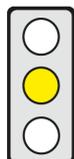


## KEY ISSUES

**Objective of the Regulation:** The Commission wants to foster cross-border investment by improving legal certainty in cross-border transactions of claims.

**Affected parties:** Financial institutions and investors



**Pro:** (1) The general rule, that the applicable law is that of the assignor's habitual residence, strengthens legal clarity and thus legal certainty.

**Contra:** (1) For syndicated loans, an exception to the general rule should be added to avoid the application of various laws.

(2) To avoid legal uncertainty, the Regulation must clarify what is meant by the habitual residence "at the material time" and should only allow overriding mandatory provisions of the law of the Member State in which the assignment has to be or has been performed.

(3) The Regulation's rules on conflict of laws overlap with those of other EU directives and regulations. This results in inconsistencies.

The most important passages in the text are indicated by a line in the margin.

## CONTENT

### Title

**Proposal COM(2018) 96** of 12 March 2018 for a **Regulation** of the European Parliament and of the Council **on the law applicable to the third-party effects of assignments of claims**

### Brief Summary

#### ► Context and objectives

- According to the Commission, one of the remaining barriers to cross-border investment is the lack of legal certainty regarding who owns ("third-party effects") a claim following its cross-border transfer ("assignment"). Due to inconsistent national rules on conflict of laws, it is often unclear which national law applies [p. 1 and 2]. As a result assignments of claims are mainly made on a national rather than on a cross-border basis [p. 5].
- The Regulation lays down uniform conflict of laws rules that determine which country's law applies regarding the ownership of a claim in a cross-border transaction [p. 2].
- The objectives of the regulation are to facilitate access to finance for companies and banks and to promote cross-border investment, through improved clarity and predictability in respect of the applicable law [p. 1].

#### ► Definitions

- A "claim" is the right of a creditor against a debtor to the payment of a sum of money or to the performance of an obligation [Recital 14, Art. 2 (d)].
- An "assignment" of a claim is its voluntary transfer by a creditor ("assignor") to another person ("assignee") [Art. 2 (c)].
- "Assignments of claims" are used by companies and banks [p. 2 and 3]
  - in factoring, to obtain liquidity through the sale of a company's claims to an assignee (often a bank),
  - in collateralisation, to obtain credit through the use of claims (e.g. cash credited to a bank account) as financial collateral to secure a loan agreement,
  - in securitisation, to optimise the use of their capital by transferring multiple claims to a "special purpose vehicle", which subsequently issues debt securities (e.g. bonds) in the capital markets.
- "Third-party effects" refer to proprietary elements, in this case to determine who has ownership rights over a claim [Art. 2 (e)].

#### ► Scope of the Regulation

- The Regulation covers conflicts of laws in civil and commercial matters. It does not cover tax, customs or administrative matters. [Art. 1 (1)]
- The Regulation applies to [Recital 16, p. 6 and 7]:
  - "traditional claims" or trade receivables,
  - claims arising from financial instruments as defined in the Directive on markets in financial instruments [MiFID, Directive 2014/65/EU, see [cepPolicyBrief](#)],
  - cash credited to an account in a credit institution.

- The Regulation only applies to the proprietary elements of assignments of claims [Art. 2 (e)]. It does not apply to contractual elements, i.e. the relationship between the assignor and the assignee, and between the assignee and the debtor. These are governed by the Regulation on the law applicable to contractual obligations (“Rome I”) [Regulation 593/2008/EC] [p. 9]. However, the Regulation does not clearly specify if it covers also proprietary effects regarding the debtor – i.e. if the debtor is included in third parties –, or if Rome I applies for those.
- Claims arising from the following are excluded from the scope of the Regulation [Art. 1 (2)]:
  - family or similar relationships;
  - matrimonial or similar property regimes;
  - bills of exchange, cheques, promissory notes and other negotiable instruments;
  - questions concerned by the law of companies and other bodies;
  - the constitution of trusts; and
  - life insurance contracts from insurance and reinsurance undertakings.
- ▶ **General rule: the law of the assignor’s habitual residence applies**
  - As a general rule, the applicable law is that of the country in which the assignor has its “habitual residence” “at the material time” [Art. 4 (1)]. The applicable law can be the law of a Member State or of a third country [Art. 3].
  - The “habitual residence” designates [Art. 2 (f)]
    - for a company or another “body”: the place of its central administration,
    - for a natural person: the principal place of his business.
  - The Commission notes that this definition of “habitual residence” is coherent with the definition of the “debtor’s centre of main interest”, which determines where the main insolvency proceedings must be opened according to the Regulation on insolvency proceedings [Regulation (EU) 2015/848, see [cepPolicyBrief](#)] [Recital 22]. This is important because conflicts of laws regarding the third-party effects of assignments of claims often arise when the assignor becomes insolvent.
  - If an assignor changes its habitual residence between two assignments of the same claim to different assignees (“*conflict mobile*”), the applicable law is that of the assignor’s habitual residence at the time of the assignment which first became effective against third parties [Art. 4 (1)].
- ▶ **Exceptions**
  - For the following assignments, the applicable law is the law of the assigned claim – i.e. the law governing the initial contract between the creditor (assignor) and the debtor [Art. 4 (2)]:
    - the assignment of cash credited to an account in a credit institution, and
    - the assignment of claims arising from financial instruments.
  - In the context of a securitisation, the assignor and the assignee may choose the applicable law [Art. 4 (3)]. This exception caters for the needs of securitisers [Recital 28]:
    - large operators who in most cases apply the law of the assigned claim and
    - smaller banks and corporates who in most cases apply the law of the assignor’s habitual residence.
- ▶ **Priority conflict**
  - In case of a priority conflict between assignees of the same claim, where the third-party effects are governed by the law of the assignor’s habitual residence for one assignment and by the law of the assigned claim for the other, the law applicable is that of the assignment which first became effective against third parties [Art. 4 (4)].
- ▶ **Matters governed by the applicable law**
  - The applicable law will determine “in particular” [Art. 5]:
    - the requirements necessary to ensure the effectiveness of the assignment against third parties – e.g. registration or publication formalities regarding the assignment –,
    - the priority between the rights of the assignee and the rights of
      - another assignee of the same claim,
      - the assignor’s creditors,
      - a competing claimant who has become the beneficiary of a claim following the transfer of a contract, and
      - a competing claimant who has become the beneficiary of a claim following the novation of a contract – i.e. the transfer of both rights and obligations, arising from the contract, to a third party.
- ▶ **Public interest**
  - The applicable law designated in the Regulation can be disregarded for considerations of public interest if
    - the law of the Member State in which a suit is filed contains overriding mandatory provisions, “regarded as crucial by a Member State for safeguarding its public interests” – e.g. the obligation to register an assignment of claims in a public registry [Art. 6];
    - the applicable law is incompatible with the “ordre public” (public policy) of the law of the Member State in which a suit is filed [Art. 7].

## Statement on Subsidiarity by the Commission

According to the Commission, action at Union level is necessary to replace divergent Member State rules and thereby remove legal uncertainty regarding cross-border assignments of claims.

## Policy Context

Along with the Regulation on assignments of claims, the Commission presented a Communication on the law applicable to the proprietary effects of transactions in securities in which it clarifies its views on existing EU conflict of laws rules regarding cross-border transactions in securities: the Financial Collateral Directive [Directive 2002/47/EC], the Settlement Directive [Directive 98/26/EC] and the Winding-up Directive [Directive 2001/24/EC].

This Regulation is part of the Commission's efforts to establish a Capital Markets Union [COM(2015) 468, see [cepPolicyBrief](#)]. Article 27(2) of the "Rome I" Regulation [[593/2008/EC](#)] also requires the Commission to present a report on the effectiveness of assignments of claims against third parties and, if appropriate, to amend the "Rome I" Regulation.

## Legislative Procedure

12 March 2018 Adoption by the Commission

13 February 2019 First Reading European Parliament (see [cep summary](#))

Open Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

## Options for Influencing the Political Process

Directorates General:	DG Justice and Consumers
Committees of the European Parliament:	Legal Affairs (leading), Rapporteur: Pavel Svoboda (EPP, CZ)
Federal Germany Ministries:	Justice (leading)
Committees of the German Bundestag:	Legal Affairs (leading)
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

## Formalities

Competence:	Art. 81 TFEU (Judicial cooperation in civil matters)
Type of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

# ASSESSMENT

## Economic Impact Assessment

The Regulation aims to improve legal certainty by determining the applicable law on who owns a claim following its cross-border assignment. **The general rule that the applicable law is that of the assignor's habitual residence** – as the Commission proposes – has the advantage of being predictable and easily determinable by third parties. It hence **strengthens legal clarity and thus legal certainty**. However, it increases transaction costs and complexity as compared with the law of the assignment contract or of the assigned claim. This is due to the fact that the Rome I Regulation already includes rules on conflict of laws regarding the contractual elements of assignments of claims. According to the Rome I Regulation, the law of the assignment contract applies to the relationship between assignor and assignee, and the law of the assigned claim applies to the relationship between assignee and debtor. Three different jurisdictional laws can therefore apply depending on the parties concerned, the parties involved in the assignment (assignor, assignee and debtor) or third parties.

**The general rule is not suitable for syndicated loans**, i.e. loans provided by a group of lenders to a single borrower, as **various laws could apply** if lenders are located in different countries. **Therefore, an exception to the general rule should be added** for syndicated loans.

Furthermore, **to avoid legal uncertainty, the Regulation should be changed**. First, the Regulation **must clarify what is meant by the habitual residence "at the material time"** in the general rule. Second, the provisions regarding overriding mandatory provisions enable national courts to apply national law instead of the applicable law for vague reasons of public interest. This results in uncertainty regarding which law will apply. This uncertainty should be reduced: **the regulation should only allow overriding mandatory provisions of the law of the Member State in which the assignment has to be or has been performed**, as suggested by the European Parliament (amendment 23, P8\_TA(2019)0086).

The universal application provision, stating that the applicable law can be that of a Member State or of a third country, raises the question of reciprocity. This is especially important given the relevance of UK law in most financial contracts. If the United Kingdom does not accept the provisions of this Regulation after Brexit, its added-value will be limited. The possibility for the assignor and the assignee to choose the applicable law by way of an agreement in the context of a securitisation is problematic because it will result in binding third parties, e.g. the assignor's creditors, to a law chosen without their consent.

## Legal Assessment

### Legislative Competence of the EU

The Regulation is rightly based on Art. 81 (2) (c) TFEU, which empowers the EU, in the area of judicial cooperation in civil matters, to adopt measures ensuring the compatibility of Member State rules on conflict of laws.

### Subsidiarity

Unproblematic. Rules on conflict of laws for cross-border assignments of claims can only be efficiently established at EU level.

### Proportionality with respect to Member States

Unproblematic.

### Compatibility with EU Law in other Respects

**The Regulation's conflict of law rules overlap with those of other EU directives and regulations. This results in inconsistencies.**

First, the Financial Collateral Directive [Directive 2002/47/EC], the Settlement Directive [Directive 98/26/EC] and the Winding-up Directive [Directive 2001/24/EC] contain rules on conflict of laws for transactions in securities. Clarifications regarding the scope of this Regulation – especially in the definition of the claims covered – are necessary to ensure that there is no overlap between this Regulation and the directives. These directives determine, in particular, the applicable law on the proprietary effects of transactions in “book-entry securities and instruments, the existence or transfer of which presupposes their recording in a register, an account or a centralised deposit system” [p. 7].

Second, the Regulation is not completely consistent with the Rome I Regulation [Regulation [593/2008/EC](#)] and further alignments with this regulation should be made to clarify the scope of both regulations. In particular, the Rome I Regulation governs both the contractual and proprietary elements of the relationships between the assignor, the assignee, and the debtor [Article 14 and Recital 38 Rome I Regulation]. However, it is not clear, whether the proprietary effects regarding the debtor are also covered by the proposed Regulation, giving rise to uncertainty as to which rules apply in this case. Hence, it should be made clear that the Regulation does not govern the proprietary effects with the debtor and only with third parties.

Third, the Regulation is only partly consistent with the Insolvency Proceedings Regulation [Regulation (EU) 2015/848, see [cepPolicyBrief](#)]: The “habitual residence” and “centre of main interests” – presuming this is the place of registered office for a legal person or the place of principal business for a natural person – are not necessarily identical. This could lead to inconsistencies concerning the applicable law in the course of insolvency proceedings. It is also unclear whether the Insolvency Proceedings Regulation already contains rules on conflict of laws. If this is the case, it would significantly reduce the scope of the proposed Regulation because the Insolvency Proceedings Regulation governs particular matters and will therefore have priority over this Regulation [Art. 10].

## Conclusion

The general rule, that the applicable law is that of the assignor's habitual residence, strengthens legal clarity and thus legal certainty. However, it increases transaction costs and complexity. For syndicated loans, an exception to the general rule should be added to avoid the application of various laws. To avoid legal uncertainty, the Regulation must clarify what is meant by the habitual residence “at the material time” and should only allow overriding mandatory provisions of the law of the Member State in which the assignment has to be or has been performed. The Regulation's rules on conflict of laws overlap with those of other EU directives and regulations. This results in inconsistencies.