# New Professional Payment Guarantee

## Executive Summary

- The law on professional payment guarantees dated 10 July 2020 entered into force on 17 July 2020
- The Professional Guarantee Law introduced a new type of flexible guarantee of payment
- The new regime has two key principles: (i) contractual freedom and (ii) legal certainty
- Parties may freely negotiate the terms of the Professional Guarantee
- The risk of re-characterisation of a guarantee as accessory guarantee (*cautionnement*) is substantially reduced
- Parties have to expressly opt for the new regime
- The Professional Guarantee is particularly useful for syndicated loans, synthetic securitisations, international capital markets transactions and credit enhancement schemes

The law on professional payment guarantees dated 10 July 2020 (the "**Professional Guarantee Law**") entered into force on 17 July 2020.

The Professional Guarantee Law introduced a special regime for personal securities (*sûretés personnelles*) providing for a payment obligation and granted in a professional context.

The Professional Guarantee Law incorporates provisions and principles of the law of 5 August 2005 on financial collateral, as amended (the "**Financial Collateral Law**"). Like the security interests (*sûretés réelles*) introduced by the Financial Collateral Law, the professional payment guarantee introduced by the Professional Guarantee Law (the "**Professional Guarantee**") has two key principles:

(i) contractual freedom and

(ii) legal certainty.

### I. Definition and scope of application

The Professional Guarantee is defined as an arrangement by which the guarantor undertakes towards a beneficiary to pay, at the request of the beneficiary or of an agreed third party, a sum determined in accordance with the agreed terms, in relation to one or more claims or the risks associated with them.

The Professional Guarantee may be granted by any persons, including natural persons, in a professional context.

The instrument of the guarantee needs to explicitely state that the guarantee arrangement is subject to the Professional Guarantee Law.

### II. Key features of the Professional Guarantee

#### A. Default provisions

The Professional Guarantee incorporates by default the typical provisions of first demand guarantees:

- the guarantor may not raise any exceptions arising from the guaranteed claims or risks;
- after payment, the guarantor has a right of subrogation vis-à-vis the principal debtor; and
- the guarantee is, in principle, not affected by insolvency of the principal debtor or other reorganisation measures related to the principal debtor.

These provisions may be derogated by the parties.

The Professional Guarantee may be granted directly to the beneficiary or to a third party acting as agent, trustee or security agent.

B. Contractual freedom

The Professional Guarantee is an alternative to the traditional regimes of personal guarantees under Luxembourg law, the suretyship (*cautionnement*) and the first demand guarantee (*garantie à première demande*).

The suretyship is governed by the Luxembourg civil code. The guarantee obligation of the suretyship is accessory to the underlying guaranteed obligation, so that the obligation to pay under the guarantee exists only to the extent that the underlying obligation exists on the same terms.

The first demand guarantee has been established by case-law, following similar regimes introduced by courts throughout Europe, in particular in France. The first demand guarantee is an autonomous guarantee, i.e., the obligation to pay is independent from the underlying guaranteed obligations.

The new regime of the Professional Guarantee Law allows parties to pick and choose elements of the different regimes without affecting the contractual arrangement. In particular, parties may modulate the accessory nature of the guarantee without re-characterising the Professional Guarantee as a suretyship.

As stated in the Professional Guarantee Law:

- The purpose and terms of the Professional Guarantee and in particular the terms of the guarantor's payment obligation under the Professional Guarantee may be freely agreed between the parties.

- The parties may expressly refer to the claims or risks guaranteed for the determination of the amount and the terms and duration of the Professional Guarantee.

- The Professional Guarantee may be called in all cases contractually determined by the parties, including in the absence of a default or realisation of risks.

III. Practical application

Guarantees issued in the context of syndicated loans, synthetic securitisation transactions, high yield bonds issuances and credit enhancement schemes from multilateral development banks usually take the form of a first demand guarantee, but provide for certain elements typical of suretyship, such as a link to underlying obligations or claims.

In Luxembourg, these guarantee arrangements have been generally recognised as enforceable under the principle of freedom of contract in the Luxembourg civil code. However, parties had to be very careful in drafting the guarantee instruments. Enforceability legal opinions were usually qualified with respect to the risk that the first demand guarantee could be re-characterised as a suretyship. This risk is now removed by the Professional Guarantee Law. With regard to synthetic securitisations, in which credit risk of loss was transferred by using a guarantee, there were some doubts as to whether the granting of such a guarantee could constitute an insurance contract and hence a regulated insurance activity carried out by the grantor of the guarantee. With the coming into force of the Professional Guarantee Law there are further arguments strengthening the view that such a guarantee should not qualify as an insurance contract.

The new regime of the Professional Guarantee Law introduced a new flexible instrument that can be adapted to the needs of market participants.

The Professional Guarantee strengthens the attractiveness of Luxembourg as a legal hub for financing transactions and structured finance instruments in particular synthetic securitisations.

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