THE 2001 CAPE TOWN CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

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The Luxembourg Rail Protocol

Enhancing the scope of Financial Services Centres

- It is estimated that worldwide annual spending on new rolling stock is now approaching EUR 63.3 billion, which is mainly financed, or has finance underwritten, by governments. This places heavy burdens on governments, and the resulting budgetary constraints often restrict additional investment in new rolling stock. As a result, the private sector is increasingly required/asked to provide credit for the procurement of new and used railway equipment - subject to acceptable security.

- The Luxembourg Rail Protocol to the Cape Town Convention on International Interests in Mobile Equipment is a new international treaty on the recognition and prioritisation of security interests held by private sector creditors lending on, or leasing, all types of railway equipment from conventional passenger and freight railcars and locomotives, to “yellow” rail equipment, metro and light rail trains, trams and cable cars. The Protocol makes it easier and cheaper for the private sector to finance railway equipment without the need for state guarantees or support. It has established a new international registry based in Luxembourg, where security interests will be registered and publicly searchable. The registry will be accessible 24/7 through the internet, facilitating prospective creditors or purchasers checking for rival claims to the rail equipment being financed or purchased.

- The Protocol has been in force in contracting states since **March 8, 2024**. Gabon, Luxembourg, Paraguay, South Africa, Spain, Sweden, and the European Union in respect of its competences, have all ratified the Protocol (as well as the Convention). Italy, France, Switzerland, Mozambique, Germany, and the UK, have all signed the Protocol and are moving at various speeds towards ratification and many other states around the world are actively looking at adoption of the Protocol.

- According to a survey prepared for the Rail Working Group by the economic consultancy Oxera, the Protocol will deliver direct micro-economic benefits of **EUR 19.4 billion** to 20 selected states in Europe. A second study, covering many states in the ex-USSR "1520" region, demonstrates benefits in this area that are well above an additional EUR 13.9 billion.

- The Protocol applies to leases and security created on a broad range of rail equipment: high-speed and light rail trains, freight locomotives and wagons, trams and metro/subway trains, track maintenance equipment, people movers at airports, and gantries and cranes running on rails at ports.

- A financier providing debt to banks, lessors, or investment funds located in a state that has adopted the Protocol benefits from the fact that when it takes security as a creditor over the financed rolling stock it has a clear set of rights and can register its security interest in the financed equipment at the international registry in Luxembourg. This establishes the priority of the creditor's rights over other subsequently registered rights. The registry also offers a way, for the first time, for third parties to search against any item of rolling stock to check if another creditor has a claim on the asset concerned. This ensures that the creditor's security can be enforced more effectively, while helping to combat errors and even fraud if financed equipment is offered for sale or as security for another financing.

- Financing companies, which can include operators and investors, located in a state where the Protocol applies, benefit from a common, creditor-friendly security system - even though the funds may be used ultimately to finance rolling stock operating in a different country, or even in several jurisdictions. This saves financiers money by:

    - Lowering bank capital requirements, and therefore the cost of capital, based on lower creditor risks (especially when "Basel IV" comes into operation in 2025)
    - Allowing more competitive funding as private and institutional investors recognise the attractions of a simple, common system
    - Rationalising and simplifying documentation, legal costs, and transaction structure costs
    - Reducing export credit agency premiums, where applicable

- In addition, the Protocol provides legal underwriting for operating leasing, thereby supporting higher residual value assumptions by lessors (and reducing initial rents) because of the ease of repossession and remarketing. In turn this creates savings on equipment costs through manufacturing economies of scale, since operating leasing encourages standardised products.

- States with a strong financial services sector benefit from the Protocol even when they have a very small or no domestic rail system, because the benefits of the Protocol are based on the domicile or "seat" of the debtor and not on where the rolling stock is physically located. This opens new business opportunities for Financial Service Centres (FSCs) in contracting states. For example:

- It will be more attractive for rolling stock leasing companies to establish operations in such an FSC.

- Joint ventures that finance or operate rolling stock anywhere in the world could be set up as single purpose companies (SPCs) in an FSC, ensuring the most cost-effective credit terms if the SPC has its “seat” in a contracting state, no matter where the operators or the rolling stock are located.

- A joint-procurement SPC set up by operators in different countries could buy new or used rolling stock for the group with greater negotiating power as orders are bigger and they can finance the rolling stock as a package. If the SPC is in a contracting state that has adopted the Luxembourg Rail Protocol, the secured lenders to the SPC gain the benefit of the Protocol.

- SPCs may also be an excellent joint funding vehicle – for example as a lessor of rolling stock to various operators that then raises capital from banks or institutions, or through creating secured syndications of debt to finance the rolling stock. In this case, the collateral provided as part of the funding has the benefits of the Protocol if the SPC is in a contracting state to the Protocol.

- Similarly, a leveraged fund or an issuer of (green) bonds based in a contracting state will be able to offer its lenders and bond-holders enhanced security with the benefit of the Protocol.

In today’s global economy, FSCs play an essential role in international commerce. But as the fiscal benefits fade, they must look even harder for ways to help business work more efficiently. The Luxembourg Rail Protocol provides these centres with a valuable new facility to offer to investors and other stakeholders in the rail sector.

So regardless of whether a state has a significant domestic rail network, if it has adopted the Protocol, it will be attractive for investors to finance railway equipment through vehicles established in that state. This represents an exciting new business opportunity for an FSC.

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