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The Luxembourg Protocol – FAQs for the UK market

The Luxembourg Protocol (the “Protocol”) will create a new global system for recognizing and prioritizing secured creditor rights in relation to railway rolling stock i.e. secured lenders, lessors and conditional vendors taking a reservation at title. The creditor’s security interest will be registered at an international registry based in Luxembourg and the Protocol will create new and clear enforcement rights for the creditor on debtor default or insolvency. But how exactly would it work and why, briefly, would it be important for the various stakeholders in the British rail market?

1. Will the Protocol bring any financial benefit to the rail sector?

We are sure that it will, although the exact amount of the benefit will depend on the negotiating skills of debtors and lessees, the existing credit rating of the debtor and the Basel II and III model of the lender. In strict financial terms, in the UK we would expect the banks’ lending rates to go down by somewhere between 25 and 50 basis points. However this is only part of the story because the banks should be able to justify reduced allocation of capital allocation and therefore lower costs. It should also facilitate banks lending for longer periods and they and financial institutions taking a more robust view on residual value risk, facilitating much cheaper rentals on operating leases.

2. Is the Protocol important for UK Plc.?

Yes it is. Not only will it lead to cheaper and more plentiful private sector finance but, bearing in mind that the Protocol applies based on the location of the debtor, it should lead to better rates for financiers and lessors financing rolling stock outside of the UK from a UK base. It has the potential to provide additional credit support for rolling stock exports and more generally support the City in developing new innovative financing structures in relation to rolling stock.

3. What equipment does the Protocol apply to?

The Protocol applies to all vehicles running on rails, or running above or under a guideway. This means that not only does the Protocol bring advantages for financing of conventional rolling stock (rail, tram and metro) but it also underwrites financing in relation to road-rail equipment, people movers at airports, cable cars and even gantries and cranes at ports.

4. Is the Protocol necessary for UK domestic transactions?

While not essential, using it will create, at a nominal cost, a much more secured position for lessors and other secured lenders and, for the first time, introduce a system for registering security interests in a public register.

The Rail Working Group is a not-for-profit association constituted under Swiss law representing a broad cross section of the global railway community.

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5. *What is the cost of registration?*

The charge has not yet been set but the costs should be small especially when a registration is made for a security interest on a group of assets.

6. *Is registration of security interests mandatory?*

Not at all. But it would be advisable if the creditor wishes to be sure that its security interest cannot be overreached by another party.

7. *What is URVIS?*

URVIS stands for Unique Rail Vehicle Identification System. This is the unique number which would be issued for an item of rolling stock by the International Registry once the Protocol is operating. It must be permanently attached to the equipment concerned. Unlike other identifiers this number will never be changed or recycled and will only ever be allocated to one specific item of rolling stock.

8. *Why do we need a unique number?*

At the moment there is no unique and non-repeatable number applicable to rolling stock worldwide. One common system would make it easier to move rolling stock, subject to financing, into other jurisdictions and it would also create an un-impeachable system for identifying rolling stock for creditors in the UK. In addition it will make physical tracking of vehicles easier for creditors, especially when identifiers are combined with GPS or track side recognition systems.

9. *How do the creditor/lessor security rights under the Protocol impact step in rights and other provisions of the Railways Act?*

Article XXV of the Luxembourg Protocol is designed to deal with government step-in rights. It acknowledges that in certain cases, as a matter of public policy, government needs to step-in to stop the financed rolling stock being possessed by the creditor. But in that case the Protocol provides that the creditor needs to be put into the financial position it would have been in had the government not stepped in.

10. *When does the Protocol apply?*

The Protocol applies to all transactions where a UK related debtor enters into a security agreement, a lease or a conditional sale with the reservation of title after the date that the Protocol comes into force in the UK.

11. *Does it protect an owner's title?*

Not directly since the purpose of the Protocol is to protect parties taking a security interest in an asset. However indirectly it does protect the owner if it wishes to be protected since there is a facility for an owner to register a notice of sale under the Protocol which will then place third parties on notice of the transferred title to the then current owner. But this is optional.

12. *How does the Protocol affect the priority of security interests?*

What the Protocol does is set out a simple system for recognition of priority of security interests. Basically the first to register will have priority. However, it will be possible for other holders of security interests to change their priorities by a mutual agreement.



13. Do I need to refer to the Protocol in agreements I am entering into now?

It would be highly beneficial to do so. The best option would be to create a clause which would allow the creditor or debtor to require re-execution of the financing agreements once the Protocol is in force. This would give, on the one side, the creditor the opportunity to take the protection of the Protocol, and on the other side, the debtor quiet possession against security interests registered subsequently.

14. Will it affect existing transactions and their security interests?

Not immediately. Pre-existing interests are protected, in terms of their priorities, for a period of at least 3 years after the introduction of the Protocol in a specific jurisdiction. This period can be extended to a maximum period of 10 years depending on the declaration made by the ratifying state. However a prudent creditor can re-execute the finance documentation once the Protocol is in force allowing it to immediately register its security interest and take advantage of the additional benefits accruing to the creditor under the Protocol.

15. Does my equipment need to move between different countries to take advantage of the Protocol?

Not at all since the Protocol creates a new security system for creditors which will be valuable in domestic transactions. But the Protocol is particularly important where rolling stock is crossing jurisdictional boundaries since then there is no assurance that the domestic law under which the security is created would be respected in the other jurisdiction(s).

16. How important is the location of the equipment?

The location of the equipment is not critical to the application of the Protocol. The Protocol looks to the principal place of business of the debtor. Rolling stock can and often does cross borders so to make the applicability of the Protocol dependant on the location of the rolling stock would result in the Protocol being potentially applicable one day and not the next. However it is important for creditors that the jurisdictions in which the rolling stock is travelling also have adopted the Protocol so that local law cannot interfere with the repossession rights given to creditors through the Protocol under the initial security documentation.

17. When will the Protocol come into force in the UK?

We do not know for sure but our best guess is that the supporting legislation should come into force either in late 2016 or early 2017. The Protocol itself does not come into force until it is ratified by 4 countries and OTIF (as the Secretariat) makes a declaration that it can come into force.

18. What stage has the UK ratification process reached?

Currently the British government is considering ratification and will go out to consultation with the industry shortly. It is however on record as supporting the Protocol.

19. Can we help with the implementation process?

Yes you can. Firstly by communicating to the British government that this is a worthwhile project and then by joining the Rail Working Group. By being part of the Rail Working Group's UK Contact Group there will be opportunities to work with government to ensure the Protocol's correct implementation.



20. *Which other countries have adopted the Protocol?*

So far the Protocol has been ratified by both Luxembourg and the European Union in relation to its areas of competence. Of the other EU countries Germany, Italy and Switzerland have signed the Protocol. However a significant number of countries within the EU are now working towards ratification.

21. *Are there any ongoing costs after registration?*

Directly no. A creditor may wish to check from time to time if there are any rival (even if subordinate) registered interests on its financed equipment. This would trigger a search fee.

22. *What are the opening hours of the International Registry?*

The International Registry will operate on a 24/7 basis through the internet. As a global system registrations and searches will be able to happen at any time of the day or night through out the year save where there is (minimal) down time for system maintenance. We would expect any down time to be notified in advance and take place at less busy periods.

23. *How does this fit with registration and identification of railway vehicles by the European Rail Agency?*

There is no inconsistency and in many respects the registration under the Protocol would be complementary to registrations and identifications through the rules and regulations set out by ERA. The European Vehicle Number is designed to deal with the registration of an item of rolling stock for the purposes of its admission to the rail system (sometimes called immatriculation). The Protocol is focused on a completely different objective, namely securing financiers. Moreover the equipment covered by the ERA does not take into account all of the types of rolling stock as defined in the Luxembourg Protocol. For example trams do not come under the auspices of the ERA. Nonetheless there is already a strong working link with the ERA and we intend to facilitate direct links between the ERA website and that of the International Registry.

24. *Is my registration only recognised in other countries which have also adopted the Protocol?*

On one level this is correct. A jurisdiction which has not adopted the Protocol cannot be required to apply it. On the other hand the registration of security interests, accessible to the public 24/7 through an internet site means that even as a matter of domestic law, the rights of a third party claiming to be a purchaser without notice, trying to take possession of the rolling stock would be severely diminished given that the purchaser could easily check on the registry and see competing (and prior) interests.

25. *What happens if my equipment runs through a country which has not adopted the Protocol?*

Technically the creditor rights against the asset will not be recognised in the non-ratifying jurisdiction unless the recognition comes as a matter of domestic law. However the rights between the creditor and the debtor where the debtor is located in ratifying jurisdiction remain the same. So in practice, the debtor/lessee or its administrator or liquidator should still have an obligation to return equipment as required under the Protocol if there is a default or insolvency.