In case of discrepancies between the French and the English texts, the French text shall prevail.

Luxembourg, 20 February 1995

To all credit institutions

CIRCULAR IML 95/116

Re: **Entry into force of:**

- **the Law of 21 December 1994 amending certain legal provisions concerning the transfer of claims and pledging;**
- **the Law of 21 December 1994 concerning repurchase agreements transacted by credit institutions[1].**

Ladies and Gentlemen,

We draw your attention to the entry into force of two new laws dated 21 December 1994 and published in Mémorial A No 124 of 31 December 1994. The first law amends quite fundamentally the legal provisions concerning the assignment of a claim, the pledge and the commission contract and the second regulates, for the first time, repurchase agreements transacted by credit institutions.

The purpose of this circular is to briefly describe the major amendments introduced by the above-mentioned two legal texts, without providing legal interpretation.

I. Law of 21 December 1994 amending certain legal provisions concerning the transfer of claims and pledging

Firstly, the new law amends certain articles of the Civil Code regarding the assignment of a claim. Secondly, it amends and usefully puts together the provisions concerning pledging in the Civil Code and in the Commercial Code, in which it restores a title relating to commercial pledge as well as a section on commission contract.

[1] The provisions related to the pledge and the transfer of title for security purposes as well as those related to the repurchase agreements are currently included in the Law of 5 August 2005 on financial collateral arrangements, published in Mémorial A 2005, No 128 (Law of 5 August 2005 (coordinated version) – CSSF).

Furthermore, the new law introduces a certain number of amendments to the legal provisions in force regarding the pledge of the goodwill and regarding commercial companies, without however changing them substantially.

Finally, it repeals the Law of 29 February 1872 on commercial collateral loans as well as the Law of 1 June 1929 on pledging of transferable securities, as most of the provisions in these legal texts have been included in the Commercial Code.

A/Assignment of the claim (new Article 1690 of the Civil Code)

The use of a notification made by means of a bailiff's writ or of an acceptance in an authentic form is henceforth no longer required to make the assignment of a claim effective against third parties.

According to the new Article 1690 of the Civil Code, the assignment of a claim is effective against third parties as soon as it is notified to the assigned debtor or accepted by the latter. The notification and acceptance can be made in an authentic form or under private seal.

B/New regulation on pledging

Pursuant to the new law, the pledge of transferable securities as well as the pledge of monetary claims, created either by a merchant or by a non-merchant, are henceforth deemed to be an act of commerce, so that the rules on commercial pledge provided for in the Commercial Code are applicable in the framework of the relations between the banks and their customers.

The application of the new regulation entails simplifications, notably with regard to the publicity and the execution arrangements of the pledge.

1° Publicity of the pledge (Article 114 of the Commercial Code)

In case the pledge concerns a monetary claim, the transfer of possession from the pledgor (collateral provider) to the pledgee is henceforth sufficiently carried out by way of a notification to the debtor of the claim. By analogy to the new rules governing the assignment of a claim, the notification can be made under private seal or in authentic form or even be replaced by an acceptance under private seal or in authentic form from the debtor of the pledged claim, which is automatically the case when the creditor combines the roles of debtor of the pledged claim and of pledgee.

Consequently, in the frequent situation encountered during the relations between the banks and their customers, where a cash deposit is used as collateral for the repayment of a loan granted to the depositor (being the bank's debtor), the pledgee bank no longer needs to notify itself, as the debtor of the pledged claim, of the existence of the pledge agreement by means of a bailiff's writ.

2° Execution of the pledge (Article 118 of the Commercial Code)

The new regulation includes specific provisions concerning the realisation of the pledge relating to transferable securities as well as the pledge of a monetary claim.

Where the pledge is composed of transferable securities listed on a stock exchange, the creditor may, in the event of failure of the debtor to make payments due, after a notice of default, either sell the securities on the stock exchange or obtain appropriation thereof.

In the absence of listing, the securities are sold on the stock exchange through public auction and by a public officer.

In case of a pledge relating to a monetary claim, the parties can henceforth agree that, after a notice of default, the pledgee is entitled: i) if the sum is owed by himself to the debtor, to offset the amount owed by the debtor against the pledged claim (the cash deposit used as collateral for repayment) and ii) if the sum is owed by a third party, to request, upon maturity, payment in his hands from the third party up to the amount of his claim.

II. Law of 21 December 1994 concerning repurchase agreements transacted by credit institutions

The purpose of this new law is to create legal certainty by providing a specific legal framework to a specific banking transaction already widely used in our financial centre. Indeed, this transaction has not so far been governed by specific provisions, so that its legal nature was subject to discussion.

1. Scope:

The new provisions apply to repurchase agreement transactions where one of the parties or both parties are credit institutions within the meaning of Luxembourg law, i.e. credit institutions incorporated in Luxembourg as well as those established in Luxembourg as a branch of foreign banks.

2. Definition of repurchase agreements:

Repurchase agreements are transactions in which a transferor transfers to a transferee a title of an asset belonging to him against payment of a price, by agreeing that the transferee either must (repurchase agreement based on a firm purchase and resale agreement) or can (repurchase agreement based on a firm purchase agreement with resale option) resell it to the transferor at a price agreed in advance.

The law specifies that the transferor has under no circumstances the possibility to refuse to repurchase the asset transferred under a repurchase agreement.

Under the law, repurchase agreements may cover all types of assets, including fungible assets, particularly bills, claims and transferable securities.

3. Legal regime:

The law lays down that both the transfer of the asset from the transferor to the transferee at the beginning of the transaction and the reassignment of the asset from the transferee to the transferor at the end of the repurchase agreement constitute an effective property transfer.

This fact does not, however, affect the accounting treatment of the repurchase agreement which continues to be governed by Article 11 of the Law of 17 June 1992 relating to the banks' annual accounts.

Furthermore, the reassignment of the asset at the end of the transaction does not retroactively affect the capacity of the transferee as owner of the transferred asset during the term of the repurchase agreement.

Finally, the law provides that even if, during the repurchase agreement, one of the parties to the transaction is subject to collective winding-up proceedings occurring after the transfer of the asset, the reassignment of the asset must be carried out under the agreed terms. However, if the collective winding-up of a party has made the reassignment under the agreed terms materially impossible, the parties would be exempt from their respective obligations.

Yours faithfully,

INSTITUT MONETAIRE LUXEMBOURGEOIS

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