

WILDGEN & PARTNERS NEWSLETTER

The Luxembourg law of 5 August 2005 on Financial Collateral Arrangements

November 2005

1. INTRODUCTION

On 5 August 2005, the Luxembourg Parliament passed the law on financial collateral arrangements (the "Law").

The Law implements the Financial Collateral Directive 2002/47/EC of 6 June 2002 (the "Directive").

The Law applies to pledges, transfers of title by way of security (*transfert de propriété à titre de garantie*), repurchase agreements (*mise en pension*) and netting (*compensation*) arrangements.

The Law abolishes the law of 21 December 1994 on transactions relating to repurchase agreements as well as the law of 1 August 2001 on the transfer of title in security.

However part III and IV of the Law more or less duplicate the law of 21 December 1994 on operations of repurchase agreement and the law of 1 August 2001 on the transfer of title in security.

Consequently, this summary will only be limited to updates in the matter of pledge agreements.

2. PLEDGE AGREEMENTS

Scope and Definition.

The Law applies to pledges over Assets. Assets are defined as financial instruments and receivables.

Financial Instruments must be understood in their widest sense, which includes among other things, shares in companies, other securities equivalent to shares / units in companies, undertakings for collective investment, bonds and other forms of debt instruments.

Creation of Pledge.

To create a pledge, the Law requires the pledgee or a third party selected by the pledgor to take possession of the pledged Assets.

Article 5 (2) of the Law provides the following dispossession proceeding:

- i) in the case of Financial Instruments in book entry form: here the relevant instruments must have been recorded in the account held by the depositary in the name of the pledgor, the pledgee, or any other persons acting as pledgee or third party holder, and must be designated as being pledged or the pledge must have been notified to the depositary;
- ii) in the case of Financial Instruments in bearer form: the relevant Financial Instruments must have been delivered to the pledgee or a third party;

iii) in the case of Financial Instruments in registered form: the pledge over the relevant instrument must have been recorded in the register where the relevant instruments are themselves recorded;

iv) in the case of Financial Instruments payable on demand, by endorsing the relevant instruments indicating that the relevant instruments have been pledged,

v) in the case of receivables or Financial Instruments not referred to above: the transfer of possession is achieved vis-à-vis all third parties, whether for receivables the debtor has been notified of the creation of the pledge or the pledge is accepted by the debtor and, for Financial Instruments, the creation of the pledge has been notified to or accepted by the issuer of such Financial Instruments or, if the Financial Instruments are held by a third party holder, by the notification to or acceptance by that third party holder.

Retention of Pledged Assets.

Article 5 (4) of the Law expressly recognizes the right for the pledgee to retain Assets pledged in his favor.

Second rank pledges.

Article 6 of the Law expressly recognizes the validity of second or lower ranking pledges and regulates their creation, perfection and enforcement

Voting Rights attached to Financial Instruments.

The Law provides that voting rights are regulated by the agreement of the parties. Where no agreement exists between the parties, voting rights are granted to the pledgor, unless the pledgee has a right to use the collateral. In such case voting rights are granted to the pledgee.

Right of the Pledgee to use Collateral

The Directive defines the right of use as the right of the collateral taker to use and dispose of financial collateral provided under a security financial collateral arrangement as if he was the owner thereof.

The Law provides therefore that the pledgee may use and dispose of the Assets provided that: i) the parties have agreed this; and ii) the pledgee, on the due date for the performance of the relevant financial obligations covered, shall either transfer equivalent collateral or set off the value of the equivalent collateral against or apply it in discharge of the relevant financial obligations.

Enforcement of the Pledge.

The pledgee no longer has to give notice to the pledgor before enforcing the pledge.

The Law provides for the following enforcement procedures:

- i) the appropriation of the Assets at a price determined pursuant to a valuation process agreed between the parties;
- ii) the sale of the pledged Assets by mutual consent either at a private sale at arm's length, by sale on a stock exchange or by public sale;
- iii) the request to a Luxembourg court that title to the Assets be given to the pledgee for payment of all or any part of the outstanding amount upon an expert's evaluation;
- iv) the setting-off

vi) in the case of Financial Instruments: the appropriation of such instruments at their market value if they are traded on the Luxembourg or other foreign Stock Exchange, or regulated market. In the case of units or shares of an UCI, which calculates and publishes its net asset value, at the price of the last published net asset value.

Enforcement in Insolvency.

The right of the pledgee to enforce the collateral is no longer suspended in case of winding up proceeding or in the event of other competing claims among creditors.

Transitional Regime.

The Law is retroactive and applies to pledge agreements entered into before its coming into force.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate advice after a thorough examination of the particular situation

WILDGEN & Partners
69, Boulevard de la Pétrusse
L 2320 LUXEMBOURG
Phone +(352) 404960-1
Fax +(352) 404409
E-mail: lawyers@wildgen.lu
Visit our website: www.wildgen.lu