LMA | Loan Market Association

14 March 2023

Sent via online submission
https://commission.europa.eu/

Dear Sir or Madam,

Loan Market Association response to the European Commission proposed directive on harmonising certain aspects of insolvency law

The Loan Market Association ("**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 800 organisations across 65 jurisdictions and consists of banks, non-bank investors, borrowers, law firms, rating agencies and service providers.

We welcome this opportunity to provide feedback upon the Commission's proposed Directive harmonising certain aspects of insolvency law 2022/0408 (COD). Our members are supportive of the objectives to improve the efficiency and speed of national insolvency regimes, the ability to recover assets from the liquidated insolvency estate and a predictable and fair distribution of recovered assets. These are all key considerations taken into account in the transactions that our membership is regularly involved with, and we are therefore supportive of further harmonisation that promotes cross-border investment and preserves the value of those transactions.

The LMA as you know has previously articulated its support for further harmonisation, and we are pleased to see that aspects of insolvency law that we consider conducive to further harmonisation form part of the draft proposal including that it is being pursued expeditiously and by way of an EU-wide directive. Of course we appreciate that the proposed directive will need national implementation and therefore such implementation will provide greater detail, however we do think that it is important that the parameters of the directive are clear, so that the harmonisation objectives are properly realised. In particular, as recognised in the introductory remarks and the preamble to the proposal, it is important that the directive is coherent with other EU legislative frameworks.

Taking each of the aspects of the proposal in turn, we have the following feedback:

Avoidance actions

We think that the harmonisation by way of introduction of certain minimum standards makes sense for avoidance provisions, although the proposal will still permit variances where national law measures go beyond the minimum standards, and this may mean that such differences will still be a factor in the costs, pricing and risk assessment of providing credit and investment. Further, while we note that in the context of preferences there are some protections for contracts which currently fall under the protections of financial collateral directive and the settlement and finality in payment and securities settlement systems directives, we note that these are not extended to other avoidance actions (e.g. transactions at an undervalue) and even the protections currently articulates for preference actions may not extend to all netting and derivative contracts which form an important role in the management of financial risk. We think it is important that the protections are expanded. In particular so that the proposal is coherent with the other directives.

Tracing assets belonging to the insolvency estate

Access to and searches of bank account information by designated courts

While we appreciate that the court's ability to access and search bank account information is limited to the national centralised bank account registry established pursuant to article 32a of the Directive (EU) 2015/849, and must be upon a formal application to the court by the appointed insolvency officeholder, we are concerned that the practicalities of access to that information with the court acting as a gateway, may not always result in a significant increase in the level of recoveries, and could contribute to additional costs in seeking access to that information. We also query the additional burden this may place on the court in terms of its effective monitoring of access to the register.

Access to beneficial ownership information and access to national asset registers

While we consider that providing access to insolvency practitioners to this kind of information might be useful in terms of tracing assets, we query how much it will enhance the recoveries to insolvent estates where it is often the case that debtors wishing to thwart the insolvency process, may also be less likely to have complied with their obligations to make the necessary disclosures to the registers in the first place. Where the appropriate disclosures have been made, having access to the registers may reduce the costs in the diligence required in formal insolvency processes.

Pre-pack proceedings

We have a number of concerns in respect of this aspect of the harmonisation. Firstly, we assume that the cross reference in article 23 of the proposed directive to the articles 6 and 7 of the Restructuring Directive is intended to include the same carve outs for netting arrangements, but confirmation of this would be welcomed.

We are concerned that the ability to assign executory contracts in article 27 of the proposed directive in conjunction with a pre-pack but without the consent of the counterparty may inadvertently extend to financial contracts. We think that the wording of the directive therefore ought to make it clear that such arrangements are not included.

We are also concerned that there are no express protections for secured creditors in respect of the provisions relating to the ability to release debts and liabilities as set out in article 28 of the proposed directive. Further where interim finance is provided, it is unclear as to whether this ought not to be to the detriment of existing secured creditors, which we assume to be the case, but article 33(1)(c) is unclear. Such provisions also appear to be at odds with the provisions in article 34 which look to replicate protections for those with security interest in line with their treatment in a winding up. Although even article 34(4) suggests that the requirement for creditor consent to release security can be overridden as long as the secured assets relate to assets that are "necessary for the continuation of the business", and either the creditor's best interest test is met or the secured creditor fails to make a better offer. In particular it is not clear which security interests are exactly meant when referring to security interests that "encumber the business". Such terms should be further defined to avoid any interpretation issue as their meaning may vary from one Member State to another. Moreover, it is usually when the value of the claims is above the market value of the business that there is an appetite to enforce or participate in acquiring such assets. There is also a lack of clarity in article 33(3) in terms of credit bids. Does this mean that credit bid can only form part of the consideration, or does this mean that such bids will be considered less favourably than cash bids of a lower value?

In the context of liquidation, ordinarily, one expects that the secured creditor maintain its priority and entitlement in the waterfall to any proceeds of realisation. While the proposed directive also states in article

19 that the pre-pack proceedings will comply with the ranking of claims and rules on distribution of proceeds, as mentioned and in article 34(4) they may be released. It is not entirely clear how this will operate in practice. If the assets are sold free of any 'security' it seems like the onus is on the secured creditor to challenge the pre-pack before the sale, we assume this includes the ability to question the value placed on those assets, or any security?

Directors' duties to request opening of insolvency proceedings

Imposing a mandatory minimum mandatory filing period and imposing personal liability for losses incurred as a result, may for some jurisdictions be a very significant shift, and while we hope that it will encourage distressed entities to seek early assistance in addressing solvency issues, it could have a negative impact and trigger premature filings. We query how this will operate in practice with the Restructuring Directive, in particular in the context of situations where pursuing a rescue may be more appropriate but cannot be achieved within the mandatory time period.

Winding Up of Microenterprises

The proposals seem sensible and a cost effective way of dealing with such entities, in particular including the provisions of a standard form entry and an electronic auction platform. We do have some concern that the simplified process may be considered too debtor friendly and ought to include more creditor safeguards to prevent abuse. Without appropriate safeguards, the procedure may negatively impact the approach to investment and the provision of credit to such enterprises. This may have been what was intended by the limited protections contained in articles 42(3) (creditor challenge to open the procedure), 43(4) (approval for disposals, where there is no insolvency practitioner appointment) and 44(2) (exemptions from the stay). But it is not entirely clear and in fact simply shifts the burden of costs in terms of challenge to the creditor, who will be already exposed to a loss. Given the nature of these entities, perhaps it is envisaged that the process will be largely followed as an administrative process facilitating closure. However, given the fact that the simplified procedure is designed to a discharge of the debtors, owners, members and founders, perhaps some deterrent against potential abuse might be useful?

Creditors' committees

We welcome the ability for creditors to participate in creditors' committees. As the proposal recognises such committees will not be appropriate in all cases, but especially in complex and high value cases may be a useful way of ensuring the process is conducted appropriately.

Measures enhancing transparency of national insolvency laws

The key information factsheet will be useful resources for creditors and other stakeholders, not just in understanding the myriad of difference insolvency procedures and their effects, but also making risk, cost and return assessments more cost effective.

Conclusion

We hope that you will find our feedback constructive, we would be delighted to assist the Commission in the furtherance of the proposed directive. Should you wish to discuss any aspect of this response further, please contact Nicholas Voisey (nicholas.voisey@lma.eu.com or +44 (0)20 7006 5364).