

LUXEMBOURG AMENDS LAW ON FINANCIAL COLLATERAL ARRANGEMENTS

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INTRODUCTION

Luxembourg is the second largest investment fund center in the world after the U.S. Assets under management (“A.U.M.”) in Luxembourg exceed U.S. \$5.0 trillion. Luxembourg’s success as a financial center largely is due to its advanced investment fund legislation and the legal framework in respect of financial transactions and collateral arrangements. The relevant legislation is the Collateral Arrangements Law of August 5, 2005 (“the Collateral Arrangements Law”). Earlier this year, it was amended by the law of July 20, 2025 (“the Amendment”) intended to update the Collateral Arrangements Law to reflect current developments in market practices. This article explains the changes made by the Amendment.

DIRECTIVE 2002/47/EC

The Collateral Arrangements Law was initially adopted in Luxembourg to transpose Directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002 (“Directive”). The aim of the Directive was to create a harmonized E.U.-wide legal framework for the receipt and enforcement of financial collateral typically provided by a borrower to support a financial transaction, whether the borrowing reflected customary banking and lending or more complex structured products trading). In this way, it would provide additional security to lenders, reduce credit losses, and encourage cross-border business within the E.U. The importance of the Directive can hardly be overestimated in times of financial crises.

The Directive set the framework for cross-border use of financial collateral. It abolished formal requirements to register the collateral, and in their place, provided minimum evidentiary requirements, such as a written pledge. This enabled enforcement of a pledge by sale or appropriation of the pledged collateral outside of insolvency proceedings. This gave the holder of the financial collateral an easier path to ensure satisfaction of the underlying obligation. In addition, the Directive required Member States to recognize close-out netting arrangements. In sum, the Directive provided contractual flexibility and legal certainty to the parties.

In comparison to E.U. Regulations, E.U. Directives do not have a direct binding effect in the E.U. Member States. They are pieces of legislation that set out goals that all E.U. countries must achieve. It is up to the individual Member States to adopt their own laws to reach these goals. The Directive provided Member States with a broad range of options regarding implementation and allowed Member States to adapt the Directive to local legal frameworks.

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THE COLLATERAL ARRANGEMENTS LAW

The Collateral Arrangements Law, as further amended, is a perfect example of how the Luxembourg parliament created a competitive market within the E.U. by transposing a Directive to provide a flexible framework for the enforcement of claims against pledged collateral posted by borrowers. To illustrate, the terms for the provision of a collateral can allow for control arrangements, not only possession. Collateral substitution not prejudicing security interest is also possible.

The main pillars of the legal framework created by the Collateral Arrangements Law are as follows:

- **No registration formalities.** Financial collateral arrangements and netting agreements are recognized commercial transactions not requiring any registration. Evidence of the arrangement in writing or by any other legally equivalent manner is considered sufficient for the collateral to be valid.
- **Control arrangements.** The provision of collateral will be recognized if it is delivered, transferred, held, registered, or otherwise designated to be in the possession or under the control of the collateral taker or of a person acting on its behalf.
- **Security trustee.** The Collateral Arrangements Law expressly recognizes that a security arrangement exists by allowing the provision of the collateral to be in favor of a person acting for the account of the beneficiaries of the collateral, a fiduciary, or a trustee. Usually, it is assumed that the creditor also received the collateral and acts as the pledgee. The Collateral Arrangements Law specifically allows for the collateral to be held by a fiduciary or a security trustee without any need of parallel debt arrangements with the collateral agent.
- **Enforcement of pledge without prior notice.** In the event of a triggering default, the pledgee may enforce the pledge without prior notice, unless otherwise provided.
- **Range of enforcement procedures.** The main procedures are (i) out-of-court appropriation at the price determined by the valuation method agreed between the parties (normally, an independent auditor is appointed for this purpose) and (ii) a private sale to a third party in a commercially reasonable manner. Other methods include public auction under simplified procedures discussed below and court order. Specific rules apply to publicly traded financial instruments and insurance contracts, also discussed below.
- **No effect of insolvency.** Provisions of Luxembourg or foreign law governing reorganization measures, winding-up procedures, attachments, liquidations, or similar procedures do not constitute an obstacle to the enforcement and performance of pledge agreements.

THE AMENDMENT

The Amendment leaves the main provisions remain intact, but several important revisions:

- It confirms the contractual flexibility of the parties and the possibility to enforce a collateral arrangement, even if the secured obligation has not become due and payable.
- It updates and modernizes enforcement procedures.
- It introduces a new public auction regime for the enforcement of the financial collateral arrangement.

These amendments aim to strengthen Luxembourg as a creditor-friendly jurisdiction that provides flexibility for structuring financial transactions.

ENFORCEMENT EVENT

The definition of the “enforcement event” in the Collateral Arrangements Law did not clearly address whether a financial collateral arrangement could be enforced only when the secured obligation becomes due. The Amendment clarifies the definition of an enforcement event by providing that it is an event of default or any other event whatsoever as agreed between the parties that triggers an enforcement action. This affirms the concept of contractual freedom between the parties. They may agree that an enforcement event may occur even if the secured obligation has not become due and payable. Consequently, an enforcement event includes a breach of a financial covenant, warranty, or representation. Where the relevant financial obligations are not due at the time creditor action is taken, the proceeds will be applied to satisfy the relevant financial obligations, unless otherwise agreed.

INTRODUCTION OF CURRENT MARKET CONCEPTS

The Amendment replaces outdated references to a stock exchange with the term “trading venue,” including any regulated market, Multilateral Trading Facility (“M.T.F.”), or Organized Trading Facility (“O.T.F.”).

The Amendment provides that if an enforcement event occurs and the collateral consists of financial instruments admitted to trading, the pledgee may, without prior notice (i) assign or cause the pledged collateral to be assigned on a trading venue to which it is admitted to trading or (ii) appropriate the pledged financial instruments or have them appropriated by a third party, at market price (if such instruments are admitted to trading on a trading venue), unless otherwise provided for in the pledge. These enforcement methods complement other methods provided for in the Collateral Arrangements Law.

The definition of a “financial sector professional” as a recipient of title to collateral transferred on a fiduciary basis now includes any payment institution or any electronic money institution.

The introduction of modern concepts is a good example of how the legal framework has adapted to the fast-evolving market in order to follow current practices and I.T. development.

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EXPANDED SCOPE OF COVERED COLLATERAL OVER UNITS AND SHARES OF (U.C.I.'S) AND INSURANCE CONTRACTS

The enforcement procedure has been modernized to reflect current practices. The Amendment confirms that an enforcement action may be taken units and shares of undertakings for collective investments (“U.C.I.’s”) and insurance contracts serving as collateral.

The pledgee may appropriate the units or shares of a U.C.I. at the market price where such units and shares are admitted to trading or at the price of the last published net asset value (“N.A.V.”), provided that the last publication of the N.A.V. does not exceed one year. Previously, an appropriation was possible only in cases where N.A.V. was published on a regular basis.

Also, the pledgee is now able to request the redemption of the pledged units or shares of a U.C.I. at the redemption price in accordance with the constituent documents of the U.C.I.

Finally, the Amendment expressly confirms the possibility for the pledgee to exercise all rights arising under the pledged insurance contract. Consequently, in the case of a life insurance contract or a capital redemption operation, the pledgee may exercise the right to surrender or request the insurance undertaking to pay any sums due pursuant to the insurance contract.

PUBLIC AUCTIONS

Under the Collateral Arrangements Law, public auctions were carried out at the Luxembourg Stock Exchange. The procedure was slow and inflexible. Now, a creditor may choose and appoint an auctioneer among bailiffs (*huissiers*) or notaries sworn in under the law of the Grand Duchy of Luxembourg. The auctioneer will determine the modalities and criteria of the auction procedure. This new regime is in line with the standard auction procedures in Luxembourg.

CONCLUSION

With the Amendment in place the Collateral Arrangements Law has been modernized to meet trading platforms of the 21st Century, adding to the attraction of Luxembourg as a preferred location for investment funds.



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