Lending and Taking Security in Luxembourg: Overview

by Bob Scharfe, Marion Lanne, Georgios Patsinaridis, Rafaella Gavrielidou, and Yassine Bouzetit, Luther S.A.

Country Q&A | Law stated as at 01-Jan-2025 | Luxembourg

A Q&A guide to lending and taking security in Luxembourg.

This Q&A provides a high-level overview of forms of security over assets, release of security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, risk areas for lenders, structuring the priority of debts, debt trading and transfer mechanisms, agent and trust concepts, enforcement of security interests, borrower insolvency and cross-border issues on loans.

Forms of Security over Assets

Real Estate

1. 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.
- 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.

Formalities

Several formalities must be met to create 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 are subject to the form of the relevant 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 et de la TVA*) (Administration Registry). 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. Renewal of the registration of the mortgage must take place within the first ten years of its registration with the Mortgage Registry 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 mortgages as security interest over real estate.

    Real estate pledge agreements 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 acquisition of real estate. 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 in order to continue to be enforceable against third parties for a further ten years, the registration must be renewed.

The 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

2. 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 *Law of 14 July 1966*, the *Law of 19 June 1967*, and *the Law of 29 March 1978*, as amended, provide for a specific kind of mortgage that may be granted over such assets, although mortgages are usually restricted to immovable assets.

Common Forms of Security

Pledges are the most common form of security to be used regarding movable property. Most categories of assets can be secured, including financial instruments and future assets. There are two types of pledges:

- Civil pledges (*gages civils*), governed by the Civil Code.
- Commercial pledges (*gages commercials*), governed by the Luxembourg *Commercial Code* (*Code de commerce*) and, to some extent, the 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 debt incurred. In the case of a default under the credit agreement, the lender may offset the value of the transferred assets with the outstanding debt and, as the case may be, retransfer to the defaulting debtor the remaining assets after netting.

Ownership rights in relation to the assets that 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, which then 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.** 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, where the debtor of a pledged claim or receivable must either be notified or accept the pledge under the form of a notice or acceptance letter (either authentic form or under private seal). This must be

countersigned or signed by the debtor, as the case may be, or the pledge agreement may be countersigned by the debtor for acknowledgment and acceptance purposes.

- **Commercial pledges.** A commercial pledge does not have to be in writing and may be proved by any means permitted by the Commercial Code. The enforceability of the pledge against third parties is also subject to notification of or acceptance by the debtor as in the case of civil pledges above.

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 run 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

3. 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 *Law of 5 August 2005 on financial collateral arrangements*, as amended (Collateral Law) are (see *Question 1*):

- Shares.
- Units.
- Bonds.
- Debt instruments.
- Certificates of deposit.
- Loan notes.
- Payment instruments.
- Claims.
- Term financial instruments which give rise to a cash settlement (including electronic money market instruments).
- Any other instruments evidencing ownership rights.
- Claim rights or securities related to financial underlyings, indices, commodities, precious metals, produce, metals, merchandise, goods or risks.

These financial instruments can take different forms and be transferred through various means, including physical or digital formats, book entry, electronic registration mechanisms, distributed ledgers (crypto-assets, NFTs and so on). They may be governed by different laws and delivered in different ways.

The Collateral Law implemented the *Financial Collateral Arrangements Directive (2002/47/EC)*, as amended, with regards to introducing 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 (*gage*).
- Transfer of ownership for collateral purposes (*transfert de propriété à titre de garantie*).
- Repurchase agreement (*mise en pension*).

However, the most common form of security in Luxembourg are pledges.

Formalities

The rules governing the creation and enforceability of a security interest over financial instruments depend on the financial instruments that constitute 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 different forms, including but not limited to the:

- 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 the book-entry securities being 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 in 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 in turn 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 also provides for repurchase agreements of assets. These include 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

4. 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 requires security interests over these intercompany loans to track 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. 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

5. 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 specified in *Question 5*, pledges over bank accounts are enforceable against third parties, as well as towards the account bank once the account bank has been notified of, and has confirmed its acknowledgment of, the pledge. Such a pledge can take the form of an unblocked account, where the pledgor retains signing rights over the relevant account

until an event of default has occurred and the form of blocked account, where the pledgee takes over the signing rights as of the date of the execution of the agreement. The pledge over a bank account includes a waiver by the account bank of its contractual first ranking lien, any pleas (*exceptions*) and any rights that may adversely affect the pledge. It is common practice to attach the following forms 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.
- In relation to an unblocked account: a blocking notice addressed to the account bank, and a blocking confirmation to be signed by the account bank and sent to the pledgee and the account holder in the event of partial or total non-performance of the secured obligations (whereby an unblocked account is then blocked).
- An enforcement notice addressed to the bank, within which the methods for enforcement are specified.

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

Intellectual Property

6. 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

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 as follows:

- Benelux Office of Intellectual Property (for trade marks and designs).
- 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 the need for 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

7. 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, including, for example, future claims, future shares or future bank accounts.

Fungible Assets

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

Other Assets

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

Release of Security over Assets

8. 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 share 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 share 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 (for instance, the relevant debtor or the account bank).

Special Purpose Vehicles (SPVs) in Secured Lending

9. 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 some 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. 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) may require the prior approval of the shareholders depending on the SPV's legal form. If shares that are assigned to an unidentified person, and approved in the course of the realisation of the pledge, where that realisation is not effected through public auction, 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

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

If certain legal structures are put in place (see below), the risk of recharacterisation is unlikely. 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 factoring. This is where financial sector professionals will purchase commercial debts and proceed to collect these for their own account when making 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

Secured creditors in possession of the secured asset (for example, the holder of a pledge) have the right to retain possession of these assets until their 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, 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, Commercial Code).

Other Structures

Delegation of payment. Delegation of payment arises when an additional debtor secures payment of a creditor's debt.

Comfort letter. A statement about the value and standing of one of its subsidiaries, issued by the parent company. 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 and 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

11. 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. To mitigate the liability of the Luxembourg company's managers or directors, 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 three 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 may be re-qualified 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 the form of a letter or an agreement under private seal. The guarantee is not subject to any filing requirements and may 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.
- **Professional payment guarantee (*garantie professionnelle de paiement*).** This guarantee is an undertaking by the guarantor (a legal entity), to pay the beneficiary, at the request of the beneficiary or of an agreed third party (that is, a security agent, trustee or fiduciary agent), an amount determined in accordance with the agreed terms in relation to one or more claims or associated risks. The professional payment guarantee goes beyond the traditional dichotomy between suretyships and first demand guarantees as the new framework provides the parties with greater contractual freedom, while preserving legal certainty and protecting against recharacterisation. Parties must expressly agree that their guarantee instrument is subject to the law on professional payment guarantees dated 10 July 2020 for the regime to apply. As a consequence, and unless stated otherwise, the defences arising from the guaranteed claim or risk cannot be raised by the guarantor.

Risk Areas for Lenders

12. 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*) (including a Luxembourg European company (*société Européenne*) or a Luxembourg partnership limited by shares (*société en commandite par actions*)) may for the purpose of acquiring its own shares:

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

(*Law of 10 June 2009, as amended.*)

However, this can 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 the operation will be concluded at "fair market conditions" in relation to all parties involved, especially with regards to interest received by the company and with regards to security provided to the company in exchange.
- 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. Such report must indicate the:
    - reasons for the transaction;
    - interest of the company in entering into the transaction;
    - conditions on which the transaction is entered into;
    - risks involved in the transaction for the liquidity and solvency of the company; and
    - price at which the third party is to acquire the shares (deposit and publication formalities of such a report are required).
- 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.
- The company must include, among the liabilities in the balance sheet, a reserve, unavailable for distribution, of the amount of the aggregate financial assistance.

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. Criminal and civil penalties may apply (for example, a jail term of between one month and two years and a fine of EUR5,000 to EUR125,000).

The financial assistance restrictions as set out in the LSC, do not apply to private limited liability companies (*sociétés à responsabilité limitée*) (see *Question 1*).

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) (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. However, a company may 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 or group 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 short 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 80% and 95%) of the guarantor's own funds, subordinated debt or net assets.

Corporate Benefit

See above, *Financial Assistance: Corporate Benefit.*

Loans to Directors

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

- Subject to certain conditions (see above, *Financial Assistance*), public limited liability companies (*sociétés anonymes*) cannot 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

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

Others

Under Article 12 of the Grand Ducal Decree of 27 May 1937, as amended, pledges over a going concern can only be granted to credit institutions and breweries authorised by the Luxembourg Government.

13. 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

14. 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, for example:

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

Intercreditor Arrangements

Intercreditor 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

15. 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, Civil Code). A first demand guarantee that is self-sufficient 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

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

Agent Concept

The principle of the agent concept (*mandat*) is recognised by the Civil Code as a contract under which the principal grants an agent the 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 can therefore be granted to security agents acting for the lender(s) who do not own any of the debt secured by the collateral.

Trust Concept

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 the *Law of 27 July 2003 on the trust and on 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:

- 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.

(Law of 23 July 2003 on the trust and on fiduciary contracts, as amended.)

Enforcement of Security Interests

17. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? How are the main types of security interest usually enforced? What requirements must the lender comply with?

Enforcement

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, on the occurrence of an agreed event of default, without prior notice, to enforce the pledge by appropriation, sale or compensation, auction 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. However, enforcement is a court driven process, and 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

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 on commercial terms at arm's length in a private sale organised by a stock exchange, any trading facilities (multilateral trading facilities or organised trading facilities) 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.

Borrower Insolvency

Rescue, Reorganisation, and Insolvency

18. Are company rescue or reorganisation procedures (other than 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:

- 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.

(Articles 593 to 614, Commercial Code.)

The *Luxembourg law of 7 August 2023 on business preservation and modernizing bankruptcy law* (Reorganisation Law) has introduced the following reorganisation procedures:

- Conciliation through the Minister of the Economy or the Minister for SMEs.
- Reorganisation (out of court) by mutual agreement (*réorganisation par accord amiable*).
- Judicial reorganisation (*procédure de réorganisation judiciaire*), carried out through (as applicable):
    - A collective agreement (*accord collectif*);
    - the transfer of assets by court order (*transfert par décision de justice*); or

- a stay of payment (*sursis*) to negotiate a mutual agreement.

The judicial reorganisation procedure is, in principle, not expected to have a material impact on the security interests being subject to the Collateral Law.

It should be noted that Article 30 of the Reorganisation Law prohibits creditors from accelerating debts or terminating agreements once a judicial reorganisation application has been filed and when a judicial reorganisation measure is in progress. This restriction can be worked around, however, if the relevant security agreement provides that the enforcement of the security interest is not exclusively dependant on the acceleration of the secured debt and can be initiated based on other events (such as breach of financial covenants, initiation of insolvency proceedings and others).

19. 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 21*) and may affect certain transactions (see *Question 20*). However, the start of insolvency proceedings does not prevent the enforcement of security interests governed by the Collateral Law (see *Question 1*).

20. 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 of 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). This is because they are not subject to the hardening period rules (see above) and are valid and enforceable against third parties, auditors, administrators, liquidators and other similar entities. This is 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.

21. 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:

- 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.

(Article 2102, Civil Code.)

Preferred creditors with a general preferential right are paid according to the following priority list:

- Legal fees incurred in the 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.

(Article 2101, Civil Code.)

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).

However, the regime offered by the professional payment guarantees granted under the *Law of 10 July 2020 establishing a Register of Fiducies and Trusts*, and the financial collateral provided for under the Collateral Law in Luxembourg, allows a bankruptcy-proof enforcement of this collateral derogating from the customary ranking of the creditors above.

Cross-Border Issues on Loans

22. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders, or taking guarantees from foreign subsidiaries of the borrower?

In principle, lending constitutes a regulated activity in Luxembourg (that is, entities intending to provide loans to foreign borrowers must hold the applicable licence from their competent regulatory authority).

Foreign lenders incorporated in another EU member state can exercise such activities based on their existing authorisation from the European Central Bank and/or from their relevant national regulatory authority.

Foreign lenders established in third countries (that is, non-EU jurisdictions) can carry out lending activities through a branch in Luxembourg. In this case, the same authorisation would be required as for Luxembourg financial institutions.

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.

23. What regulatory requirements does a UK lender have to comply with to purchase a loan made to a borrower in your jurisdiction?

Since 1 January 2021, UK-based financial institutions, without a valid authorisation from the competent authorities of the EU, have lost their authorisation to provide financial services in Luxembourg. To obtain a valid authorisation, UK firms must fully establish their operations in the EU and ensure that they have adequate human, financial and operational resources with respect to those operations (the EU authorities are especially vigilant in this regard and does not allow "empty shell" companies).

Contributor Profiles

Bob Scharfe, Partner

Luther S.A.
Phone: +352 27484 667
bob.scharfe@luther-lawfirm.com
www.luther-lawfirm.lu

Professional and academic qualifications. LLM in International Business Law, University of Kingston Upon-Hull; Master's degree in Private Law, University Robert Schuman, Strasbourg; Certificate in General Management; Stanford University Graduate School of Business; Admitted to the Luxembourg Bar in 2008

Areas of practice. Heads the banking, finance and capital markets practice of Luther's Luxembourg office. Advises banks, multi-national corporations, and private equity firms on a wide range of banking and financing matters, capital markets, structured finance, securitisation and insolvency law aspects, and structuring private equity investments through Luxembourg. He also has solid experience in general corporate law and specialises in securitisation transactions involving regulated and non-regulated entities.

Languages. English, French, German, Luxembourgish

Marion Lanne, Senior Associate

Luther S.A.
Phone: +352 27484 674
marion.lanne@luther-lawfirm.com

www.luther-lawfirm.lu

Professional and academic qualifications. Master's degree in International and European Business; Bachelor's degree in Business Law and Common Law from the University of Lorraine, France

Areas of practice. Banking, finance and capital markets. Focuses on a wide range of banking, finance and capital markets matters. She also gained sound experience in insurance and regulatory matters.

Languages. English, French, Italian

Georgios Patsinaridis, Associate

Luther S.A.
Phone: +352 661850999
georgios.patsinaridis@luther-lawfirm.com
www.luther-lawfirm.lu

Professional and academic qualifications. LLM, Corporate and Financial Law, University of Glasgow, UK; Bachelor's degree in law, Democritus University of Thrace, Greece.

Areas of practice. Banking, finance and capital markets. Focuses on a wide range of banking, finance and capital markets matters. Experience in restructuring and insolvency matters.

Languages. English, Greek, French

Rafaella Gavrielidou, Associate

Luther S.A.
Phone: +352 27484 1
rafaella.gavrielidou@luther-lawfirm.com
www.luther-lawfirm.lu

Professional and academic qualifications. LLM, Corporate and Financial Law, University of Glasgow, UK; LLB, University of Glasgow, UK

Areas of practice. Banking, finance and capital markets. Focuses on a wide range of banking, finance and capital markets matters.

Languages. Greek, English, French

Yassine Bouzetit, Associate

Luther S.A.
Phone: +352 27484 1

yassine.bouzetit@luther-lawfirm.com
www.luther-lawfirm.lu

Professional and academic qualifications. Master's Degree (Master 1) in Business Law, University Paris II Panthéon-Assas; Master's Degree (Master 2) in Business Law, University Paris-Dauphine.

Areas of practice. Banking, finance and capital markets. Focuses on a wide range of banking, finance and capital markets matters.

Languages. French, English, Spanish

END OF DOCUMENT

