before the security contract was entered into.

Mortgages and privileges duly acquired can be registered until the court has issued a judgment declaring insolvency. However, registrations can be annulled if the following occurs:

- Registration took place during the hardening period or during the preceding ten days.
- The date of the creation of the security and the date of the registration are separated by more than 15 days.

Additionally, any contract or payment can be annulled by the court if the other party had personal knowledge about the company's insolvency.

However, as an exception to these rules, security interests governed by the Collateral Law can, in principle, not be challenged under Luxembourg or foreign bankruptcy law (including reorganisation measures and winding-up proceedings), are not subject to the Luxembourg law hardening period rules set out above and are valid and enforceable against third parties, auditors, administrators, liquidators and other similar entities, even if they were granted on the day when a reorganisation or winding-up proceeding was opened by a court, provided that they were granted before the court decision.

24. In what order are creditors paid on the borrower's insolvency?

If the debtor becomes insolvent, secured creditors are paid prior to the unsecured creditors from the proceeds of the sale of the debtor's assets, if all the required formalities have been complied with. However, several privileges and claims rank above the claims of secured creditors.

The order of priority payments is as follows:

- Creditors of the bankrupt estate.
- Preferred creditors.
- Ordinary unsecured creditors.
- Shareholders, who are treated as subordinated creditors and receive any surplus from the liquidation (*boni de liquidation*), if any, in proportion to their shareholding.

If there is a conflict in relation to movable assets among preferred creditors with a preferential right, these creditors are paid according to the following priority list (*Article 2012, Luxembourg Civil Code*):

- Lessors' claims.
- Pledgees' claims (unless the pledge is governed by the Collateral Law, in which case the pledgees have priority over any claims).

- Costs of preserving assets.
- The unpaid price of equipment used in the debtor's industrial undertaking (*établissement industriel*).
- Other preferential claims.

Preferred creditors with a general preferential right are paid according to the following priority list (*Article 2101, Luxembourg Civil Code*):

- Legal fees incurred in creditors' interest.
- Super-preferential employee claims. These are claims by the debtor's employees which relate to their last six months of employment, and any claim which relates to the termination of employment contracts.
- Employees' social security charges.
- Other preferential claims.

If the company's assets are not sufficient to pay the preferred creditors with a general preferential right, the claims of these creditors take preference over the other creditors (including creditors with a special preferential right or with a mortgage).

CROSS-BORDER ISSUES ON LOANS

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?

There is no restriction on granting security over movable and immovable property to foreign lenders. However, pledges in respect of going concerns can only be granted to authorised credit institutions and breweries.

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls in force that could prevent any repatriation of realisation proceeds or other payments to a foreign lender under the security document or loan agreement.

TAX AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Taxes vary depending on the nature of the security.

Documentary taxes

Stamp duty of EUR2 is payable per filing for a mortgage, a pledge on real property or a pledge on a going concern.

Registration fees (*droits d'enregistrement*)

The following fees apply:

- **Mortgage.** A fee of 0.24% on the total amount of the secured debt.
- **Pledge on real property.** A fee of 2.4% on the total amount of the secured debt.
- **Pledge over a going business concern.** A fee of 0.24% on the total amount of the secured debt, or a fixed duty of EUR12 (about US$18). The fixed duty may be available if the underlying credit agreement has a sufficient connection with a foreign jurisdiction.

Nominal registration fees are also payable in all these cases.

Mortgage registration tax (*droits d'inscription or droits de transcription*)

The following fees apply to registration of a mortgage in the Mortgage Registry:

- **Mortgage or pledge on an ongoing business concern.** A tax of 0.05% on the total amount of the secured debt, for first registration and renewal.
- **Pledge on real property.** A tax of 1% on the total amount of the secured debt, for first registration and renewal.

Nominal registrar's fees are also payable in all these cases.

Notaries' fees

Notary fees are calculated on a sliding scale, based on the value of the mortgaged or pledged property, or the amount secured if the security is over a going concern. A notarial deed is not strictly required for a real estate pledge or pledge on a going concern, but is recommended.

The usual sliding scale is as follows:

- EUR50 to EUR3,800: 0.3% to 4%.
- EUR3,800 to EUR10,000: 0.15% to 1.5%
- EUR10,000 to EUR50,000: 0.1% to 0.6%.
- EUR50,000 to EUR100,000: 0.025% to 0.5%.
- EUR100,000 to EUR990,000: 0.01% to 0.1%.
- EUR990,000 to EUR1.25 million: 0.01% to 0.05%.

28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

Creditors should take taxes and fees into consideration when deciding which kind of security to take, though enforceability and legal certainty are also important factors. Costs can be minimised by taking security over shares, claims and financial instruments under the Collateral Law, as the costs of taking security over such assets are minimal. Security over such assets also offer a high degree of certainty to financial markets participants because the Collateral Law aims to protect such interests, even if the agreement was entered into during the pre-bankruptcy suspect period (*see Question 23*).

REFORM

29. Are there any proposals for reform?

There are currently no proposals for major reform in this area.

ONLINE RESOURCES

W www.legilux.public.lu/leg/index.html

Description. Official website giving, among others, access to Luxembourg laws in French language. The information is up-to-date, subject to legal gazette publication delays. There is currently no official translation of the Collateral Law available in the English language.

Practical Law **Contributor profiles**

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- Considerable expertise in capital markets transactions, including issues of equity and debt securities such as high yield bonds, IPOs, listings, takeovers, exchange offers, structured finance and in cross-border banking transactions, insolvency, debt restructuring, insurance and reinsurance transactions.
- Specialises in securitisation transactions involving regulated and non-regulated entities.
- Advises on regulatory aspects relating to banking, finance, capital markets, insurance and reinsurance matters.

Non-professional qualifications. Master's degree in economic law, Université Libre de Bruxelles.

Recent transactions

- Advice to Altice S.A. and its subsidiaries in connection with the financing of the acquisition of the Portuguese assets held in Portugal Telecom by Oi S.A. for a total amount of approximately EUR7.4 billion as well as the related security package (February 2015).
- Issuance of US$320 million 7.75% senior notes due 2025 and US$500 million 8% senior secured notes due 2020 by Altice (June 2015).
- Advising Danaher Corporation on a US$11.5 billion Euro commercial paper programme established in connection with the issuance of multi-currency notes by two Luxembourg subsidiaries regarding the financing of the acquisition of Pall Corporation (July 2015).
- Issuance of EUR500 million senior notes due 2017; EUR600 million 1.00% senior notes due 2019; EUR800 million 1.70% senior notes due 2022 and EUR800 million 2.500% senior notes due 2025 by Danaher Corporation (July 2015).
- Issuance of US$5.19 million 7.38% senior secured notes due 2026 by Numericable-SFR SA. The senior secured notes were admitted to trading on the Euro MTF Market of the Luxembourg Stock Exchange in May 2016.
- Issuance of CHF750 million senior fix-rate bonds due 2028, CHF540 million senior fix-rate bonds due 2023 and CHF100 million senior fix-rate bonds due 2017 by one of the subsidiaries of Danaher Corporation (December 2015).
- Issuance of JPY30 billion 0.352% senior notes due 2021 by one of Danaher Corporation's subsidiaries (March 2016).
- Advising a German bank on the financing of acquisitions of real estate objects located in Germany, carried out by German investors through Luxembourg companies (October 2015).
- Advising a Chinese bank on the launch of its mortgage loan activities (April 2016).

Languages. English, French, German, Dutch (speaking and reading knowledge)

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Recent transactions

- Advice to Altice S.A. and its subsidiaries in connection with the financing of the acquisition of the Portuguese assets held in Portugal Telecom by Oi S.A. for a total amount of approximately EUR7.4 billion as well as the related security package (February 2015).
- Issuance of US$320 million 7.75% senior notes due 2025 and US$500 million 8% senior secured notes due 2020 by Altice (June 2015).
- Issuance of US$5.19 million 7.38% senior secured notes due 2026 by Numericable-SFR S.A. The senior secured notes were admitted to trading on the Euro MTF Market of the Luxembourg Stock Exchange in May 2016.
- Issuance of EUR500 million senior notes due 2017, EUR600 million 1.00% senior notes due 2019, EUR800 million 1.70% senior notes due 2022 and EUR800 million 2.500% senior notes due 2025 by Danaher Corporation (July 2015).
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- Issuance of JPY30 billion 0.352% senior notes due 2021 by one of Danaher Corporation's subsidiaries (March 2016).
- Advising a German bank on the financing of acquisitions of real estate objects located in Germany, carried out by German investors through Luxembourg companies (October 2015).

Languages. English, German, Russian, Spanish