LUXEMBOURG

Law and Practice

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Loyens & Loeff is an independent European full-service business law firm providing integrated legal and tax advice, with specialists in Dutch, Belgian, Luxembourg and Swiss law. The Luxembourg banking and finance practice helps clients to navigate the increasingly complex debt and financial regulations, and has been involved in the most innovative and complex deals of the European market, most of them prize-winning financings for acquisitions, restructurings, loans or high-yield transactions. More specifically, the firm's acquisition finance expertise includes acquisitions, recapitalisations, refinancing and intercreditor issues. The team has ample experience in negotiating all forms of financing arrangements for any type of business, and integrated co-operation with the M&A and tax teams ensures clients' needs are addressed precisely. The team is part of a fully integrated firm with home markets in the Benelux and Switzerland, and offices in all major financial centres, such as London, New York, Paris and Tokyo.

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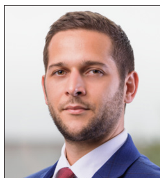

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1. Market

1.1 Major Lender-Side Players

Located in the heart of Europe, Luxembourg remains an attractive place for international groups, investors and banks to establish their activities or investments. Supported by innovation and multiple attractive markets, Luxembourg has become an important jurisdiction for start-ups but also shines in non-financial matters, such as the space sector or the development of new programmes such as Fit 4 Sustainability.

Luxembourg remains a prime jurisdiction for debt, credit and opportunities funds and other major players in acquisition financing or development financing. Although the general context of inflation is not favourable for real estate financing, sustainable financing (and the development of the green stock exchange) is still growing.

Luxembourg corporate structures are usual in most transactions, as Luxembourg corporate law allows for flexibility and efficiency. Being an onshore jurisdiction that is stable and has a good reputation, Luxembourg is the go-to place for structure acquisitions, investment vehicles

and financing in general. The country's attractiveness is further enhanced by the efficiency of the enforcement of the collateral granted over Luxembourg companies.

Luxembourg is additionally recognised for its stock exchange, where debt securities are listed on regulated markets or the Euro MTF market, and also for its innovation in having the world's first and leading platform dedicated exclusively to sustainable finance.

Based on the above, Luxembourg is an attractive jurisdiction for major players – whether local, European or international, banks or investment funds or other lending or investment vehicles – to provide their services, make investments, attract clients or list their securities.

1.2 Corporates and LBOs

Various international corporate financing and leverage acquisition financing is implemented through Luxembourg.

1.3 Geopolitical and Global Health Considerations

While the market has almost recovered from the turmoil of the COVID-19 pandemic, the geopolitical situation and the related crisis that hit Europe in the first quarter of 2022 raised some concerns regarding inflation, increases in interest rates and asset class pricing. However, the market remained stable although the regularity of deals was impacted. The banking and finance industry and the cross-border market continued to be dynamic. This was also the case for cross-border real estate finance, notably in the United Kingdom, Ireland and continental Europe. The use of Luxembourg vehicles as either lending companies, sponsors or financing entities allowed the Grand Duchy to remain pretty active.

2. Documentation

2.1 Governing Law

The main finance documents (other than the security agreements) are usually governed by foreign law – mainly English or US law. However, Luxembourg law is being used more frequently as the governing law of the main finance agreement due to Brexit and an increase in acquisition financing activity among Luxembourg lenders.

Regarding security over assets, Luxembourg applies the lex rei sitae principle so all assets located within the Grand Duchy of Luxembourg territory shall be governed by Luxembourg law.

As the fund financing sector develops rapidly, new Luxembourg law governed security agreements are emerging as well, and the main fund documents are governed by Luxembourg law.

2.2 Use of Loan Market Agreements (LMAs) or Other Standard Loans

The main financing documents, such as facility agreements, are based on Loan Market Association (LMA) or Loan Syndication and Trading Association (LSTA) standard loan agreements. They contain the terms and conditions that are considered market practice in the major jurisdictions and other financial centres. Financing agreements governed by Luxembourg law also follow the standard market terms and conditions laid out in the LMA or LSTA template documentation.

2.3 Language

The language used depends on the market targeted by the finance documents and the nationality of the parties involved. Although English continues to be the most used language, French and German also have a large share in the financing documents.

2.4 Opinions

Legal opinions are part of acquisition finance transactions and are a common condition precedent in all financing transactions. Lenders' counsel usually provide the enforceability opinion covering the enforceability of the Luxembourg law governed security agreements, while the borrowers' counsel provide the opinion related to the capacity of the Luxembourg company to enter into the various transaction documents, including conformity with the articles, consent, non-bankruptcy, choice of law and jurisdiction and enforcement of judgment.

3. Structures

3.1 Senior Loans

Structures involving Luxembourg entities may differ depending on the aim and circumstances of the transaction.

For example, a specific holding company may be implemented at an upper level in order to allow the rollover of management and key persons. In another example, notes or bonds might be issued at the acquisition company level and a senior or mezzanine loan granted at the holding company level, in order to separate the security package.

Typical structures include having a top or master Luxembourg holding company receiving the funds and acting as an umbrella company and various Luxembourg or foreign law governed subsidiaries holding the relevant "silos" structure, or having a Luxembourg holding company acting as a joint venture company for investors, holding itself as a Luxembourg company or a foreign subsidiary that will be the parent of the targeted company.

The Luxembourg companies commonly used are non-regulated companies, and their form depends on their role in the structure. For rolling-over vehicles or pooling vehicles, the company would take the form of a partnership. Pure holding companies usually take the form of limited liability companies and are usually below the parent company.

In almost every financing, those Luxembourg vehicles would be financed by their parent, by means of either equity (shares, premium or reserves) or debt (loans or other debt instruments).

The external debt portion can take various forms, such as senior loans, mezzanine loans, first and second lien and PIK loans or debt securities issuances. The form used varies according to the financing needs, the market conditions and the availability of certain sources of financing or the needs of certain lenders.

International banks usually grant the senior loans but would tend to mitigate their risk by syndicating the debt shortly after the first utilisation. Syndication occurs within six to 12 months, and allows other participants such as securitisation vehicles or other debt funds to hold a portion of the debt.

3.2 Mezzanine/Payment-in-Kind (PIK) Loans

The lending of funds to third parties on a regular basis is a regulated activity under Luxembourg law and is subject to a specific licence granted by the Luxembourg supervisory authority of the financial sector (the *Commission de Surveillance de Secteur Financier* – CSSF).

Mezzanine loans are granted by banks or new players as debt funds. As they are often subor-

dinated in payment and in ranking with respect to the security package, their appeal lies in the higher interest rates applying to such loans.

Their form may vary from simple unsecured loans to having a convertible feature and PIK interest rate.

As indicated, new players have emerged in these types of financing, especially in Luxembourg – mainly subsidiaries of Luxembourg-based debt funds or even securitisation vehicles. Such mezzanine financing would therefore have specific features in order to fall outside the scope of the licensing obligation imposed by the CSSF such as PIK interest or the issuance of a warrant. It would therefore be considered as an investment rather than a pure financing.

3.3 Bridge Loans

Bridge loans are used to bridge the gap between the time when the funding is needed and the time that the funds receive money from their investors, or when the financing set up includes debt securities to be issued, or are granted at a later stage (such as debt securities or notes issuances).

Bridge loans allow for agility in the financing acquisition structure, reducing the number of capital calls, managing the control and visibility of financing needs, as well as the fund flow and prompt positive responses in terms of attractive deals and bids.

3.4 Bonds/High-Yield Bonds

The terms and the timing of bond issuances depend highly on market conditions, particularly fluctuation in interest rates, and on the general economic outlook.

Their terms and conditions are usually governed by US or English law, although Luxembourg law governed terms and conditions are on the rise due to the appetite and flexibility of the Luxembourg markets.

In addition, Luxembourg law expressly allows the issue of bonds by a Luxembourg company under a foreign law and the possibility to disapply all provisions of the Luxembourg law of 10 August 1915 on commercial companies, as amended, relating to bond issuances.

Finally, Luxembourg law has recently added additional flexibility by extending the possibility to issue bonds (publicly or not) to additional forms of companies.

3.5 Private Placements/Loan Notes

Luxembourg acquisition structure are usually financed by means of loans (either senior or mezzanine). However, depending on the volume of the transaction, the volatility of the market, the circumstances and the funding available, the issuance of debt securities remains a useful alternative to raise funds.

3.6 Asset-Based Financing

As the Grand Duchy of Luxembourg is a small country, few industrial players are present and real estate assets are rarely located in Luxembourg. Nevertheless, Luxembourg vehicles are often used to structure the acquisition and related financing, irrespective of their location.

4. Intercreditor Agreements

4.1 Typical Elements

Almost all international acquisition financing transactions (irrespective of their volume or the number of layers of financing involved) in Lux-

embourg include an intercreditor component or a subordination. Intercreditor or subordination agreements are generally governed by a foreign law but sometimes Luxembourg law is chosen.

Intercreditor arrangements related to acquisition finance structures set forth the commercially agreed respective rights of the finance parties as well as those of the intra-group lenders and shareholders, including ranking and priority. The application of payments and proceeds and the consequences of the occurrence of events of default or enforcement are also included in the intercreditor arrangements, as are the security agent appointment and terms.

4.2 Bank/Bond Deals

As every type of financing needs to regulate the rights of the various lenders and creditors of the companies, intercreditor arrangements are also used in bank/bonds deals.

4.3 Role of Hedge Counterparties

When the structure of the financing includes a hedging component and counterparty, relations and interactions between the senior lenders and the hedge counterparty are regulated by intercreditor agreements. Payments to the hedge counterparty are usually defined as a permitted payment, and hedge counterparties benefit from a senior ranking claim.

5. Security

5.1 Types of Security Commonly Used

Luxembourg companies in acquisition structures are commonly holding companies whose main assets consist of the holding of participations, intercompany receivables and assets on bank accounts.

The most common forms of security are pledges, assignments and transfers by way of guarantee (and, with respect to real estate, mortgages). Sometimes, Luxembourg companies also hold intellectual property rights and real estate.

The law of 5 August 2005 on financial collateral agreements, as amended (the Financial Collateral Law), provides for a strong framework where financial collateral arrangements are largely excluded from the scope of bankruptcy.

Security governed by the Financial Collateral Law benefits from the following appealing features:

- confidentiality: the agreements are concluded under private seal and are not subject to registration with public authorities nor published on a national register;
- an extended scope of application, as financial collateral is very broadly defined in the Financial Collateral Law;
- different rankings of pledges;
- the flexibility to regulate the rights of the parties during the term of the agreement (use of the rights, use of collateral assets, distributions, etc);
- straightforward and cost-efficient perfection requirements;
- no requirement of prior notice in the case of enforcement; and
- the bankruptcy or insolvency remoteness of the pledgor.

The Financial Collateral Law provide for three types of security:

- transfer of ownership by way of security interest (*transfert de propriété à titre de garantie*);
- repurchase agreement (*mise en pension*); and

- pledge over collateral (assets) (*gage sur avoirs*).

The latter is the most common collateral in acquisition finance and is usually materialised by:

- a pledge over the shares (or other type of equity securities) of the holding company located in Luxembourg;
- a pledge over its material accounts open with a financial institution located in Luxembourg; and
- a pledge over the intra-group claims and over capital commitment (with respect to Luxembourg funds) owed to the Luxembourg company.

Shares

Pledges over shares (including future shares and related assets) and other equity instruments are a must. The pledge is entered into between the owner of the shares and the pledgee, which is usually the security agent acting for the various lenders. The agreement itself will reflect the commercial agreement related to the exercise of voting rights, the use of the pledged assets and distribution. The enforcement method shall also be specifically described (as required by law).

Bank Accounts

Pledges can be taken over cash or securities accounts located in Luxembourg. Accounts can be operated freely even when pledged or can be blocked, depending on the agreed commercial terms reflected in the pledge agreement. In order to permit a first ranking pledge, the account bank will be asked to waive its general pledge over the account (during the term of the pledge created under the specific pledge agreement) and to acknowledge the pledge.

Receivables

Intra-group receivables are usually pledged. As fund financings are used more often in Luxembourg, the scope of receivable pledges has been widened and can now include capital commitments (as those are assimilated to claims).

Luxembourg law also provides for the following security to be granted.

Other Movable Assets

Movable assets are subject to commercial pledges (*gage commercial*) and would be governed by the Luxembourg Commercial Code.

Specific assets such as aircrafts and ships must be secured by a specific mortgage.

Inventory

Pledges on inventories are basically not used in Luxembourg, as they are very complicated to implement, the pledgee must hold a special authorisation and the pledges are subject to restrictions.

IP Rights

Pledges over IP rights can be made on:

- patents (*brevets*);
- trade marks (*marques*);
- designs (*dessins et modèles*); and
- copyrights (*droits d'auteur*).

A pledge over trade marks and designs must be registered with the Benelux Office of Intellectual Property (OBPI), while a pledge over patents shall be registered with the Patent Registry of the National Intellectual Property Services.

Other pledges over IP rights are generally governed by private agreements.

Real Estate

A mortgage (*hypothèque*) over real estate takes the form of a notarial deed enacted in front of a notary. It shall be registered with both the Administration Registry (*administration de l'enregistrement et des domaines*) and the Mortgage Registry (*bureau de conservation des hypothèques*). The registration of the mortgage is subject to a registration fee and must be renewed every ten years in order to remain enforceable against third parties.

5.2 Form Requirements

Written agreements between the parties (or any other legally equivalent matter, as determined by the Commercial Code) are accepted as evidence for any type of security.

The Financial Collateral Law goes a step further and allows agreements in electronic format or any other durable form, provided that the collateral to which the security applies is clearly identified.

Perfection requirements differ depending on the assets subject to the security (registration in writing in a register or allocation in a designated account or simply a mark in the financial system that the assets are subject to security).

No public register or other public records (save for the mortgage registry) are available in Luxembourg.

5.3 Registration Process

The perfection requirements depend on the type of asset.

Customarily, the security agreements will cover any additional and future collateral entering into the possession of the grantor of the security. If additional instruments are acquired by the pledgor, the inscription of the pledge will need to be updated.

Securities over IP rights, aircrafts, ships over a certain tonnage, inventories and real estate are each subject to their own registration requirements (see **5.1 Types of Security Commonly Used**).

Shares and Other Forms of Securities (Equity or Debt)

The company whose securities are pledged should either be a party of the pledge agreement or be notified of the pledge.

For securities in registered form, perfection is made through the registration in the relevant register of the relevant securities of the pledge.

For securities in bearer form, perfection is made through the registration in the relevant register held by the depositary agent.

Bank Accounts

In order to allow a first ranking pledge, the account bank will be requested to waive its general pledge onto the pledged account(s) and to acknowledge and accept the pledge granted by the account holder to a third party.

Book Entry Financial Instruments

The pledge is perfected by one of the following:

- the mere conclusion of the pledge agreement if the custodian is the pledgee;
- the conclusion of the pledge agreement if the pledgee is a third party and the custodian is a party thereto, or the notification of such agreement to the custodian if it is not a party to the agreement;
- a book entry registration to an account of the pledgee; or

- a book entry registration to a third party account.

Receivables

The debtor owing the pledge receivable to the pledgor should either be a party of the pledge agreement or be notified of the pledge.

A pledge over receivables due from third parties that is not perfected has an impact on enforceability and ranking, as the debtor is not aware of the pledge.

5.4 Restrictions on Upstream Security

The granting of guarantees and security shall be examined at the company level and is subject to corporate interest and power (see **5.6 Other Restrictions**).

The granting of upstream security or guarantees must therefore be expressly allowed or provided by the company's corporate objective. The corporate interest analysis remains a matter of facts, which shall be assessed by the relevant management body of the Luxembourg company.

If the above conditions are fulfilled, a Luxembourg company may only grant security or guarantees for its own benefit or the benefit of group companies or third parties (including upstream or cross-stream security) subject to certain conditions (see **5.6 Other Restrictions**).

5.5 Financial Assistance

Financial assistance is defined under Luxembourg law as advancing funds, making loans, granting security and providing guarantees by a Luxembourg company for the purpose of the acquisition of its shares by a third party.

Financial assistance only applies to certain forms of companies, such as public limited liability companies (*société anonyme* and *société anonyme simplifiée*) and corporate partnerships limited by shares (s *ociété en commandite par actions*).

Transactions concluded by banks and other financial institutions in the normal course of business or transactions effected with a view to the acquisition of shares by or for the employees of the Luxembourg company or certain group companies are not subject to such conditions, with the exception of the net asset test condition.

Financial assistance may be provided under the responsibility of the board of directors on the following conditions (called the whitewash procedure):

- fair market conditions (particularly regarding interest received by, and security provided to, the company);
- the interest of the company;
- an investigation of the credit standing of the relevant third party;
- a submission to the general meeting of shareholders of a report by the board of directors covering, inter alia, the reasons for the transaction, the interests of the company, the conditions, the liquidity and solvency risks, and the price at which third parties are willing to acquire the shares – such report must also be filed with the register of commerce and companies, and will be published;
- the approval by the general meeting of shareholders at qualified majority; and
- the net assets test – the financial assistance provided is considered as if it were a distribution and therefore must not cause the net assets of the company to fall below the share capital and non-distributable reserves of the company. Among the liabilities in the balance

sheet, the company shall include a reserve of the amount of the aggregate financial assistance, which is unavailable for distribution.

5.6 Other Restrictions

The granting of security over its assets or providing guarantees are not considered to be in the normal course of business of companies as they may lead to the company being put in distress in case of an enforcement.

Whether such operation is allowed and benefits the company shall be assessed on a case-by-case basis, according to the specific circumstances. The conditions to be satisfied relate to corporate power, corporate authority and corporate benefit.

Corporate Power

Limits on corporate power can be imposed either by law or by the articles of incorporation of the company.

Limits on corporate power imposed by law

There have been discussions to assess the possibility for a Luxembourg company to grant a guarantee or a security without monetary consideration. However, this situation would contradict the core aim of a commercial company, which is to make profits.

The discussions then moved from the granting of guarantee or security without consideration to the form or type of consideration that can be received by the Luxembourg company, whether such consideration can be direct or indirect and if the notion of profit can be extended to an indirect profit (or foreseeable profit). Non-monetary consideration, indirect profit or expected future outcomes may now be considered as a cause to grant a guarantee or security.

Therefore, the validity of a proposed guarantee or security for a company can be challenged in exceptional cases when the circumstances do not reasonably allow justification, even indirectly, of a potential benefit thereof or a motivated interest therefor.

Limits on corporate power imposed by the articles of incorporation

The articles of incorporation of the company set forth the corporate governance and limits of the decision making. The object clause, in turn, sets forth the limits within which the management is entitled to develop and carry out the company's activity.

Luxembourg companies that are party to an acquisition structure will have a financial participation company objective– ie, an objective limited to holding and managing participations in other companies in Luxembourg or abroad. The granting of security or guarantee (including cross and upstream guarantees) shall be expressly provided in the corporate objective.

If the provision of a guarantee or security by a Luxembourg company would be considered to exceed the corporate objective provided under the articles of incorporation, it can be considered to be ultra vires. In such cases, if the guarantee or security has been signed in accordance with the articles of association, the company shall be considered to be bound by the relevant transaction, but its management may be held liable.

Corporate Authority

Decisions on the granting of guarantees or security fall within the competence (and under the responsibility) of the board of directors/managers, unless the articles of association of the Luxembourg company provide otherwise. The members of the board shall take their decision

based on all factual matters available to them, including draft documentation and the circumstances and financial and commercial elements of the transaction. They should pay particular attention to the following:

- the interest rate applicable to the guaranteed obligation;
- the interest payment date, reimbursement, termination dates and options;
- specific representations and warranties;
- negative pledges;
- covenants; and
- the effect of their decision on the financial capacity of the company.

Minutes of meetings of the board of managers/directors shall reflect the discussion accordingly and the reflections made by the members in order to justify the corporate benefit. Usually, the transaction is approved together with all related transaction documents. A specific power of attorney is generally granted to any manager/director to finalise and execute the documentation.

Corporate Benefit

A Luxembourg company must always act in its corporate interest, which can be linked to the French concept of *intérêt social*.

The corporate interest is not defined by law as such; the concept has been developed by doctrine and court precedents. Different interpretations have been given to the term "corporate interest", with the prevailing interpretation being based on the institutional theory of the company and concluding that the interest of the company is more than the interest of the shareholders – it is the interest of the company in itself as a legal entity and for its own benefit.

Whether an action is in the corporate interest of a company is a matter of fact rather than a legal issue. The board of managers is responsible for this determination, which is made on a case-by-case basis and in the light of all prevailing circumstances. The assessment shall be made by the management body, and the members of the management board are solely responsible for this assessment at the level of the Luxembourg company.

The test for determining whether a Luxembourg company has acted in its corporate interest when entering into a transaction is first applied on a standalone basis. If a company is to receive appropriate remuneration in relation to the transaction it is entering into, said transaction is generally considered to be in the company's corporate interest.

A company will usually be able to evidence its corporate interest simply by looking at its own situation on an isolated level. This is typically the case where a guarantee is issued or a security granted as a downstream guarantee or security in favour of the debts of a direct or indirect subsidiary, or if they anticipate returns in the future. It can also be the case if the company is to guarantee or secure a debt that is ultimately on-lent to it or its subsidiaries.

In acquisition financing transactions, all group members will usually be asked to give guarantees and provide security to secure the borrowers' obligations. Guarantees and security may be downstream, upstream and cross-stream. There is no Luxembourg legislation governing group companies that specifically regulates the establishment, organisation and liability of groups of companies. Consequently, the concept of group interest as opposed to the interest of the individual corporate entity is not expressly

recognised. However, based on current French and Belgian case law, and provided that the corporate object allows the granting of guarantees to group companies, a Luxembourg company can legitimise its corporate interest if:

- there is a group of companies (to which the company belongs);
- it can be evidenced that the company derives a benefit from granting such assistance (eg, if more advantageous credit terms can be obtained both at the group level and at the level of the Luxembourg company); and
- the assistance is in terms of the amounts involved is not disproportionate to the company's financial means and the benefits derived from granting such assistance.

Although the notion of a "group" of companies is not recognised in Luxembourg, it can be evidenced by means of the equity participation in the various entities. The interest and benefit shall be common and is usually financial or social. It should also be assessed in the due diligence performed on the targeted group or asset and the aim and strategy to be implemented by the newly formed group (refinancing indebtedness, integrating an international component related to the targeted clients or markets or expansion).

The guarantee granted must not exceed the financial abilities of the committing company. In this respect, a certain practice has developed in Luxembourg and certain other jurisdictions whereby it is customary to include "guarantee limitation" language that limits the guarantee to a percentage of the net assets of the company. Although said clauses give comfort in this respect, the inclusion of guarantee limitation language is not sufficient in itself to justify the corporate benefit of the company.

As underlined, the assessment of the corporate interest criteria shall be carried out on a case-by-case basis, reviewing all the facts related to the applicable situation/circumstances. Failure to have a specific corporate interest at the Luxembourg entity level can trigger the liability of the managers/directors (who have not done their assessment properly) and the potential annulment of the transaction on the ground of illegal cause (*cause illicite*) if the Luxembourg courts consider the transaction to be a misappropriation of the corporate assets of the Luxembourg company. Anyone with a legitimate interest can bring an action before the Luxembourg courts – ie, shareholders, creditors of the shareholders and other creditors of the company.

5.7 General Principles of Enforcement

Criteria for Enforcement

Events of default or enforcement events are freely determined between the parties. They usually refer to non-payment, the commencement of insolvency proceedings and material breaches of contract.

The main financing agreements (such as the credit agreement) may provide that the debt shall be accelerated prior to the enforcement. This criteria should be checked on a case-by-case basis.

Procedures for Enforcement

Guarantees are usually simply enforced my means of notice. Such enforcement formalities are usually set forth in the guarantee agreement itself.

The procedures for the enforcement of security differ depending on the type of security being enforced. Mortgages and civil and commercial pledges are enforced by a public auction sale of the pledged assets. Debtors shall be notified by

a bailiff before an enforcement procedure can begin.

For pledges on financial instruments governed by the Financial Collateral Law, several enforcement remedies are available. Unless otherwise agreed between the parties, no prior notification shall be given to allow the enforcement.

The pledgee may choose the manner of enforcement, as set forth by the Financial Collateral Law.

One or more of the following enforcement methods can be applied:

- appropriating the pledged assets or causing the appropriation of the pledged assets by a third party at a price determined prior to or after its appropriation in accordance with an agreed valuation method – the valuation methodology has to be agreed between the pledgor and pledgee and is usually provided in the relevant security agreement;
- selling or causing the pledged collateral to be sold by private sale in a commercially reasonable manner;
- sale over a stock exchange or by public auction;
- obtaining a court order that the pledged assets are attributed to the pledgee in discharge of the secured liabilities, according to a valuation made by a court-appointed expert;
- to the extent possible, setting off the pledged assets against the secured obligations;
- if the relevant financial instruments are listed, appropriating these financial instruments at the market price, or if they are units or shares of an undertaking for collective investment that determines and publishes a net asset value on a regular basis, at the price of the latest published net asset value; and
- if the pledged assets are monetary claims owed by a third party, demanding payment from the third party, subject to certain conditions.

Effect of Insolvency Proceedings on Enforcement

The occurrence of an insolvency proceeding rearranges the order of priority of creditors and payments. It can also challenge the validity of certain transactions (including payments, the granting of guarantees or security, and the sale of assets) and agreements concluded during the hardening period (*période suspecte*) and/or up to ten days preceding the hardening period. The date on which the hardening period starts is fixed by the court, but it is a maximum of six months (plus ten days) before the start of insolvency proceedings.

However, security governed by the Financial Collateral Law is excluded from the bankruptcy estate and an enforcement may therefore take place.

6. Guarantees

6.1 Types of Guarantees

Guarantees granted by a Luxembourg company are usually built in the main credit agreement and are generally accompanied by parallel debt language in order to facilitate enforcement by the security trustee.

Under Luxembourg law, there are three types of guarantee.

- The first demand guarantee (*garantie à première demande*) is a standalone guarantee. No exceptions or exemptions derived from the initial loan agreement can be opposed by

the guarantor to the lenders. The guarantee may take the form of a letter or an agreement under private seal, and is not subject to any filing requirements and becomes enforceable against third parties at the time of its execution (unless otherwise expressed therein). The "first demand" and autonomous criteria of the first demand guarantee shall be explicitly reflected in the documentation to avoid any risk of requalification as a suretyship (*cautionnement*). Such risk could exist if it appears from the guarantee documentation that the guarantee is an accessory to the loan agreement and its related obligations.
- Suretyship (*cautionnement*) is an accessory to a principal obligation. The guarantor is therefore entitled to raise all the defences that belong to the borrower under the principal obligation or relating to the guaranteed obligations, and that are inherent to the debt arising from the loan agreement. Exceptions that are purely personal to the borrower are excluded. The suretyship typically takes the form of an agreement under private seal, with no further or additional formalities.
- The professional guarantee (*garantie professionnelles de paiement*) tends to mitigate the risk of requalification of the first two categories of guarantees and particularly the risk of requalification of the first demand guarantee into suretyship, which is less favourable to the beneficiary of the guarantee. The parties to the professional guarantee agreement shall only refer to the law of 10 July 2020 on professional guarantees to benefit from its advantages and to qualify as a professional guarantee. The agreement needs to be evidenced in writing under private seal (including in electronic form). Flexibility is the key word to define the professional guarantee. Based on the right to contractual freedom, the parties may agree to fix their conditions to call the guarantee – the existence or not of an event of default, the exclusion of defences, continuing obligations, etc.

6.2 Restrictions
The guarantor shall comply with the usual conditions such as corporate power, corporate authority, corporate benefit and no financial assistance (see **5.6 Other Restrictions**).

6.3 Requirement for Guarantee Fees
The provision of a guarantee by a Luxembourg company shall be remunerated in order to justify the corporate interest and benefit of the company to grant such guarantee. Such remuneration can take different forms, such as a fee or other monetary consideration (see **5.6 Other Restrictions**).

7. Lender Liability

7.1 Equitable Subordination Rules
The concept of "equitable subordination" is not recognised under Luxembourg law.

7.2 Claw-Back Risk
The occurrence of insolvency proceedings may challenge the validity of certain transactions (including payments, the granting of guarantees or security, and the sale of assets) and agreements concluded during the hardening period (*période suspecte*) and/or up to ten days preceding the hardening period (see **5.7 General Principles of Enforcement**).

The receiver may also challenge the validity of certain transactions outside the hardening period if the transaction or agreement concluded results in the defrauding of creditors and relieving the company of its assets.

The following transactions are automatically void when concluded during the hardening period (or the preceding ten days, as the case may be):

- transactions transmitting property without reasonable counterpart (such as gifts, waivers) and transactions (even without transfer of property) entered into by the company for a low consideration;
- payments of debts that were not yet due and payable, made by whatever means;
- payments of debts (which are due and payable) made other than in cash (or by cheque and similar payment instruments) – ie, payments in kind (*dation en paiement*), set-off, sale or otherwise; and
- security granted for debts previously incurred.

A set-off between reciprocal debts that are both claimable and due for immediate payment is still valid during the hardening period. However, a contractual set-off is not permitted unless there is a strong connection (common cause) between the mutual claims to be set off, to the extent they can be considered indivisible.

The Financial Collateral Law expressly includes set-off and netting arrangements, which would therefore be considered as bankruptcy remote. The same applies to Luxembourg security agreements subject to the Financial Collateral Law.

Using the same logic, the professional guarantee survives in the insolvency of the debtor.

Claw-back rules are generally not an obstacle to the enforcement of valid security interests prior to the adjudication in bankruptcy if the enforcement has taken place before the declaration of bankruptcy.

8. Tax Issues

8.1 Stamp Taxes

Registration duties are levied on certain legal deeds or acts. While the registration formality is compulsory for certain deeds or acts enumerated by the law, the registration of an act or a deed can also be made voluntarily. The registration of a document is also required if such document is attached to a deed which itself must be registered or is deposited with a notary.

Depending on the act or operation, registration duties are levied at either a fixed amount (EUR12 in general or EUR75 for certain specific deeds) or at a proportionate amount (as a general rule, proportionate duties are computed based on the fair market value of the assets or rights transferred, except where the law provides for a different basis). Proportionate registration duties apply to specific deeds or acts enumerated in the law. Deeds that are not subject to proportional duties are therefore subject to fixed registration duties.

Deeds that are subject to mandatory registration and that trigger proportionate registration duties are limited and mostly concern agreements relating to real estate properties located in Luxembourg (transfer of real estate, mortgages, etc) or aircrafts or vessels registered under the Luxembourg flag.

Documents evidencing a debt claim are not subject to mandatory registration under Luxembourg laws. If registered, a 0.24% proportionate registration duty is due (assessed on the amount of the claim), unless the debt instrument takes the form of a negotiable security.

8.2 Withholding Tax/Qualifying Lender Concepts

In principle, interest payments made by a Luxembourg company are not subject to withholding tax in Luxembourg, except under certain specific circumstances (eg, certain profit participating securities, equity instruments or instruments deemed to be equity and similar arrangements) or where the interest payments are made (or deemed to be made) by a paying agent established in Luxembourg to individuals resident in Luxembourg, in which case the withholding tax is a final tax (*retenue à la source libératoire* – RELIBI).

Loan documents typically provide for an obligation for a Luxembourg borrower to gross up interest payments made to a lender for any withholding tax becoming due, except for the aforementioned RELIBI. Furthermore, it is market practice that the gross up obligation is limited to lenders who are so-called "qualifying lenders" on the date of the loan agreement; in other words, it is standard that the withholding tax risk of a change in law is allocated to the borrower. The concept of "qualifying lender" essentially covers lenders to which payments can be made without being subject to withholding tax (or that benefit from an exemption), or lenders that are tax resident in a country with which Luxembourg has concluded a treaty providing for an exemption (or reduced rate) of withholding tax for interest.

8.3 Thin-Capitalisation Rules

Luxembourg tax law does not provide for thin-capitalisation rules other than the general arm's length principle. If a Luxembourg company is considered to be excessively indebted, the interest on the exceeding portion of the debt financing would be treated as a non-tax-deductible hidden dividend and may be subject to a 15% dividend withholding tax.

Based on the arm's length principle, the debt-to-equity ratio of a Luxembourg company has to be substantiated through a transfer pricing study. In the past, the tax authorities generally required an 85:15 debt-to-equity ratio as a matter of practice for (related party or third party) loans taken up by a Luxembourg company to finance shareholdings qualifying for the Luxembourg participation exemption regime. Considering the new OECD guidelines on financial transactions issued in 2020, the debt-to-equity ratio for such investments should now also be benchmarked.

Luxembourg applies earnings stripping rules in accordance with Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD I). Subject to certain exclusions, the earnings stripping rules limit the deduction of the net amount of interest expenses and economically equivalent expenses (ie, the excess, if any, of such expenses over interest income) in a taxable year to 30% of EBITDA for tax purposes or EUR3 million, whichever is higher. The earnings stripping rules do not distinguish between third party and related party interest. Moreover, if the ratio of equity to assets of a taxpayer is equal to or higher than such ratio for the consolidated group to which it belongs, such taxpayer is excluded from the scope of the rules.

The rule should have no tax impact if the Luxembourg company uses the amounts borrowed under a loan agreement to grant other loans: in compliance with the arm's length principle the Luxembourg company should derive interest income in excess of its interest expenses and thus the Luxembourg company should not

exceed borrowing costs. Similarly, if the Luxembourg company uses the amounts borrowed under a loan agreement to acquire shares in another company qualifying for the Luxembourg participation exemption regime, the earning stripping rules should not adversely impact the Luxembourg company.

9. Takeover Finance

9.1 Regulated Targets

The main regulated industries in Luxembourg that relate specifically to acquisition finance are credit institutions, "professionals of the financial sector" (PSF – such as investment companies, administration or transfer agents, and domiciliation companies), investment funds and insurance companies. The competent regulators are the CSSF and the *Commissariat aux assurances* (CAA), which is the supervisory authority for the insurance sector.

Any transaction involving the sale or acquisition of a qualified interest in a credit institution or other PSF must be disclosed to the CSSF. Various thresholds are described by the applicable law but, in any event, any person who acquires or sells a qualifying holding or exceeds or goes below a specific threshold shall provide evidence of their professional standing (assessed on the basis of police records and any evidence that shows their good repute and knowledge) and financial strength.

Various private equity houses have recently requested the prior approval of the CSSF to acquire administration agents or support PSFs. The same applies to insurer and reinsurer companies, where the prior approval of the CAA was sought. The supervisory authorities are not very inclined to approve private equity houses as new shareholders for regulated entities, in order to preserve the stability of the Luxembourg financial place. Therefore, they take a particular interest in verifying that all the conditions are met, and clients must be aware of such timetable. Acquisition and financing documentation shall be adapted and clearly mention the requirement for regulatory approval. Particular attention shall also be paid to the granting of securities or guarantees as regulated entities are usually forbidden to provide those, unless it is in relation to the development of their own regulated activities. The structuring of the transaction to provide an adequate yet acceptable security package, from a regulatory perspective, is likely to be more time-consuming than for the acquisition of an unregulated business.

9.2 Listed Targets

Shares of listed companies that are based in Luxembourg are not necessarily listed on the Luxembourg Stock Exchange: it is more common to have such shares listed on a foreign exchange, often in the jurisdiction where the group's operational business is located, and therefore the rules of such jurisdiction would apply.

Due to this, cases where the target company is a Luxembourg company listed on the regulated market of the Luxembourg Stock Exchange where Luxembourg takeover rules would apply are rather exceptional, but not totally remote – eg, the takeover of Arcelor by Mittal. In such cases, the rules of the Luxembourg law dated 19 May 2006 on public takeovers (the Public Takeover Law) implementing EC Directive 2004/25 would apply in its entirety.

According to Article 3(e) of the Public Takeover Law, "an offeror must announce a bid only after ensuring that he can fulfil in full any cash consideration, if such is offered, and after taking all rea-

sonable measures to secure the implementation of any other type of consideration." Article 6(3) l) of the Public Takeover Law further provides that the offer document – which the offeror is obliged to prepare and make available to the public – must contain, inter alia, information concerning the financing of the bid.

Even if there is no legal requirement to obtain funds, the offeror shall be advised to obtain firm commitments for the financing of the offer. This concern may also be raised by the Luxembourg regulator.

Offering documents governed by Luxembourg law and approved by the Luxembourg regulator generally contain provisions confirming that firm commitments have been given with respect to the financing of the offer and thus guarantee the completion thereof, providing a certain comfort to the relevant players involved.

Generally, Luxembourg should comply with the rules of more than one jurisdiction, and market practice would align to what is customary in London, Paris or Frankfurt.

10. Jurisdiction-Specific Features

10.1 Other Acquisition Finance Issues

There are no further major considerations that are important to acquisition finance practice in Luxembourg.

Trends and Developments

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Loyens & Loeff is an independent European full-service business law firm providing integrated legal and tax advice, with specialists in Dutch, Belgian, Luxembourg and Swiss law. The Luxembourg banking and finance practice helps clients to navigate the increasingly complex debt and financial regulations, and has been involved in the most innovative and complex deals of the European market, most of them prize-winning financings for acquisitions, restructurings, loans or high-yield transactions. More specifically, the firm's acquisition finance expertise includes acquisitions, recapitalisations, refinancing and intercreditor issues. The team has ample experience in negotiating all forms of financing arrangements for any type of business, and integrated co-operation with the M&A and tax teams ensures clients' needs are addressed precisely. The team is part of a fully integrated firm with home markets in the Benelux and Switzerland, and offices in all major financial centres, such as London, New York, Paris and Tokyo.

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Acquisition Finance in Luxembourg: an Overview

Like the rest of the world, Luxembourg has almost recovered from the COVID-19 pandemic, and focus is now shifting to the implementation of environment, social and governance (ESG) principles. The fund industry was the first market to raise the level of financing by including ESG components; from a financing perspective, marketing ESG products is now one of their main concerns. ESG criteria have also started to emerge from a financing perspective, especially in acquisition and development financings. Although this remains a hot topic in all transactions, the economic and politic situation also impacted the market in 2022 and is having deferred effects on transactions. New markets and opportunities are emerging, however, bringing new transaction prospects.

Innovation, Technology and Blockchain

Implementation of the Pilot Regime

As an innovative country, Luxembourg has taken an important step towards express legal recognition of DLT technology in the financial sector. Notably, with respect to the Pilot Regime Regulation, on 15 March 2023 Luxembourg adopted the Blockchain Law, implementing Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (the Pilot Regime Regulation).

The Pilot Regime Regulation has been directly applicable within the European Union since 23 March 2023, and introduces a pilot regime that allows national competent authorities to temporarily exempt (for a six-year test phase) DLT market infrastructure from some of the special requirements imposed by the existing legislation on traditional market infrastructure.

The aim is to avoid these requirements preventing the operators of such infrastructure from designing solutions for transaction negotiation and settlement on crypto-assets assimilated to financial instruments, without weakening the existing requirements and safeguards applying to traditional market infrastructure and therefore the identification and temporary neutralisation of possible obstacles to the trading and settlement of DLT transactions in the current legislation. In return for providing exemption from certain requirements, the competent national authorities may impose compensation measures adapted to DLT requirements, in order to preserve the integrity of the markets and guarantee the protection of investors. However, no exemption of investor information is allowed.

In addition, and in order to increase legal certainty, the Pilot Regime and the Blockchain Law included in the definition of financial instruments those financial instruments issued using DLT. This has had an impact on the assets covered by the law of 5 August 2005 on financial collateral arrangements (the Financial Collateral Law). The Financial Collateral Law has indeed been amended by the Blockchain Law, and now provides that financial instruments registered or existing in securities accounts held within or through secured electronic recording systems, including DLT registers or databases, are also capable of being pledged and subject to the favourable regime of the Financial Collateral Law.

To complete this framework, the law of 1 August 2001 concerning the circulation of securities, as amended, provides that neither the validity nor the enforceability of securities or guarantees provided in accordance with the provisions of the Financial Collateral Law are affected by the holding of securities accounts within such a secured electronic recording device or by the registration of securities in the securities accounts by means of such a secured electronic recording device.

The above clarifications are a continuation of the laws of 1 March 2019 and 22 January 2021, which explicitly recognise the possibility for the actors concerned to use DLT in terms of the circulation and issuance of securities.

Virtual asset service provider

Building on innovation and especially on technology, a new type of player has been approved by the Luxembourg supervisory authority in the financial sector (the *Commission de Surveillance du Secteur Financier* – CSSF): the virtual asset service provider. There are already several companies that provide such services, but it is the first time that an entity can partner with a credit institution and provide custody to crypto-assets. It can also provide the transfer of crypto-assets alongside the safekeeping and/or administration of crypto-assets or instruments enabling control over crypto-assets, including custodian wallet services.

Luxembourg could now add crypto-assets to those assets located in Luxembourg that may be subject to acquisition financing and financial collateral. Time will tell if the market develops an appetite for this kind of transaction.

Banking Turbulence

The collapse of Silicon Valley Bank (SVB) (the 16th largest bank in the United States, with USD212 billion in assets) has led to a level of concern in financial markets across the world that has not seen since the global financial crisis 15 years ago. The failures have exposed the inadequacy of regulatory reforms. The markets and authorities have reacted quickly, in order to avoid there being a systemic effect on other banks and other parts of the world.

Not long after the SVB collapse, Credit Suisse was bought by UBS, meaning that, as well as taking over the largest bank in Switzerland, it removed the possibility of a total or partial nationalisation in the event of failure. Seen as an emergency rescue plan, the acquisition constitutes a real opportunity for UBS shareholders. The transaction has been structured to preserve the remaining value of the business while limiting its downside exposure.

Although those banks are not directly located in Luxembourg, the banking turbulence has raised some concerns at the regulator level. Credit institutions in Luxembourg are heavily regulated and must provide capital adequacy at all

times. Although the acquisition market is slowly decreasing, the situation is expected to become more favourable in the third quarter of the year.

Globalisation

Regulated entities other than credit institutions are also subject to globalisation. Regulated entities such as domiciliation companies or professional support entities (also regulated by the CSSF) are more frequently becoming the targets of private equity funds and are sometimes merged or absorbed.

At first, the Luxembourg regulator prohibited the acquisition by private equity firms of participations in regulated entities, arguing it was for the stability of the Luxembourg financial market and wanting to avoid any speculation on the performance of regulated entities. This position has now been softened, and private equity firms may become shareholders or take a majority participation in regulated entities, provided that they comply with all the requirements imposed by the CSSF, such as financial soundness, a strategy to develop the activity of the Luxembourg regulated entity and a commitment to maintain the stability of the Luxembourg financial market. During the past five years, such acquisitions have multiplied, and a higher increase in such transactions is expected for the next two to five years.

Globalisation has a direct impact on the Luxembourg acquisition market as local regulated entities are usually acquired directly or indirectly by either competitors (becoming a bigger player) or other regulated companies that want to extend their areas of expertise.

Due diligence is therefore on the rise and should be the first step of an acquisition and related financing.

Enforcement and Restructurings

While the market has almost recovered from the turmoil of the pandemic, the geopolitical situation and related crisis in Europe that hit the first quarter of 2022 raised some concerns regarding inflation, increases in interest rates and asset class pricing.

The emergence of a financial crisis could be predicted, as debtors are starting to renegotiate the terms of their financing, extending payment deadlines or the amount of the secured obligations.

Anticipation is really a key word in the negotiation of those refinancings, but banks are also looking for comfort as they are becoming a bit sensitive on money lending if the borrower is not performing.

Certain players have an appetite for the acquisition of distressed companies. Those types of situations also attract investors who are waiting for the best moment to acquire a company, especially one in distress, in order to acquire additional competence at a lower price, extend their original market or simply kill the competition (subject to clearance).

In that context, there may be an increase in the refinancing of existing banking arrangements, either by means of an extension of the repayment deadlines or term, a revaluation of ratios and financial covenants or an increase of the secured liabilities, or by means of a mix of additional financing and refinancing between the issuance of notes and bank loans. Those additional financings would not come cheap and would in fact increase the debt burden on the borrower, which is already in trouble. Those restructurings would, however, avoid an even worse case scenario, such as bankruptcy.

The number of enforcements is also expected to rise. A bitter feeling remains from the 2008 crisis and, as such, creditors would be more inclined to enforce, especially if they hold a share pledge agreement over the holding company in Luxembourg. Although some banks or noteholders may be ready to enforce, borrowers may still push for a more consensual solution, even if it comes at a high price, in order to preserve their credibility or their reputation.