EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

FINANCIAL SYSTEM SURVEILLANCE AND CRISIS MANAGEMENT
EU/Euro area financial system

CONSULTATION DOCUMENT

DEVELOPMENT OF SECONDARY MARKETS FOR NON-PERFORMING LOANS AND DISTRESSED ASSETS AND PROTECTION OF SECURED CREDITORS FROM BORROWERS' DEFAULT

Commission européenne/Europese Commissie, 1049 Bruxelles/Brussel, BELGIQUE/BELGIË - Tel. +32 22991111
https://ec.europa.eu/info/business-economy-euro_en

Interested parties are invited to provide feedback on the questions raised in this consultation document **between 10 July and 20 October 2017 at the latest to the online questionnaire available on the following webpage**:
https://ec.europa.eu/info/consultations/finance-consultations-2017-non-performing-loans_en

Please add to your replies on this website any documents that you deem useful in this context.

Please note that this consultation document contains two separate sections. The first section covers aspects related to secondary markets for (non-performing) loans, more specifically in view of the sale and transfer of loans and loan servicing activities by a third party. The second section deals with aspects related to the protection of secured creditors from borrowers' default and aims to gather information that can inform the design of a new type of loan security, labelled "accelerated loan security".

This public consultation is addressed to all stakeholders, including, but not limited to, public authorities, citizens, legal professionals, market participants and borrowers. Some of the questions below are more specifically targeted to participants in markets for secondary loans. This will be indicated in the introductions to the relevant subsections

Respondents are invited to provide evidence-based feedback and specific operational suggestions to questions raised in both sections. Do not feel obliged to answer the complete questionnaire. Please select those questions which you deem relevant to answer. In doing so, please be as succinct and concrete as possible.

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published unless respondents indicate otherwise in the online questionnaire.

Responses authorised for publication will be published on the following webpage: https://ec.europa.eu/info/consultations/finance-consultations-2017-non-performing-loans_en#contributions

CONTENT OF THE CONSULTATION DOCUMENT

INTRODUCTION

The financial crisis and ensuing recessions have left some European banks with high levels of non-performing loans (NPLs), with significant adverse impacts on banks' profitability and their ability to lend, including to SMEs. A European strategy for NPLs could help to address this issue across the EU and support national actions in the countries concerned. Accelerating the resolution of NPLs is a top priority for the EU, as clearly manifested in the Commission Reflection Paper on the deepening and completing of the Economic and Monetary Union[1]. As part of its efforts to address the NPL issue, the Commission will present measures to support secondary markets for non-performing loans. The Commission will also launch an impact assessment with a view to considering a possible legislative initiative to strengthen the ability of secured creditors to recover value from secured loans to corporates and entrepreneurs[2].Furthermore the Council is preparing a comprehensive action plan with clear targets, timetables and a monitoring mechanism. The Commission will take active part, together with other European stakeholders and Member States, in the realisation of the action plan.

One of the key policy areas in this context is the development of secondary markets for distressed debt. This is an essential element to tackle high levels of NPLs across Europe. Despite some momentum in recent years, secondary markets for loans remain small and less developed in Europe compared to some third countries. This is the case especially for distressed debt. If banks were better able to off-load legacy assets from their balance sheet via secondary markets for credit, they could use their managerial capacity more on evaluating new lending business, while other firms could specialise in related services such as debt collection, collateral administration and credit restructuring. Economies of scale and increasing specialisation as well as a better potential to exploit technological progress might be fostered if banks had better possibilities to unbundle pre and post-contractual credit services.

Another important policy area would be to remedy the current absence of a contractual-based out-of-court enforcement mechanism to facilitate the swift repossession of securities. The absence of such instrument may have contributed to the current high stock of NPLs in banks' balance-sheets. Protection of secured creditors from borrowers' default, including timely and clear collateral foreclosure, seems to be extremely heterogeneous across Member States' legal frameworks. Enhanced modern and more harmonised EU measures enabling to effectively recover value from secured loans, concluded by banks and corporates and entrepreneurs, while minimising the cost of recovery processes, could help to avoid future build-up of NPLs and increase cross border flows in corporate lending. Any initiative to achieve such a result should maintain a fair balance between debtors' and creditors' respective interests and not be to the detriment of the current level of debtors' protection (in particular as regard specific categories of debtors such as natural persons, households in financial difficulties, consumers).

[1] Reflection Paper on the Deepening of Economic and Monetary Union, 31 May 2017, https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union_en

[2] Communication - Mid-term review of the capital markets union Action Plan https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan_en

As announced in the Capital Markets Union Mid-term Review[3] and also raised in the Commission Reflection paper on Economic and Monetary Union, the Commission will, as part of its efforts to address the NPL issue, look at policies that aim to improve the functioning of secondary markets for NPLs, which would allow banks to sell their NPLs to a larger pool of investors potentially leading to transaction prices that better reflect the underlying value of the assets. This will lead to cleaned up balance sheets of credit institutions, making these better prepared to provide new credit to the economy. As furthermore announced in its Capital Markets Union Mid-term Review, the Commission will also launch an impact assessment with a view to deciding on the need for a possible legislative initiative to strengthen the ability of creditors to recover value from secured loans to corporates and entrepreneurs. In this context, the Commission could explore the merit of an EU new security right called "accelerated loan security".

The Commission services, therefore, launch this public consultation on potential EU actions in the areas of (1) *development of secondary markets for non-performing loans and distressed assets*, which includes the loan servicing by third parties and the transfer of loans, and (2) *protection of secured creditors from borrowers' default*, i.e. the accelerated loan security instrument. .

SECTION I: SECONDARY MARKET FOR LOANS

1. BACKGROUND

Currently, EU markets for distressed debt tend to be characterised by comparatively small trade volumes, a limited number of active investors and large bid-ask spreads. This might reflect various factors, such as significant differences in the required rates of return for banks and investors and in loan recovery expectations, and how servicing costs are taken into account. It is therefore of interest to understand how this market currently functions and gather information on whether, and how, public policy could assist its further development. In particular, it is of interest to ascertain if there are specific impediments that constrain the sale and transfer of loans.

The lack of independent servicing capacity in some markets may hinder the development of liquid secondary markets for loans and especially distressed debt. Hence, developing third party loan servicing capacity, where inadequate, could help the further development of such markets and by consequence NPL resolution. Furthermore, when banks sell defaulted loans, third-party servicers represent an alternative to manage those loans on behalf of investors, which usually do not have appropriate capacity to service NPLs.[4]

The purpose of this public consultation is to enable Commission services to evaluate the practical problems and restrictions that might currently hamper the development of secondary markets for NPLs, and loan contracts more generally, with a view to potentially removing them where appropriate. Stakeholders' responses should help the Commission services to define the problem caused by legal hurdles, estimate the problem's scale and evaluate whether action at EU level to solve the problem would produce greater benefits compared with action at the level of Member States due to its scale or effectiveness.

---

[3] Communication from the Commission on the Mid-Term Review of the Capital Markets Union Action Plan (COM(2017) 292 final), https://ec.europa.eu/info/sites/info/files/communication-cmu-mid-term-review-june2017_en.pdf

[4] Or, in the case of securitization transactions, on behalf of special-purpose vehicles, which do not have this capacity by definition.

2. TRANSFER OF LOANS

Banks may transfer performing or non-performing loans to outside investors in order to manage the composition of their balance sheet, their risks and to allow a potential business model re-orientation. Loan contracts can, in principle, be transferred from the originating creditor to a third-party investor under private law regimes. This is most often done via a sale and transfer agreement with the new creditor, which takes over the original creditor's rights and obligations.

Sales can contribute to strengthening banks' balance sheets and their profitability in the medium to long term, as the transferring bank would not incur the additional administrative expenses and potential additional losses related to the future management of the loans. In addition, removing NPLs from a bank's balance sheet reduces the uncertainty around the bank's asset quality and loan valuations, as uncertainty on possible future losses associated with the NPL portfolio disappears. In the short term, however, the sale of NPLs might in some cases stress the bank's capital position and raise concerns regarding the viability of the bank.

In some cases, acquirers of NPL contracts, including non-banks, may be more effective in recovering value, in particular through the potential use of better management and servicing. Especially some smaller banks may lack the required in-house capacities and internal processes to manage large portfolios of non-performing loans. Moreover, banks and non-bank investors may face a different set of incentives and constraints when managing loans. Banks may be more reluctant to restructure loans to avoid moral hazard and so-called strategic defaults of existing borrowers.

The sale of a loan to a third party can entail a loss of information on the debtor compared to the level of information available to the originating entity. This can be a disadvantage for a third party in the management of these loans. Also a debtor might not be indifferent to the identity and business practices of the creditor. To protect the debtor, but also for other reasons, legal restrictions on the transfer of loans are in place in many Member States.

An important aspect in the functioning of secondary markets for NPLs are the large bid-ask spreads. These reflect, in addition to uncertainties about future cash flows, information asymmetries between sellers and buyers and also first-mover disadvantages/coordination challenges. Together, these factors may significantly constrain the price discovery process. Potential buyers tend not to have access to reliable, granular, readily available standardised information on asset quality and loan tapes in banks. As a consequence, potential buyers may in some cases offer a price that does not reflect the value of portfolios for sale, thus hindering potential transactions.

Questions below are in principle addressed to all stakeholders. However, for some of the questions in particular feedback from legal profession, market participants and borrowers are solicited.

Questions:

1. Would you consider the current size, liquidity and structure of secondary markets for NPL in the EU an obstacle to the management and resolution of NPLs in the EU? If yes, would you consider such obstacle to be significant?
2. What are the key considerations for banks in deciding whether loan sales should be a significant part of their strategy to manage its NPLs?

   In answering please specify

- bank internal factors (i.e. any factors inside the bank including the type and characteristics of the NPL portfolio, management capacity etc.)
- external factors (i.e. any factors outside of the bank

that are important considerations in this context.

3. What would be the best way(s) of attracting a wider investor base to secondary loan markets, especially for non-performing loans?
4. In order to widen the investor base, please specify
   - which incentive(s) should be given?
   - whether certain obstacles to widening the investor base should be removed?
5. What are the specific advantages to the development of secondary markets when the acquiring investor is a bank, an investment fund or another type of entity?

   In particular, would you see specific advantages for
   - helping banks overcome legacy assets;
   - creating investment opportunities for specialised investors?
6. What are the main concerns linked to each of these investor types?
7. What are potential benefits and risks from a public policy point of view when considering the appropriate legal framework for secondary markets for loans, and especially NPLs?

   Please rank the following dimensions (in order of importance):
   - debtor protection,
   - privacy,
   - data secrecy,
   - promoting increased market size and depth and equal treatment of investors
8. How can one best strike the balance between such dimensions?
9. Do differences in these benefits and risks across Member States justify national differences in the framework for secondary markets for loans? If yes, in which way?
10. Would you consider current rules applicable in Member States pertaining to secondary markets for NPL in the EU a significant obstacle to the further development of these markets?
11. What is the most suitable manner to protect a debtor in the case of transfer of a loan and/or collateral by the creditor to a third party?
12. What are the (potential) advantages from specialisation across jurisdictions or asset classes?
13. Are you aware of obstacles to operating in secondary markets across national jurisdictions? Would you consider these obstacles to be significant, and/or influence your geographical scope of business operations?
14. Do you consider that an EU regulatory framework (Directive or Regulation) regulating certain aspects of the transfer of loans would be useful? What are in your view the key elements that should be addressed in such a framework?
15. Please provide any other comments that you find useful in relation to this section.

3. THIRD PARTY SERVICERS

The depth and maturity of the third party servicing industry is considered an important factor for secondary markets. Specialised loan services offered by third-party providers

can reduce maintenance and workout costs. Access to effective servicing platforms may encourage opportunistic investors into becoming recurring buyers, by eventually raising recovery values, e.g. through the beneficial effect of improved access to the information relevant to conduct due diligence.

Deriving profits from NPLs requires relevant expertise to enable effective and efficient management. Leveraging outside expertise from specialised servicing companies can therefore provide significant support. Especially entities with a large share of NPLs could become overstretched, dedicating significant time and resources to the workout of those assets, to the detriment of their core business activities.

Where it is not efficient or possible to build sufficient in-house expertise and infrastructure, internal workout departments could benefit from easy access to dedicated loan servicing companies. Outsourcing to or partnership with one or more specialised servicers in many cases allows to reduce the workload as well as to improve collection performance and operational key performance indicators.

However, account should also be taken of the possible negative impact of certain practices for the protection of the debtors, especially the households in financial difficulties.

Questions below are in principle addressed to all stakeholders. However, for some of the questions in particular feedback from legal profession, market participants and borrowers are solicited.

Questions:

16. What are the advantages of having access to third-party loan servicers in terms of secondary loan market efficiency?

    In particular, do you see specific advantages for
    - helping banks overcome legacy assets;
    - creating investment opportunities for specialised investors?

17. Are there any obstacles for banks and non-bank investors to have access to third-party loan servicers?

    If yes, please specify the nature of these obstacles, i.e.
    - regulatory,
    - legal, or
    - other

18. What are the advantages and risks of outsourcing specific activities to third-party loan servicers compared to internal workout of loans? Please be concrete as to the activities that have been outsourced and why this has proved to be beneficial or not.

19. What are the main risks for debtor protection, in particular for the households in financial difficulties, which are linked (directly or indirectly) with the practices of the third-party loan servicers?

20. In the markets and jurisdictions that are relevant to you, is third-party loan servicing mainly focused on management of performing loans, non-performing loans, or both? Please describe the advantages and drawbacks of both situations.

21. Do, in your experience, third-party loan servicers concentrate on a specific asset class or does their asset mix tend to be more diverse? Please describe the advantages and drawbacks of both.

22. What specific services are offered by third-party loan servicers, in the markets and jurisdictions that are relevant to you?[5] Which services do you consider to be most instrumental in terms of market efficiency? Please be as concrete as possible.

23. Do you consider that a EU regulatory framework (Directive or Regulation) regulating third-party loan servicers would be useful?

    If yes, should such legal framework include rules on
    - the licensing requirements for such servicers;
    - the supervision of such servicers?

    Are there any other elements that should be covered by such a legal framework?

24. Please provide any other comments that you find useful in relation to this section.

4. REMOVING POSSIBLE CONSTRAINTS TO THE DEVELOPMENT OF SECONDARY MARKETS FOR LOANS

Cross-border activities require unique competences and involve unique challenges. Besides the impact of differences in legal regimes across Member States, differences in customer preferences, business practices, etc. can hinder firms from fully realizing their strategic objectives. These impediments can become barriers to market entry and hinder the efficient operation of cross-border institutions. Such hurdles might also stem from legal frameworks or the practical application of such rules.

Questions:

25. Are you aware of significant differences in business practices in different markets and jurisdictions, for example through voluntary codes of conducts, industry standards, etc.? If yes, does this, and how, constitute an obstacle to your business?

26. As a market participant, are you actively partaking in several national markets? If so, do you encounter obstacles to operate internationally in an efficient manner? Please specify.

27. In the markets and jurisdictions that are relevant to you, are there unduly onerous legal restrictions in place:
    a. on the sale of loan portfolios, including to non-bank entities? Please specify these restrictions and their impact.
    b. on banks that want to outsource some or all loan servicing functions to third-parties, including to non-bank entities. Please specify those restrictions and their impact.

    Such undue restrictions could for example concern the areas of debtor protection, privacy, data secrecy, equal treatment of investors.

    If yes, could the removal of such undue requirements be considered? Please specify where such an approach could be contemplated and describe the advantages and drawbacks thereof.

28. What specific aspects could be improved, in order to facilitate existing cross-border activities and/or entry into new markets? Going beyond mere facilitating, what would accelerate the resolution of NPLs?

[5] The range of activities could include debt collection, monitoring loan performance, payment and invoicing services, gathering and developing information, one-stop-shop, full life-of-loan services that include sourcing and structuring of debt and equity, underwriting and due diligence services, etc.

29. Do you consider that the development of a common EU approach would have an added value in the areas of:
    a. the sale and transfer of loans?
    b. loan servicing by third parties?

    If yes, which areas so far regulated under national law should be the focus of such harmonisation efforts? Potential focal points could include third party servicers' licensing regimes, capital requirements, trade secrecy and consumer protection.

    Are there other actions that could be taken at EU level that would yield significant benefits for market efficiency (for example EU guidance or recommendations, the creation of a central register of loan servicers, etc.)?

30. Please provide any other comments that you find useful on this section.

SECTION II: POTENTIAL MECHANISM TO BETTER PROTECT SECURED CREDITORS FROM BORROWER DEFAULT

5. BACKGROUND

When enforcement procedures to foreclose collateral are inefficient or ineffective banks are exposed to a higher risk of accumulation of NPLs, one possible remedy may be to strengthen the capacity to secured creditors to recover value from their security rights swiftly, without being forced to wait for the result of judicial enforcement proceedings that are often suboptimal in terms of timing and recovery rate. These protections are currently not available in all Member States.

In the absence of an out-of-court enforcement mechanism, Commission services would like to explore the merits and demerits of establishing a new kind of loan security, labelled "accelerated loan security". This could be envisaged as an EU contractual instrument to facilitate the effective foreclosure of collaterals. Common provisions to this end would ensure that such secured loan conditions exist on a consistent basis in all Member States.

While foreclosure proceedings are normally of a judicial nature, extra-judicial mechanisms are available only in some Member States. These Member States have (more or less recently) implemented legislative reforms to provide banks with contractual-based security rights which allows for a swift out-of-court repossession of collaterals. Drawing inspiration from these national experiences, the rationale for a possible EU intervention to establish an 'accelerated loan security' would be to ensure that this possibility is available in all Member States. This could prevent the potential emergence of systemic vulnerabilities in the banking systems of Member States which could become a matter for collective concern (in particular within the euro-area).

Sound arrangements of this kind can have significant economic benefits for Member States which adopt them, including fostering the provision of credit by national and foreign lenders and other credit providers. This can promote the development and growth of domestic companies (in particular small and medium-sized enterprises). A greater convergence in EU secured loan enforcement systems could benefit enterprises and consumers by making credit more readily available. More integrated loan recovery systems play also an essential role for EU capital markets to function efficiently, increasing the attractiveness of the EU and the Member States as investment destinations for third-country investors.

The purpose of this public consultation in this area is to enable the Commission to understand the main impediments, gaps, and weaknesses of the pan-European existing legal tools in recovering value for unpaid loans. It will also help the Commission to evaluate the extent to which EU level action represents a more efficient means of completing these gaps and thus delivers results which could not be achieved through action at national level.

6. THE RATIONALE FOR A POSSIBLE EU ACCELERATED LOAN SECURITY

This section presents the rationale for a possible instrument, an "accelerated loan security, which would equip EU banks across the EU with a swift, out-of-court power procedure to recover value from the secured loan in the event of debtor's default. Under the envisaged instrument, the bank would have the right to acquire ownership of the

encumbered assets with a view to satisfying the secured claims through the proceeds of the sale. This would improve the predictability and the timeframes of foreclosure proceedings which is key for the NPLs strategy.

An accelerated loan security could offer banks and their clients a new kind of collateral that might be added to the *spectrum* of securities rights already existing at national level.

Collateral givers would benefit the advantage of increased options to secure their loans and an easier access to finance. At the same time, banks may benefit from their enhanced power to recover and realise value from unpaid loans, safeguarding their priority right faster than in ordinary in-court enforcement. This will reduce risks when granting credits.

If found to be useful, this new loan security could be introduced as a self-standing piece of EU financial legislation (of banking law for instance). Its contractual nature might ensure flexibility as regards the structure of a possible accelerated loan security instrument and be adapted to the different national legal frameworks and the specific needs of the banking system.

By doing so, the architecture of the possible accelerated loan security may require careful balancing to minimise any possible impact on national private law (including property law, pre-insolvency and insolvency law) and public law (including registration system when several and different security rights are created over the same assets).

Questions:

31. Do similar forms of out-of-court enforcement allowing banks to enforce secured loans exist in your country?.

    If yes,
    - please describe these.
    - what are the benefits of these provisions for banks in terms of enforcement and value recovery from NPLs?
    - what are the main risks and challenges arising from these forms of out-of-court enforcement tool?

32. Do you see benefits in ensuring that every Member State makes available an instrument along the lines of the 'accelerated loan security' facility?

33. Do you see the accelerated loan security as a valuable instrument to avoid future accumulation of NPLs in banks' balance sheets?

7. FUNCTIONING OF A POSSIBLE ACCELERATED LOAN SECURITY INSTRUMENT

The accelerated loan security could be designed as a new type of contractual security right over movable and immovable assets to secure a loan granted by a bank to a business. The possible core feature of the EU accelerated loan security could be the "accelerating" clause: once certain conditions are met, the effect of the debtor's default could be the retention or the transfer of the ownership of the movable or immovable assets, given as a guarantee by the debtor, to the bank.[6]

Having acquired the ownership over the encumbered assets, the bank could therefore be in the position to foreclose the collateral (*i.e.* to execute directly the security right) via an

[6] The way to achieve the ownership transfer from debtors to banks may vary on the basis of the different contractual options or statutory rights available under national law (e.g. effect of a loan condition precedent, ordinary autonomous sale agreement linked to the enforcement of the security, retention of title clause, title transfer by way of security etc.).

out-of-court enforcement, without any judicial intervention: should the secured claim not be fully or partially paid, the bank might have the right to directly recover value from the collateral either by selling the assets (in a private sale and not in a judicial auction) or by keeping them.

In both cases, the (minimum) value of the assets may be established in advance by an independent expert, following the criteria that could be set out in the security right or in the loan contract. Whenever the evaluation of the asset leads to a value higher than the debt amount, the bank may have the duty to pay back the difference to the borrower once the asset is sold.

If an accelerated loan security were set up, the balance between debtors and creditors' interests would have to be carefully safeguarded. This implies considering possible advantages of such instruments for debtors - notably for instance, through the possibility of the debtors' full discharge from further repayment obligations, when the recovered value from the sale of assets is lower than the value of the outstanding loan.

On social equity grounds, the case for a more harmonised European approach for secured loans seems potentially more difficult to make for households[7] or consumers particularly if primary family residences are at stake. These considerations are less present in the case of small businesses and corporates.[8] It therefore seems appropriate to exclude some categories of collateral givers (e.g. natural persons, householders, consumers, non-professional borrowers) the scope of an accelerated loan security should be limited to business financial transactions (i.e. loans between banks and entrepreneurs and corporates, excluding consumers). Even for business borrowers, the execution of such an instrument should be limited in respect of certain classes of movable assets and real estate properties (e.g. the main residence of the borrower and other owner's relatives).

Questions:

34. Do you agree with the possible main features of an accelerated loan security as described above?

    If not, what are the features that you do not agree with and why?

35. What are the (additional) features that an accelerated loan security should have in order to enhance its effectiveness in avoiding the encumbrance of bank balance sheets with further NPLs in terms of functioning of the mechanisms?

36. Do you agree with the proposed restriction on the scope of a possible accelerated loan security instrument to loans to businesses and corporates, and on the exclusion of primary residence of borrower even in the case of these loans? Please explain the reasons for your answer.

37. In what ways could an accelerated loan security be rendered potentially advantageous to borrowers to ensure its willing take-up by debtors (e.g. possible discharge of debtors in case the value of the assets becomes less than the debt)?

[7] Especially in case of first-owned houses which are the usual family domicile.

8 Ideally, this security right (known in some Member States as rights in rem) may be limited to loans backed by movable and immovable assets, such as mortgage and pledge (including floating charge and non-possessory pledge) and may not grant creditors any personal right (known as rights *in personam*), such as guarantee or a surety-ship.

8. RELATIONSHIP WITH RESTRUCTURING AND INSOLVENCY FRAMEWORKS

A potential accelerated loan security instrument, along the lines described, would be fully consistent with national laws of insolvency and restructuring, with Commission's proposal on preventive restructuring and second chance launched in November 2016[9] and also with the EU rules on jurisdiction and applicable law in insolvency proceedings (Insolvency Regulation).

The specific features of a possible accelerated loan security as presented so far, namely the automatic transfer of property of the assets to the bank (*i.e.* accelerated clause) and the possibility to recover value from unpaid loans by a private sale of the encumbered assets (*i.e.* out-of-court enforcement), may not affect the national rules and principles of pre-insolvency and insolvency proceedings, which in case of conflict would prevail. Therefore, an accelerated loan security, if introduced, would not prevent those provisions from having their desired effects, thereby maintaining the balance of debtors-creditors' interests and the order of priority of different creditors.

Being based on *sui generis* contractual provisions, an accelerated loan security would not require any harmonisation of Member States insolvency law. This instrument might be designed to face situations where the borrower is in default towards the bank (e.g. because of non-payment of instalments) but before the borrower enters into a restructuring or an insolvency proceeding. In other words, it would be possible to reclaim the accelerated secured loan and to realise the value of the secured assets outside of the insolvency and restructuring proceedings.

Given that an accelerated loan security may allow banks to foreclose their collateral by means of a privileged out-of-court tool, the envisaged measure would *de facto* reduce the value of the debtor's residual assets. As such, the structure of a possible accelerated loan security needs to be articulated very carefully so that it is coherent and consistent with the functioning of pre-insolvency and insolvency frameworks.

This means, for instance, that in situations where a viable debtor is in a preventive restructuring process an accelerated loan security may be suspended and its contractual provisions may not be activated during the "stay" of individual enforcement action[10]. If an insolvency proceeding is opened before the execution of an accelerated loan security, the bank contractual right to foreclose the collateral may not be triggered. Moreover, any possible effect of an accelerated loan security may be consistent with the ranking of creditors in the Member States. For example, it might be assumed that an accelerated loan security would secure loans that are backed by mortgages and pledges (or comparable security rights already existing under national law). In an insolvency proceeding, such accelerated loan security may then have the same ranking position as pledges and mortgages under the applicable national rules.

To make the best use of an accelerated loan security instrument while preserving the integrity of the existing national and EU legal frameworks each Member State would remain free to enable the judge overseeing the insolvency proceeding to allow the bank to sell the goods if deemed useful. For example, the judge might decide, in the interest of the insolvency proceedings, to allow the bank to sell the encumbered asset instead of having the asset sold in a public auction. In this case, the bank would have the obligation to pay back the entire proceeds of the sale and wait to be satisfied under the ranking of

[9] http://ec.europa.eu/information_society/newsroom/image/document/2016-48/proposal_40046.pdf

[10] Art. 6 of the Commission proposal on *preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures* - COM/2016/0723 final - 2016/0359 (COD) http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016PC0723

creditors' rules. This choice might appear particularly desirable in the Member States affected by inefficiency in their judicial insolvency proceeding (because of factors linked to the length of the procedure, the lack of a market in relevant assets, or the strong depletion of the assets' value in case of judicial auction).

Questions:

38. How should an accelerated loan security instrument be designed in order to be consistent with the preventive restructuring framework and the insolvency law of your country (e.g. stay on enforcement actions, cram-down on minority creditors, avoidance actions, ranking of creditors)? In your view, what would be the main obstacles to ensure such consistency?
39. How should an accelerated loan security instrument be designed in order to be consistent with the public and private law rules and principles (including for instance property law, public and private law) of your country? In your view, what would be the main obstacles to ensure such consistency?
40. How should an accelerated loan security instrument be designed in order to be consistent with the existing national collateral legal framework?

NEXT STEPS

The Commission services will carefully evaluate the responses to both sections in this consultation and produce separate summary feedback statements on both sections.