Loan
Market
Association
the authoritative voice
of the EMEA market

10 Upper Bank Street
London E14 5JJ
Tel. +44 (0)20 7006 6007
Fax +44 (0)20 7006 3423
lma@lma.eu.com
www.lma.eu.com

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Dear Sirs

Proposal for a Regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims (Com (2018) 96 final) (the "Proposal").

We refer to the above proposal of the Commission which was put forward for adoption by the EU Parliament and Council on 12th March 2018. The Loan Market Association ("LMA") welcomes the opportunity to provide feedback on this Proposal in accordance with the Commission's request for feedback. The LMA hopes that these comments are helpful to the Commission. They are intended to assist the Commission in achieving the stated aims of the Proposal and the wider aims of the Capital Markets Union Action Plan.

The Loan Market Association

The LMA is the trade body for the European, Middle Eastern and African syndicated loan markets. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 670 organisations across EMEA and consists of banks, non-bank investors, law firms and service providers.

Scope of LMA Feedback

This LMA feedback is only concerned with the effect of the Proposal on the assignment of claims in the context of the European secondary loan trading market. The impact of the Proposal on this area of the financial markets is not mentioned in the Proposal or in its Impact Assessments. However, the implications of the Proposal on this market would be significant and the Proposal could, in our view, disrupt a fully functioning and thriving cross-border European secondary loan market by creating new problems for that market, increasing the complexity of those transactions, lengthening settlement times and adding costs.

The European Secondary Loan Market

Lenders' participations in syndicated credit facilities are regularly sold in the secondary loan market on a cross border basis. A syndicated loan or credit facility is one in which two or more lenders (comprising banks or non-bank investors) together provide credit facilities to a borrower on common terms but not necessarily in equal amounts. Origination and syndication of the loan or credit facility takes place in the primary market; this is where arrangers of the loan or credit facility distribute participations to other lenders/investors. The vast majority of syndicated loan or credit facilities in the EMEA region are made to corporate borrowers of all sizes. The overall EMEA syndicated loan market was approximately €1 trillion in 2017.

Following final allocation of commitments to lenders in the primary market, a lender's participation in the loan becomes "free to trade", subject to the terms and conditions

contained in the syndicated facility agreement and agreed with the borrower. The secondary loan market refers to the sale and distribution of syndicated loans by lenders in the original syndicate and by subsequent purchasers of the loan. The European secondary loan market has aided the growth of the syndicated loan market by opening the market to a wide variety of types of institution, including, non-bank institutional investors, such as fund managers, insurance companies, pension funds and hedge funds, fuelling an increase of liquidity available to borrowers within both the primary and secondary markets. Volumes in the EMEA secondary loan market have ranged between €50 – 60 billion over the last 3 years. Indeed, secondary loan market activity in Europe has been relatively constant since the financial crisis, reflecting the ongoing desire of banks to manage their lending portfolios (realising capital, managing risk, complying with regulatory capital requirements and/or crystallising a loss) and of a variety of investors to participate in this market. The European primary and secondary loan markets are orderly, efficient and liquid markets which are of significant benefit to corporate borrowers looking to raise capital through the loan markets at competitive pricing and as an alternative to other sources of funding.

Assignments of Claims in the European Secondary Loan Market

Lender's participations in syndicated credit facilities are regularly sold in the secondary loan market by way of assignment. Secondary loan trades are typically settled by the lender (assignor):

(a) assigning (i) its rights, but not its obligations, under the facility agreement, including amounts owing to it in respect of outstanding credits; and (ii) if applicable, its right to prove/claim in the insolvency proceedings of the borrower; and

(b) transferring both its rights and its obligations under the facility agreement or novating such rights and obligations so that the lender ceases to be a lender and the purchaser becomes the lender in its place.

It should be noted that although in the case of an assignment described in paragraph (a) above, the market standard forms of assignment do not involve a corresponding transfer of obligations vis à vis the borrower; the assignee would usually be required to undertake the same obligations as the assignor vis à vis the other lenders to ensure, for example, the principle of pro rata recoveries amongst the syndicate of lenders is retained. In the case of a transfer described in paragraph (b) above, the market standard form of transfer documentation will involve a transfer of both the lender's rights and its obligations vis à vis the borrower and all other parties to the facility agreement.

The definition of "assignment" in the Proposal includes, "*a voluntary transfer of a right to claim a debt against a debtor*" and the definition of "claim" includes "*the right to claim a debt of whatever nature*". In the case of method of settlement described in paragraph (a) above, such assignments fall comfortably within the remit of the Proposal and will therefore be subject to its new conflict of laws rule. In the case of the method of settlement described in paragraph (b) above, we note the Explanatory Memorandum and the Impact Assessments and the preamble to the Proposal state that it "*does not cover the transfer of contracts (such as derivative contracts), in which both rights (or claims) and obligations are included, or the novation of contracts including such rights and obligations*" – however, it is not clear from the definition of "assignment" whether such method of settlement is excluded by the Proposal as there is no express exclusion of transfers (by way of assignment or otherwise) of both rights and obligations relating to a claim.

When a participation in a syndicated credit facility is sold by way of assignment by a Lender (assignor) in accordance with one of the settlement methods described above, participants in the European secondary loan market would currently only look to the law of the assigned claim (so the governing law of the facility agreement) to ascertain, not only its effects in relation to contractual matters but also in relation to its effects as against third parties. Therefore, participants in the European secondary loan market only look to perfect their assignment in accordance with the laws of the assigned claim. This practise has provided legal certainty and created stability and thereby encouraged cross border investment in this market. It is important to be aware that this practise is facilitated by the fact that assignees in the European secondary loan market are, in the vast majority of cases, provided with a copy of the underlying facility agreement as part of their due diligence processes and so are always able to ascertain the governing law of the facility agreement. Given that only one facility agreement is involved in a secondary loan trade (as opposed to a bundle of facility agreements), this practise makes eminent legal and commercial sense for this market. Accordingly, it is not current market practice for any perfection steps to be carried out in accordance with the laws of the "habitual residence" of the assignor or indeed any other laws other than the law of the assigned claim.

Introducing the "habitual residence" of the assignor as the connecting factor for the resolution of proprietary disputes in the context of assignments of claims in the European secondary loan market would be a significant departure from current market practice and the current legal analysis applied by market participants to such assignments. Its application to these assignments of claims would, in our view lead to the following outcomes:

1. Assignees would be required to investigate the perfection requirements under the laws of the habitual residence of the assignor as well as investigating the laws of the assigned claim. This would be harmful to the European secondary loan market given that this market already has a settled practise to look to the law of the assigned claim. Seeking the additional advice in relation to the law of the habitual residence of the assignor will incur additional costs which could be considerable. Furthermore, the perfection steps that would need to be taken could cause additional expense. In a worst case scenario, these additional costs may make transactions uneconomic and reduce activity in this market.

2. Settlement times would be delayed whilst advice is sought as described in 1 above and whilst the additional perfection steps are complied with. This would undermine the efficiency of this market which is currently working hard to reduce settlement times.

3. Participants in the European secondary loan market may decide that the increased costs and lengthened settlement times resulting from the Proposal are unworkable and choose to ignore the new conflict rules. Participants may therefore go ahead with the transaction without seeking appropriate advice and without taking appropriate perfection steps. This would introduce legal uncertainty and would not have the desired effect of eliminating legal risk or avoiding unexpected losses.

4. A participation in a syndicated credit facility is regularly sold by way of assignment in the European secondary loan market a significant number of times on a cross-border basis. This distinguishes these types of assignments from those made in a factoring or a collateral context. The habitual residence of each assignor in the chain of assignments of a single claim could (and indeed is likely to) be different. If applied to

assignments of debt claims in the European secondary loan market, the Proposal would result in added complexity to a chain of assignments of the same claim because the perfection requirements for each assignor in the chain could be different. In such a chain of assignments the risks associated with the assigned claim would increase with each assignment of that claim. This would in turn cause legal uncertainty, undermine the stability and smooth functioning of this market and would not encourage cross border investment in it.

5. Purchasers (assignees) of participations in a syndicated credit facility may purchase participations in the same credit facility by way of assignment from different lenders (assignors). At present, assignees only have to consider the perfection requirements of the law of the underlying claim (which is currently the same for all assignments of the same debt claim). The Proposal would result in the purchaser (assignee) also having to perfect each assignment in the jurisdiction of the habitual residence of each assignor. This adds unnecessary complexity to assignments of debt claims in a secondary loan trading context but may also result in some lenders (assignors) being seen as more attractive because the perfection steps required in their habitual residence are minimal, less costly and/or less time consuming than those in the habitual residence of other lenders.

It is accepted that the harmonisation of the conflict of laws rules by using the habitual residence of the assignor as the primary connecting factor is intended to create certainty over the proprietary effects of assignment of claims across the EU given the inconsistency of national conflicts of laws rules in this area. In the context of assignments of claims used in factoring and as collateral/security, this may be helpful. However, in the context of assignments of claims in the European secondary loan market, the practise of that market is already harmonised by the current market expectations and the assumptions that the governing law of the assigned claim would apply to resolve disputes over who has superior title to that claim. The Proposal in its current form therefore has the potential to disrupt a fully functioning, settled and thriving cross border European secondary loan market by creating new problems for that market, disrupting settlement times and making cross border assignments of these claims more complex and more costly. This would be contrary to the Commission's stated aims for the Proposal.

Proposed Exception

In view of the above and the potential disruption that the Proposal would cause to the European secondary loan market, we would like to suggest that assignments of debt claims against borrowers arising out of syndicated credit facilities and carried out in the European secondary loan market should be granted an exception to the habitual residence rule. The reason for this, as explained above, is that there is already a harmonised approach to the question of the third party effects of cross-border assignments of claims in the secondary loan market based on the governing law of the assigned claim. As with the third party effects of the assignment of cash credited to an account in a credit institution and claims arising from a financial instrument, any exception granted to the secondary loan market should reflect the basis on which that market has generally been operating and the expectations of all participants in that market. Accordingly, the LMA would propose that for assignments of debt claims in the European secondary loan market, the law governing the assigned claim (i.e. the facility agreement) should be the harmonised connecting factor to resolve the third-party effects of such assignments. As with the existing three exceptions already laid down in the Proposal, this would involve laying down a specific conflict of laws rule for these

assignments of claims. This could be achieved by adding the following as a new sub-paragraph (c) to paragraph 2 of Article 4 (Applicable law) of the Proposal.

"(c) *claims arising out of a syndicated facility agreement.*"

Clarification

"*Rights and obligations*"

As mentioned above, the definition of "assignment" in the Proposal is extremely wide. It is of particular concern to the European secondary loan market to understand whether transfers of both rights and obligations under a facility agreement and novations of such rights and obligations such that in each case the lender ceases to be a lender and the purchaser becomes the lender in its place are intended to come within the ambit of the Proposal. On the basis of the Explanatory Memorandum, the Impact Assessments and paragraph (17) of the preamble to the Proposal, it would appear they are not intended to be caught but this is not borne out by the wide definition of "assignment" used in the Proposal. In this regard, we refer you to the suggested amendment to Recital 17 contained in the Draft Report of the Committee on Legal Affairs of the European Parliament dated 3.5.2018. It is suggested in such report that Recital 17 should be amended to clarify that the conflicts of law rule in the Proposal also covers transfers of rights and obligations as well as novations of contracts. No corresponding amendment has been suggested to the definition of assignment which points to a wide interpretation having been given to it.

This is of concern because participants in the European primary and secondary loan markets operate on the basis that the validity of these types of contractual arrangements, which result in the original lender being replaced by a new lender, as well as their effect *vis a vis* third parties are determined in accordance with the law of the rights and obligations so transferred or, as the case may be, novated (so the governing law of the facility agreement). Participants in the European primary and secondary loan markets do not, in addition, look to the law of the habitual residence of the transferring/novating lender to assess the validity of the transfer/novation as against third parties.

Clarity on this would be welcome to ensure that the new conflict rules generally (and not just in the European secondary loan market) do not apply in circumstances when both a claim and the obligations associated with that claim are transferred. This could be achieved by adding the following to the end of the definition of "assignment".

> "*but does not include any such transfer if corresponding obligations in relation to that claim are also transferred or assumed by the assignee.*"

If however the Commission intends the Proposal to cover transfers and novations, we would suggest that the exception for claims arising out of a syndicated facility agreement proposed above also apply to transfers or novations of debt claims.

Article 5(d) and (e)

Further complexity is added to the European secondary loan market as a result of Article 5(d) and (e) of the Proposal. As previously mentioned, lenders participations in syndicated credit facilities are regularly transferred by way of novation as well as by way of assignment. It is unclear how Article 5(d) and (e) are intended to work in this context. For example, if a

lender sells its participation in a facility agreement by novation it would effect this in accordance with the mechanism provided in the facility agreement. This is standard in the European secondary loan market. Such novation would be effected on the assumption that the law of the facility agreement would govern proprietary disputes that may arise in respect of that novation.

Article 5(d) and (e) would appear to extend the reach of this Proposal beyond the third-party effects of assignments of debt claims in the European secondary loan market to also include "transfers of contract" and "novations of contract" of the same loan participation. The Explanatory Memorandum states that the Proposal also designates the law applicable to possible priority conflicts over a claim first assigned and then transferred again (the same claim or economically equivalent claim) by means of a transfer of contract or a novation of contract. A lender purchasing a loan by way of novation would therefore also need to perfect the novation in accordance with the laws of the habitual residence of the lender of record to ensure its validity in the unlikely event of a proprietary dispute arising with an assignee of the same loan participation. For the same reasons described above, this would add unnecessary costs to participants in the European secondary loan market, would increase settlement times and would create legal uncertainty. This further reinforces the need for the exception described above for the European secondary loan market.

The LMA would like to thank you for taking the time to consider our feedback. The LMA would be pleased to answer any questions you may have, and to meet with you if you would like to discuss with us any of the points raised.

Please therefore do not hesitate to contact me by email at Nicholas.Voisey@lma.eu.com or on +44 (0)20 7006 5364 to arrange a meeting or should you require further detail on the issues raised.

Yours faithfully

N A Voisey

Nicholas Voisey
Managing Director