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Changes to Luxembourg collateral law and to regime of electronic money institutions

Law of 20 May 2011 introducing changes to the Luxembourg collateral law and to the regime of electronic money institutions

Today was published in the Mémorial (Luxembourg legal gazette) a new law (the "**Law**") implementing into Luxembourg law

(i) Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC; and

(ii) Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims.

In relation to electronic money institutions, we just wish to mention that the Law purports to remove barriers to market entry and to facilitate the taking up and pursuit of the business of electronic money institutions. A simple and technologically neutral definition of electronic money has been introduced covering all monetary value stocked electronically upon receipt of funds, serving to pay transactions. A new specific prudential regime for electronic money institutions has been introduced. This part of the Law is effective as of 30 April 2011. For more details on this part of the Law, please contact your usual Linklaters contact.

This note will hereafter focus on the main changes introduced by the Law to the law of 5 August 2005 on financial collateral arrangements (the "**Collateral Law**"). This part of the Law will enter into force on 30 June 2011. The Law will however also apply to financial collateral arrangements entered into before 30 June 2011.

Contents

The Law has introduced certain novelties but has also provided certain confirmations of existing market practices.

Facilitating Financial Collateral Arrangements over Credit Claims

One of the aims of the directive leading to the Law was to facilitate financial collateral arrangements in relation to credit claims.

The Law confirms that the identification of credit claims and the evidence of their being subject to financial collateral arrangements *erga omnes* is sufficiently done by their inclusion in a list of credit claims submitted to the collateral taker. This is without prejudice to the possibility that the financial collateral arrangements can encompass future claims.

An innovation is the introduction of the perfection vis-à-vis the debtor and third parties of pledges over credit claims by the mere conclusion of the pledge agreement. The rationale is to ensure the practicality of financial collateral over credit claims and to reduce the administrative burden and cost of taking financial collateral.

However, the debtor, until informed of the creation of the pledge, will be validly discharged if it makes a payment to the collateral provider.

To avoid any uncertainties, the Collateral Law has also been modified to provide expressly that pledges over credit claims entail the right for the collateral taker to exercise all rights of the collateral provider attached to the pledged credit claims, e.g. it may terminate the loan having given rise to the credit claims.

Perfection Requirements for Pledges over Financial Instruments in Book-Entry Form

The Law has adopted certain additional perfection methods, which are based on the anglo-saxon concept of “control” of the collateral taker over of the pledged assets.

Under the Law, pledges over financial instruments in book-entry form are perfected as follows

(i) simple execution of a pledge agreement by the depositary if the depositary is also the collateral taker;

(ii) agreement between the collateral provider, the collateral taker and the depositary OR agreement between the collateral provider and the collateral taker notified to the depositary by which the depositary will act upon instructions of the collateral taker only and without any further approval of the collateral provider;

(iii) registration of the financial instruments in the collateral taker’s account;

(iv) registration in an account opened with a depositary in the name of the collateral provider or in the name of a third party holder, the

financial instruments being designated as pledged individually or collectively by reference to the relevant account in which they are recorded.

Perfection provided above under (ii), (iii) and (iv) implies an automatic waiver by the depositary of the ranking of its pledge over the financial instruments, except if there are contrary provisions in the pledge agreement or in the case of a notification made under (ii) above where the depositary has not expressly accepted such waiver of its rank.

Additional Protection of the Collateral Taker

The Collateral Law now expressly provides that debtors of credit claims may validly waive, in writing or in a legally equivalent manner, their rights of set-off vis-à-vis their creditors or any other objections (*exceptions*) vis-à-vis the creditors of the credit claims and vis-à-vis persons to whom the creditors assigned, pledged or otherwise mobilised the credit claims as collateral.

In addition, the parties to a financial collateral arrangement may provide that the collateral provider may waive, in case of enforcement of the collateral arrangement, any recourse (personal or by subrogation) it may have against the debtor of the secured obligations.

The above waivers are valid between the parties and opposable to third parties. They are also specifically made insolvency remote by the Law.

The rationale behind these amendments is to further strengthen the position of the collateral taker by avoiding that the debtor tries emptying the financial collateral of its value and by expressly confirming market practice.

Requalification

The Collateral Law now expressly states that any right of substitution, right to withdraw excess financial collateral in favour of the collateral provider or the right to collect the proceeds thereof until further notice and the right reserved to the collateral provider to give instructions in connection with collateral, does not prejudice the financial collateral having been provided to the collateral taker.

The purpose of the amendment to article 2(3) of the Collateral Law is to specify that certain rights reserved to the collateral provider do not change the nature of the financial collateral arrangement.

In addition, the Collateral Law is amended to specify that the allocation of all rights attached to the financial instruments (including but not limited to the voting rights as provided in the past) is governed by the agreement between the parties; unless stipulated otherwise, they would be exercised by the collateral giver (unless there is a right of usage, in which case, they would be exercised by the collateral taker).

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Enforcement

Recent practice has shown that it may be prejudicial to a collateral taker to wait for the realisation of financial collateral by appropriation until the valuation of the pledged assets is completed, process which may take some time. Luxembourg legal authors had already confirmed that appropriation can take place before or after valuation.

In addition, it seemed useful to specify that appropriation can be made by either the collateral taker itself or a third party designated by the collateral taker (e.g. an SPV).

To avoid any doubt, Article 11 (1) a) of the Collateral Law now specifically confirms these possibilities.

Insolvency

The Collateral Law now clearly states that any security interests and guaranties similar to financial collateral arrangements, as defined in the Collateral Law which are granted by a collateral provider established or residing in Luxembourg and which are governed by a foreign law benefit from the same protection against insolvency, bankruptcy, composition with creditors or similar proceedings as financial collateral arrangements governed by the Collateral Law.

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