Legal Aspects of the Enforcement of Non-Performing Loans in Europe

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I hereby declare that the work submitted is mine and that where I have made use of another’s work, I have attributed the source(s) according to the Regulations set in the Student’s Handbook.

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During this wonderful journey, my family and friends have accompanied me, surrounding me with love, emotional support and encouragement. Therefore, I dedicate this work to Dionysis, Stella, Liana and Stefanos, as a minimum expression of my gratitude to them.

‘Like the water, submerse into the wild depth of your soul, calm and spurt reborn, crystal clear and enlightened.’

K.M.P.
Abstract
This dissertation was written as part of the LLM In Transnational And European Commercial Law, Banking Law, Arbitration/ Mediation at the International Hellenic University.

The present paper discusses the accumulation of Non-Performing Loans (NPLs) on banks’ balance sheets, particularly after the recent financial crisis and recurrent recessions, which adversely affects banks’ performance and intensifies systemic risk. For this reason, bank-specific measures and systemic-wide policy initiatives have been proposed and followed, with the objective of effectively managing existing high stocks of NPLs and preventing their future excessive build-up. Particularly in Europe, various policy actions have been adopted in an effort to effectively address this legacy of the crisis. Such legislative initiatives are complementary and form a comprehensive package, aimed at enhancing the Banking and Capital Markets Union, thus promoting the establishment of an integrated Economic and Monetary Union. Within the Council’s Action Plan and the Commission’s NPL legislative package, there has been proposed a Directive on a common distinct accelerated extrajudicial collateral enforcement mechanism, which enables credit institutions to efficiently recover value from the collateral pledged in secured business loans out-of-court. The contractual agreement on the voluntary use of this debt recovery mechanism shall constitute a directly enforceable title and collateral enforcement shall be expedited, under specific formalistic conditions. However, certain legal aspects of the proposed enforcement procedure are being questioned. The analysis of the extrajudicial enforcement framework highlights its deficiencies and the dangers it entails, particularly with respect to its potentially detrimental effects on debtors’ interests. Since the proposed mechanism appears greatly disruptive to the existing ‘traditional’ collateral enforcement procedures, its consistency with national pre-insolvency and insolvency proceedings and the Financial Collateral Directive is being discussed in this paper. Concluding remarks summarise the author’s opinion on the future of collateral enforcement of NPLs in Europe.

Keywords: Non-Performing Loans, enforcement, extrajudicial, collateral

Platsa Kyriaki Marina
31/01/2019
## Abbreviations

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<th>Abbreviation</th>
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<tr>
<td>AECE</td>
<td>Accelerated Extrajudicial Collateral Enforcement</td>
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<td>AMCs</td>
<td>Asset Management Companies</td>
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<td>BRRD</td>
<td>Bank Recovery and Resolution Directive</td>
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<td>CRR</td>
<td>Capital Requirements Regulation</td>
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<tr>
<td>EBA</td>
<td>European Banking Authority</td>
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<td>EBF</td>
<td>European Banking Federation</td>
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<td>ECB</td>
<td>European Central Bank</td>
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<td>ESRB</td>
<td>European Systemic Risk Board</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>EMU</td>
<td>Economic and Monetary Union</td>
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<td>FCD</td>
<td>Financial Collateral Directive</td>
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<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<td>NPL(s)</td>
<td>Non-Performing Loan(s)</td>
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<td>SMEs</td>
<td>Small and Medium-Sized Enterprises</td>
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<td>SRMR</td>
<td>Single Resolution Mechanism Regulation</td>
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I NON-PERFORMING LOANS IN EUROPE

1. Non-Performing Loans

High levels of public and private debt inherited from the recent crisis have resulted in excessive stocks of ‘Non-Performing Loans’ in the banking sector, i.e. loans designated as being default or with a very high likelihood of default.

1.1. Definition of Non-Performing Loans

The term ‘Non-Performing Loan’ (hereafter ‘NPL’) refers to a loan where the borrower, either a company or a physical person, is not able to repay a bank loan, i.e. to make scheduled payments of the agreed instalments to cover interest or capital reimbursements. Loans are deemed to be non-performing (non-current) when ‘any scheduled loan payment is past due for more than 90 days’. A loan can be non-


2 A borrower may be a natural person, acting as entrepreneur or as a consumer-householder. This distinction between professional and non-professional borrowers will be crucial in Chapter III, as the proposed Accelerated Extrajudicial Collateral Enforcement Mechanism shall be available only if contractually agreed upon between the bank creditor and the secured business borrower, i.e. a company or an entrepreneur, with the explicit exclusion of consumer loans from its scope of application.


4 See: Commission Implementing Regulation (EU) 2015/227 of 9 January 2015 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council, Text with EEA relevance, OJ L 48, 20.02.2015: ‘NPLs denote loans where the borrower is unable to make the scheduled payments to cover interest or capital reimbursements. When the payments are more than 90 days past due, or the loan is assessed as unlikely to be repaid by the borrower, it is classified as an NPL’. Also, see: ‘Non-Performing Loans: Council approves position on capital requirements for banks’ bad loans’, Press Release 594/18, Council of the EU, 31.10.2018. Also,
performing, not only because it is past due, but also because it is considered unlikely-to-pay in the future, albeit it is still paying currently. In this case, the loan is assessed as unlikely to be repaid by the borrower from a forward-looking approach\(^5\), thus also classified as non-performing\(^6\).

1.2. Non-Performing Loans and banks’ performance
Credit assets are generally evaluated based on their quality, i.e. the borrower’s initial credibility, their performance and the possibility of lender’s further recourse\(^7\) to the borrower. For instance, loans are considered to be of subprime credit quality according some criteria related to payments and borrower’s course of business\(^8\).

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see: ‘What are Non-Performing Loans (NPLs)?, ECB, 12.09.2016, available at: https://www.ecb.europa.eu/explainers/tell-me/html/npl.en.html: ‘A bank loan is considered non-performing when more than 90 days pass without the borrower paying the agreed instalments or interest’. Non-Performing Loans are also called ‘bad debt’.\(^5\)

Creditors are not expected to receive the full value of loans designated as non-performing. In cases where the bank still receives full payment from the borrower without excessive delay, the losses for the bank are in general expected to be lower, thus lower loss coverage is applicable. The new accounting standards, IFRS 9, effective since January 2018, replace the existing ‘incurred loss model’ (IAS 39 model) with a three-stages ‘forward-looking model’, resulting in the earlier recognition of credit losses.\(^6\)


Non-Recourse Loans, for instance, are loans in which the lender may not have recourse to the borrower after foreclosure, when the realised price from the sale of the mortgaged property is insufficient to cover the outstanding debt. See: Felsenheimer J. & Gisdakis P. (2008), Credit Crises: From Tainted Loans to a Global Economic Meltdown, WILEY-VCH Verlag GmbH & CO KgaA, Weinheim, pp.72-76.\(^7\)

Namely, when two or more loan payments paid past 60 days due in the last 12 months, one or more loan payments paid past 90 days due in the last 36 months, judgement-foreclosure-repossession-non-payment of a loan in the prior 48 months, bankruptcy in the last 7 years. See: Felsenheimer J. & Gisdakis P. (2008), pp.72-76.\(^8\)
NPLs are considered to be credits no longer accruing income\(^9\), in need for restructuring to reflect borrowers’ modified circumstances. Loans classified as non-performing are recorded on banks’ books\(^{10}\) with the deduction of any accrued and not actually received interest from loan revenues, until cash payment is actually realised\(^{11}\). Similarly, Non-Performing Assets are income-generating assets, including loans, which are past due 90 days or more. Charge-offs are loans declared worthless and written off the lender’s books. When ratios of Non-Performing Exposures\(^{12}\) rise, credit risk\(^{13}\) exposure also grows and failure of a lending institution may be imminent\(^{14}\).

High stocks of such NPLs thus adversely affect a bank’s short- and longer-term performance\(^{15}\), as they reduce net interest income, they increase impairments costs

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\(^{10}\) According to paragraph 148 of Commission Implementing Regulation (EU) No 680/2014, the classification of exposures as non-performing should be done without taking into account the existence of any collateral. Consequently, fully collateralised exposures in unlikely-to-pay situations should be classified as non-performing, even when it is assumed that the customer is willing to realise the collateral on a voluntary basis in order to avoid a legal enforcement by the credit institution.


\(^{12}\) ‘Non-Performing Exposures (NPEs) include NPLs, non-performing debt securities and non-performing off-balance-sheet items. NPLs represent the largest share of NPEs and this term is commonly used as *pars pro toto*. See: CRR II, Explanatory Memorandum, p. 1 and Article 47(a) on Non-Performing Exposures.

\(^{13}\) Credit risk is the probability that some assets of a financial institution, particularly its loans, will decline in value and become worthless. See: Rose, P.S. & Hudgins, S.C. (2010), p.137.


and they result in lower ratings and increased cost of funding. Furthermore, they require higher levels of provisioning to cover incurred and expected losses. Such default loan provisions reduce bank profitability and reduce the bank's regulatory capital. In case of excessive build-up of NPLs, financial fragility may endanger the mere viability of the affected institutions and consequently the financial stability of the whole economy. Moreover, NPLs occupy significant amounts of a bank's resources, both human and financial. Additional management time and servicing costs reduce the bank's risk appetite for new lending and its capacity to provide financing to the real economy, particularly to Small and Medium-Sized Enterprises (SMEs), which rely heavily on bank lending, with grave implications to the economic growth and job creation of a country.

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16 Additional capital requirements for high-risk weighted assets under ‘Pillar I’ of the Capital Requirements Regulation.

17 See: Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union, COM (2017) 592 final, 11.10.2017, p. 15 [hereafter: Communication to complete the Banking Union]: ‘Non Performing Loans weigh on the profitability and viability of affected banks and thereby constrain those banks’ ability to lend and might ultimately hamper economic growth’. Also, see: Commission Staff Working Document: Impact Assessment ‘Accelerated Extrajudicial Collateral Enforcement’ (Part 2/2), SWD/2018/76/final, 14.03.2018, accompanying the document “Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral”, COM/2018/135/Final [hereafter: Impact Assessment, Part 2/2]: ‘High levels of Non-Performing Loans (NPLs) affect financial stability as they weigh on the profitability and viability of the affected institutions and have an impact, via reduced bank lending, on economic growth’. Also, see: the Proposed Directive, Explanatory Memorandum, p. 1. Also, see: ‘What are Non-Performing Loans (NPLs)?, ECB, 12.09.2016, available at: https://www.ecb.europa.eu/explainers/tell-me/html/npl.en.html: ‘When customers do not meet their agreed repayment arrangements for 90 days or more, the bank must set aside more capital on the assumption that the loan will not be paid back. This reduces its capacity to provide new loans. To be successful in the long run, banks needs to keep the level of bad loans at a minimum so they can still earn a profit from extending new loans to customers. If a bank has too many bad loans on its balance sheet, its profitability will suffer because it will no longer earn enough money from its credit business. In addition, it will need to put money aside as a safety net in case it needs to write off the full amount of the loan at some point in time’. 
1.3. Secured and unsecured loans

Loans in general may be secured or unsecured. In secured loans\(^{18}\) the borrower pledges to the creditor a collateral in the form of movable or immovable assets (by mortgages, pledges and other comparable contractual or legal devices), in order to secure the credit against the possibility of default. In the case of NPLs secured by immovable collateral (commercial or residential real estate), it can be reasonably assumed that immovable property will have a remaining value for a longer period of time after the loan turned non-performing. Thus, a lower loss coverage level is required in this case. On the contrary, unsecured NPLs require higher and timelier minimum loss coverage to ensure banks’ financial soundness, because they are not backed by collateral or guarantees. Overall, secured NPLs are less risky than unsecured NPLs, as they give banks a specific claim on an asset or against a third party\(^{19}\).

2. Non-Performing Loans and the recent financial crisis

The recent global financial crisis of 2007-2009 and ensuing recessions, along with numerous micro- and macro-economic variables\(^{20}\) and structural factors, sometimes

\(^{18}\) See: Article 3 para. 1, point (6) of the Proposed Directive: ‘secured credit agreement’ means a credit agreement concluded by a credit institution or another undertaking authorised to issue credit, which is secured by either of the following collateral; (a) a mortgage, charge, lien or other comparable security right commonly used in a Member State in relation to immovable assets; (b) a pledge, charge, lien or other comparable security right commonly used in a Member State in relation to movable assets’.

\(^{19}\) See: CRR II, Explanatory Memorandum, p. 11.

accompanied by inadequate loan origination practices\textsuperscript{21}, predatory lending practices, poor supervision and short-terminism in banks’ corporate governance, have resulted in high levels of Non-Performing Loans, with significant adverse impacts on banks’ \textit{profitability} and \textit{their ability to lend}, particularly to small and medium enterprises (SMEs). The inability of borrowers to pay back their loans was also aggravated during the subsequent recessions and prolonged economic downturn. Phenomena as the dreadful declines in income, unemployment, high interest of housing/entrepreneurial credit, aggressive credit promotion practices, as well as unfortunate events in borrowers’ life, along with the absence of consultative support institutions have created over indebted, high-leveraged borrowers, facing increased incidents of bankruptcy or continued payment difficulties.

As a consequence, many banks suffered an excessive build-up of NPLs on their books and they found themselves unable to recover the value of their credit. Commission’s reports on NPL trends in Europe appear optimistic, however NPL amounts and ratios


have been detrimental to the economies of Member States individually and the internal market as a whole\textsuperscript{22}, while they have incurred heavy costs for taxpayers\textsuperscript{23}. NPLs reaffirm the general economic and social dysphoria and disorder: they reflect the aggravated social consequences of the financial crisis, which hamper the consolidation of the internal market from an economic point of view and may be even considered unacceptable from a social, human-centered perspective\textsuperscript{24}.

\textsuperscript{22} For further statistic information, see: First Progress Report, which reported a downward trend, a total volume of NPLs amounting to €950 billion and uneven NPL ratios within the EU (ranging from 0.7% to 46.9%); Second Progress Report, which reported a continuously falling trend of NPL ratios, improved quality of banks’ loans portfolios, a total volume of NPLs amounting to €910 billion (still, well above pre-crisis levels) and uneven NPL ratios within the EU (ranging from 0.7% to 46.7%); Reflection Paper, Annex III, p. 35, Table ‘Trends in the share of Non-Performing Loans as a share of total gross loans’: ‘The rise of Non-Performing Loans – loans that are in default or close to it – in the balance sheet of banks is both a symptom of the crisis years and a source of vulnerability. These loans are much more prevalent in southern European Member States than elsewhere in the euro area’. Also, see: Communication to complete the Banking Union, p. 15, Table ‘Gross non-performing debt instruments’: ‘It is a good sign that levels of Non Performing Loan are going down. Even in the most affected Member States, levels of Non Performing Loan have been materially reduced. This trend should be accelerated, and the build-up of new Non Performing Loans must be prevented’. Recently, the Third Progress Report, p. 7, reported a steady decline trend of NPL ratios, with a total volume of NPLs amounting to €820 billion (near pre-crisis levels) and uneven NPL ratios within the EU (ranging from 0.6% to 44.9%).


\textsuperscript{24} See: Opinion of the EESC, point 3.5: ‘The EESC draws attention to the social consequences of the financial crisis in terms of exclusion, social justice and obstacles to the completion of the internal market. In some Member States, NPLs are a reflection of how severely families and SME entrepreneurs have been affected, including being at risk of losing their homes or subject to foreclosure’ [italics by the author].
3. Addressing Non-Performing Loans

For all the aforementioned reasons, there has been acknowledged the urgency of addressing the risks related to this ‘legacy of the crisis’ and preventing its re-emergence. Addressing high stocks of NPLs may include various ad hoc (bank-specific) measures or system-wide policy initiatives.

3.1. Management and resolution of Non-Performing Loans (bank-specific measures)

Credit institutions develop comprehensive strategic plans based on best practices for effectively managing and resolving NPLs, such as setting up separate dedicated in-

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26 Strategy shall differ for each asset class (retail loans – consumer and mortgage loans on one hand and non-retail loans – commercial real estate, SME and corporate loans on the other) and be realistic and achievable by creating sustainable long-term workout solutions in a capital-efficient and cost-effective manner. Consulting agencies design and implement NPL strategies for their clients, while they publish guideline brochures on their NPL management methodology. Indicatively, see: Alvarez & Marsal (2016), Best Practices for Effectively Managing Non-Performing Loans; Deloitte, CEE NPL markets in full swing: A record year in 2016; PwC (September 2017), Non-performing Loans: Leveraging the right strategy to optimise your company’s balance sheet; Grant Thornton (2018), Non-Performing Loans (NPLs): The challenges, opportunities and our services. Also, the ECB has published a ‘Draft guidance to banks on Non-Performing Loans’ (September 2016), available at: https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/npl/npl_guidance.en.pdf, see mainly: Annex V- Common NPL-related policies, pp. 107-112.

27 About the factors influencing the design of the best NPL strategy, see: ‘Draft guidance to banks on Non-Performing Loans’, ECB, September 2016, p.10: ‘National as well as European regulatory, legal and judicial frameworks influence the banks’ NPL strategy and their ability to reduce NPLs. […] Therefore, banks need to have a good understanding of the particularities of legal proceedings linked to the NPL workout for different classes of assets and also in the different jurisdictions in which they operate where high levels of NPLs are present. In particular, they should assess: the average length of such proceedings, the average financial outcomes, the rank of different types of exposures and related implications for the outcome (for instance regarding secured and unsecured exposures), the influence of the types and ranks of collateral and guarantees on the outcomes (for instance related to second or third liens and personal guarantees), the impact of consumer protection issues on legal decisions (especially for retail mortgage exposures), and the average total costs associated with legal proceedings’ [italics by the author]. Debt recovery should include the most appropriate actions taken in a timely manner to improve debt collection and maximise debt recovery/minimise loss.
house NPL units; identifying, categorising and provisioning NPLs more rigorously; early
warning and detection/recognition of NPLs; standardising and improving collateral
valuations, private workout (consensual enforcement)\(^{28}\), legal enforcement\(^{29}\) and
underwriting processes; developing additional restructuring products, such as
forbearance\(^{30}\); developing effective management of foreclosed assets (if relevant); and
reporting and monitoring of NPLs and effectiveness of NPL workout solutions.

The ECB in its ‘Draft guidance to banks on Non-Performing Loans’, pp.109-110, has stipulated indicative
options for debt recovery, namely: ‘voluntary asset sale (borrower re-engages and agrees to sell the
asset); forced asset sale via receivers/court proceedings (assets are not held on the balance sheet of a
credit institution); foreclosure of asset (assets are held on the balance sheet of a credit institution); debt
collection (internal or external); debt to asset/equity swap; sale of loan/loan portfolio to a third party’.
Within this framework, ‘the recovery option should take into account the existence of collateral, type of
legal documentation, type of borrower, local market conditions and macroeconomic outlook, the
legislative framework in place and potential historical recovery rates per option vs. the costs involved
per option’.

\(^{28}\) Consensual debt recovery involves measures such as foreclosure, restructuring the loan with new
terms, debt to equity swapping, debt to asset swapping, collateral substitution, cash settlement via cash
generated by the underlying business or via the sale of underlying collateral with borrower’s consent or
via the sale of other assets or other cash sources of the borrower, repossession of the assets securing
the loan by borrower’s consent and out of court restructurings.

\(^{29}\) Legal enforcement could take the form of enforcing the underlying collateral if the borrower is not
cooperative, recovery through in-court restructuring schemes or through insolvency, liquidation, and
administration process. In Chapters III and IV there will be an analysis of the proposed Accelerated
Extrajudicial Collateral Enforcement mechanism in comparison with traditional in-court enforcement
procedures, the existing pre-insolvency and insolvency proceedings, and the enforcement under the
Financial Collateral Directive.

\(^{30}\) Forbearance measures include a concession by an institution towards an obligor that is experiencing
or is likely to experience deterioration in its financial situation. A concession may entail a loss for the
lender and may consist of a modification of the terms and conditions of a debt obligation or a total or
partial refinancing of a debt obligation, where such modification or refinancing would not have been
granted had the financial situation of the obligor not deteriorated. Forbearance measures can be either
short-term (e.g. reduced payments, grace period, etc.) or long-term (e.g. extension of maturity,
rescheduled repayments, interest rate reduction, etc.) and aim at ultimately helping borrowers recover
from financial difficulties and achieve sustainable payments. Measures are considered as a tool for NPL
resolution, alternative to traditional in-court collateral enforcement proceedings. For the actions
considered as forbearance measures, see: CRR II, Article 47b (Forbearance measures).
Credit restructuring through private workout on behalf of credit institutions or their specialised credit servicers, could be followed voluntarily or pursuant to national legislation\(^{31}\).

3.2. Policy initiatives to address Non-Performing Loans
At national and at European level, as elaborated in the next Chapters, policy initiatives to tackle distressed debt focus on the development of efficient secondary markets for NPLs, so that banks could off-load non-performing assets from their balance sheet via secondary markets for credit\(^{32}\), thus focusing their managerial capacity on evaluating and engaging in new lending business, by outsourcing their distressed asset to credit servicers specialised in debt collection, collateral administration and credit

\(^{31}\) In Greece, there has been established a debt re-negotiation and restructuring procedure, implementing the Law 4224/2013 (Government Gazette FEK A’ 288/31.12.2013), namely the Code of Conduct for Banks (No 116/1/25.08.2015 Decision of the Credit and Insurance Issues Committee on the ‘Establishment of the Code of Conduct pursuant to the Law 4224/2013’, Government Gazette FEK B’ 2289/27.08.2014), as amended with the Decision 195/1/29.07.2016 (Government Gazette FEK B’ 2376/02.08.2016). The amended Code of Conduct establishes general principles for credit institutions and borrowers, with the objective of restructuring or finally settling distressed debts, according each borrower’s particular circumstances. The terms of ‘non-cooperating debtor’ and ‘reasonable living expenses’ are also defined. Banks shall follow the proposed procedure, before initiating any legal procedure, but in case of non-conformity only administrative penalties by the Bank of Greece will be applicable. Among the proposed solutions of debt restructuring, there are short-term ones (arrears capitalisation, arrears repayment plan, reduced payment above IO, Interest Only- IO, reduced payment below IO, grace period), long-term ones (interest rate reduction, loan term extension, split balance partial debt forgiveness/write down, operational restructuring, debt/equity swap) and final settlement solutions (put-of court- settlement, voluntary surrender, mortgage to rent/lease, voluntary sale of property, settlement of loans, auction-collateral repossession, full debt write-off). These solutions constitute a practical example of forbearance measures, but in this case as prior to the traditional in-court enforcement proceedings (banks’ non-conformity induces -at least- administrative sanctions and may constitute a case of abusive exercise of rights on behalf of banks, along with other factors) and not as alternative to them as in the case of CRR II (where banks’ non-participation in the forbearance procedure seems to have no legal consequence) [italics and comparison by the author].

\(^{32}\) Indeed, the purchase of distressed loan portfolios is considered as an attractive investment strategy for many investors, depending on the national regulatory framework of insolvency proceedings, enforcement rights, NPLs transfer requirements, and taxation.
restructuring. NPL portfolios could also be further sold\(^{33}\) to credit purchasers\(^{34}\), thus cleaned up from credit institutions’ balance sheets, so that banks could be better prepared to provide new credit to the economy and increase their profitability. The underlying objective is the transfer and dissemination of the contractually undertaken credit risk from systemically important credit institutions to other entities, so that systemic risk of banks’ failure and spill-over effects are diminished. However, strict underwriting practices followed at national level and the existing undue regulatory impediments to loan servicing by third parties and to the transfer of loans result in disappointingly low effectiveness rates.

Swift extrajudicial repossession of collateral\(^{35}\) pledged to secure NPLs is another policy measure for the protection of secured creditors from borrowers’ default. Effective recovery of value from secured loans could help to avoid future build-up of NPLs and increase corporate lending flows. Under such initiatives, debtors’ protection may be

\(^{33}\) Selling NPL portfolios could take the form of direct sale, where banks or asset management companies (AMCs) sell NPLs in dedicated markets; securitisation, where banks, special purpose vehicles or AMCs pool and tranche loans and sell the securitised products in dedicated markets; or sale to centralised AMCs, where dedicated companies buy bad assets from the problem banks. See: Baudino, P. & Yun, H. (2017), *Resolution of non-performing loans – policy options, FSI Insights on policy implementation*, No 3, Bank for International Settlements, October 2017, p. 11, available at: [https://www.bis.org/fsi/publ/insights3.pdf](https://www.bis.org/fsi/publ/insights3.pdf).

\(^{34}\) For instance, in Greece, within the context of Greece’s Third Economic Adjustment Program, there has been introduced a new legal framework for the sale, transfer and management of claims from Non-Performing Loans and credit agreements, namely the Greek Law 4354/2015 (the ‘NPL Law’) on ‘Management of Non-Performing Loans, wage provisions and other urgent provisions implementing the agreement on budgetary objectives and structural reforms (Government Gazette, FEK A’ 176/16-12-2015). The establishment and operation of Debt Management Companies and Debt Transfer Companies is there regulated. Transfer of NPLs could also be carried out under the Greek Law 3156/2003 (the ‘Securitisation Law’) on ‘Bond loans, securitisation of claims and rights from real estate and other provisions’ (Government Gazette, FEK A’ 157/25-06-2003), as amended by the Law 4416/2016.

also promoted, in the light of safeguards for consumers and over-indebted households. However, the legal frameworks for collateral enforcement\textsuperscript{36} across Member States are divergent and out-of-court resolution is not widely preferred or even possible at national level\textsuperscript{37}.

It is the bitter truth that restructuring of NPLs and debt recovery through pre-insolvency preventive restructuring and insolvency proceedings are highly divergent among Member States, not providing legal certainty and may be time-consuming, unpredictable and inefficient. Therefore, a European strategy for NPLs\textsuperscript{38}, drawing on experience gained during the crisis and best practices effectively implemented in

\begin{footnotesize}
\begin{enumerate}
\item For instance, in Greece, collateral enforcement procedure depends on the type of the security and the legal instrument of its creation. Collateral enforcement may be carried out in a judicial procedure leading to the liquidation of the debtor's assets through public auction or through direct collection of any pledged assets by the secured party or through direct sale of the mortgaged assets under certain circumstances and exclusively for the enforcement of mortgages established over aircrafts and vessels. With respect to the enforcement of financial collaterals, in the event of default, the secured party may either realise/appropriate the financial collateral without any prior judicial or enforcement proceedings or apply a close-out netting by setting off the value of the financial collateral against the outstanding amount of secured obligations. Unfortunately, timeframes for enforcement are largely unpredictable, depending on the type of security and the enforcement procedure followed, but usually enforcement is time-consuming, costly and complicated.
\item See: Council conclusions on Action plan to tackle Non-Performing Loans in Europe, Press Release 459/17, Council of the EU, 11.07.2017, which underlines the urgency for a European strategy to address ‘cross-border spill-overs in terms of the overall economy and financial system of the EU’ that ‘alter market perceptions of the European banking sector as a whole, especially within the Banking Union’. Also, it is noted that ‘while banks are primarily responsible for restructuring their business models and resolving their NPLs issues in a timely manner, further measures to address the existing stock of NPLs and to prevent the future emergence and accumulation of NPLs would be beneficial for the EU as a whole by contributing to enhanced growth and reducing financial fragmentation’. For further analysis, see the following Chapter.
\end{enumerate}
\end{footnotesize}
Member States, could help to address this issue across the EU and support national actions in the countries concerned\textsuperscript{39}. More specifically, strengthening the ability of secured creditors to recover value from secured loans to corporations and entrepreneurs became a top priority for the Commission\textsuperscript{40}, within a comprehensive package of legislative measures it recently adopted (the so-called ‘NPL package’).

For these reasons, before analysing the proposed and existing collateral enforcement framework for NPLs in Europe, it is of outmost interest to further investigate the previous actions taken at European level to address high stocks of NPLs and to prevent their future accumulation, in the following Chapter.

\textsuperscript{39} See: Reflection Paper, p. 19.

II PREVIOUS POLICY INITIATIVES IN EUROPE TO ADDRESS NON-PERFORMING LOANS

In Europe, several policy initiatives have been adopted with the objective to effectively address the current high stocks of NPLs and to prevent their excessive accumulation in the future\(^\text{41}\). The most significant ones are elaborated in the present Chapter.

1. Reflection Paper on the Deepening of the Economic and Monetary Union

In May 2017, the European Commission published a Reflection Paper on the Deepening of the Economic and Monetary Union (EMU). In this Paper, the Commission referred to the story of the Euro so far and made some reflections on a possible roadmap towards the completion of the EMU by 2025 and its necessary toolbox. In this roadmap, progress should have been made by certain years in the axes of the Financial Union (Banking and Capital Markets Union), the Economic and Fiscal Union and the Democratic Accountability-Effective Governance policy.

The Reflection Paper underlined that a resilient to adverse shocks, transparent, more integrated and well-functioning financial system is essential for an effective and stable EMU. It reaffirmed the need to address remaining sources of financial vulnerability and fragility, in order to further promote financial integration. In the crisis turmoil, bank lending and provision of credit to the real economy was diminished, with tightened lending terms and falling lending volumes. The problem was exacerbated due to the overwhelming reliance on banks as a source of funding, particularly for SMEs, and the relative absence of other sources of financing, such as equity markets. Therefore, the completion of a genuine Financial Union shall be pursued with several measures\(^\text{42}\).

\(^{41}\) In Bibliography there is a list of all Institutional Documents reviewed in this and in the following Chapter.

\(^{42}\) The Commission stressed the significance of resolute and coordinated action at the EU level and set forth reforms in key policy areas. For the period 2017-2019, other measures towards the completion of the Banking and Capital Markets Union under the Pillar of completing the Financial Union include: ‘setting up of a common backstop for the Single Resolution Fund, agreeing on a European Deposit Insurance Scheme, reviewing European Supervisory Authorities and working towards establishing
including the implementation of further risk-reducing measures for the financial sector\textsuperscript{43}, a shift from public to private risk-sharing, a strategy to reduce Non-Performing Loans and the finalisation of Capital Markets Union initiatives.

Regarding Non-Performing Loans, in particular, the Commission reflected the imperative need for a comprehensive European strategy for NPLs by June 2017, along with a comprehensive toolbox and practical implementation, in order to address this crisis legacy and to support national actions in the countries concerned. The Commission recognised that NPLs weigh on the performance of the euro-area banking sector and result in financial fragility. This strategy should aim at addressing the existing high stocks of NPLs and their possible future accumulation, as an essential step to complete the Banking Union, to ensure competition in the banking sector, to preserve financial stability and to encourage lending within the Union\textsuperscript{44}. An integrated financial system will enhance the resilience of the EMU to adverse shocks by facilitating private cross-border risk-sharing, while reducing the need for public risk-sharing. In this way, the Banking Union shall be completed and the Capital Markets Union further developed.

\textsuperscript{43} Risk reduction and banks’ resilience shall be pursued through the Banking Package of November 2016 with further risk-reducing measures along four key policy areas: (i) Supervision, (ii) Secondary markets, (iii) Structural issues (including insolvency), (iv) Restructuring of the banking system. For the last tool, a commitment was made to agree upon such a strategy at the ECOFIN Council of June 2017. See: Reflection Paper, 4.3. A genuine Financial Union – advancing in parallel on risk-reduction and risk sharing, p. 21, Table ‘Elements to complete the Financial Union’.

\textsuperscript{44} See: Reflection Paper, 3.2. The need to tackle remaining sources of financial vulnerability, p. 14, Table ‘Why further steps towards Financial Union?’: ‘Further steps are needed to reduce and share risks in the banking sector and to provide better financing opportunities for the real economy, including through capital markets. The completion of the Banking Union and of the Capital Markets Union is paramount to achieve this’.
1.1. Communication to complete Europe’s Economic and Monetary Union

After the Reflection Paper, the Commission communicated a crystallised roadmap\(^{45}\) to strengthen and complete Europe’s Economic and Monetary Union. In this roadmap, it set a pragmatic path for a swift agreement on outstanding issues. On the top of the Commission’s agenda was action towards risk-reduction, with the objective of strengthening the resilience of EU banks. The Commission recognised that NPLs remain a challenge in the European banking sector.

1.2. Communication to complete the Banking Union

The Commission communicated a way forward to complete the Banking Union\(^{46}\) by promoting risk reduction and risk sharing, which called for a comprehensive package\(^{47}\) on tackling NPLs within the Union. One of the significant additional measures to further reduce risks in the Banking Union is to put forward risk reduction efforts on NPLs\(^{48}\). The Commission welcomed the comprehensive approach adopted by the Council’s Action Plan of July 2017\(^{49}\), consistent with the Commission’s own longstanding calls to tackle NPLs, thus the Commission will take the necessary actions within its competence. The Commission held that progress in this Action Plan would support the completion of the Banking Union and render European banks more stable and competitive\(^{50}\).

\(^{45}\) Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank - further steps towards completing Europe’s Economic and Monetary Union: a Roadmap, COM/2017/821/Final, 06.12.2017 [hereafter: Roadmap to complete the EMU].

\(^{46}\) Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union, COM/2017/592/Final, 11.10.2017 [hereafter: Communication to complete the Banking Union].

\(^{47}\) See below under II.2.

\(^{48}\) See: Communication to complete the Banking Union, p. 15: ‘Non-Performing Loans weigh on the profitability and viability of affected banks and constrain banks’ ability to lend, ultimately hampering economic growth, thus the build-up of new NPLs must be prevented’.

\(^{49}\) See below under II.2.

\(^{50}\) Communication to complete the Banking Union, p. 17.
1.3. Communication to complete the Capital Markets Union

The Commission also set as its objective the reduction of NPLs, as crucial for the EU economies’ capacity to stabilise and absorb economic shocks through deep and integrated capital markets\(^{51}\). For a well-functioning Capital Markets Union (CMU) with established secondary markets for NPLs, essential is the enhanced management of NPLs within more efficient and more predictable loan enforcement frameworks for value recovery by secured creditors\(^{52}\); value recovery from collateral in a swifter manner through extrajudicial collateral enforcement procedures will facilitate the provision of new credit flow from banks to the economy, particularly to SMEs, i.e. it will facilitate access to finance for companies.

2. Action Plan to tackle Non-Performing Loans in Europe

Indeed, reflecting the shared agreement on the need to continue and extend the actions already initiated by the Commission, in July 2017 the Council adopted ‘Action Plan To Tackle Non-Performing Loans in Europe’\(^{53}\). The Council recognised that the financial crisis and ensuing recessions have resulted in high ratios of NPLs. It also highlighted the negative effects of current high NPL ratios in a substantial number of Member States and the subsequent risk of cross-border spill-overs to the overall economy and financial system of the EU. Market perception of the EU banking sector

\(^{51}\) See: Communication by the European Commission to the European Parliament, the European Council, the Council, the European Social and Economic Committee and the Committee of the Regions: Completing the Capital Markets Union by 2019 - Time to accelerate delivery, COM/2018/114, 08.03.2018 [hereafter: Communication to complete the Capital Markets Union], p. 1: ‘Deep and integrated capital markets foster cross-border private risk-sharing in the euro area, thereby boosting the productive and innovative use of private capital, broadening and diversifying the sources and means of funding to the real economy, and reducing the need for public sector risk-sharing’.

\(^{52}\) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan, COM/2017/292/Final, 08.06.2017 [hereafter: Mid-Term Review of the CMU], 4.4. Using capital markets to strengthen bank lending and stability, p. 13.

has been adversely affected, while high NPL levels heavily reflect on investment, hence on the economy. For these reasons, in Council’s opinion, the need to swiftly resolve NPLs is imperative, in order to reduce financial fragmentation and to facilitate capital flows within the single market.

Aiming at restoring NPLs ratios to sustainable lower levels and at encouraging pro-active actions on behalf of credit institutions, the Action Plan set out a comprehensive approach, combining various complementary policy actions, at national level and at Union level where appropriate, in four areas: (i) bank supervision and regulation (ii) structural reforms of restructuring, insolvency and debt recovery frameworks, (iii) development of secondary markets for distressed assets, and (iv) fostering restructuring of the banking system. Actions in these areas should be taken at national level and at Union level where appropriate, in accordance with the subsidiarity principle. Some measures will have a stronger impact on banks' risk assessment at loan origination, while others will foster swift recognition and better management of NPLs, and further measures will enhance the market value of such NPLs. These measures mutually reinforce each other and would not be sufficiently effective, if implemented in isolation.

Under this Action Plan, the Council called upon various institutions, namely the Commission, the ECB Banking Supervision, the European Banking Authority (EBA), the European Systemic Risk Board (ESRB) and Member States, to take appropriate measures to further address the high number of NPLs in the Union\(^54\). Within this framework, there should be carried out a benchmarking exercise on the efficiency of national loan enforcement regimes from a bank creditor perspective, providing precise, reliable and comparable metrics for recovery rates, recovery times and recovery costs across Member States, along with dedicated peer-reviews on insolvency regimes across the EU. The Commission was called to further analyse the possibility of enhancing the protection of secured creditors. This objective is crucial for the analysis

\(^{54}\) For a list of measures taken by each institution, see: Annex II.
of the proposed extrajudicial collateral enforcement mechanism\textsuperscript{55}, as it seems that any EU-wide policy initiative that is creditor-friendly in essence may not explicitly be detrimental to borrowers’ rights but practically have such implied outcome.

3. First Report on the implementation of the Action Plan

The Commission published the First Progress Report\textsuperscript{56} on the implementation of Council’s Action Plan to tackle NPLs in January 2018. According to this report, one of the actions to be followed is the enhanced protection of secured creditors by more efficient methods of value recovery from secured corporate loans through the expedited and efficient Accelerated Extrajudicial Collateral Enforcement (AECE)\textsuperscript{57}. This first assessment congratulated the overall significant progression risk reduction in the EU banking sector and the reduction of NPL ratios in the Union. The need for continued concerted action at EU level was stressed, with view to a dedicated package of measures to be adopted by the Commission in March 2018\textsuperscript{58}.

Progress on the benchmarking exercise on the efficiency of national loan enforcement (including insolvency) regimes was presented to and discussed with Member States experts at the September and December 2017 meetings of the expert group on NPLs, noting a lack of access to meaningful data\textsuperscript{59}. It was noted that the management of NPLs would benefit from more efficient and predictable loan enforcement and

\textsuperscript{55} See below in Chapter III.


\textsuperscript{57} Ibid, p. 5.

\textsuperscript{58} Ibid, p. 6, Conclusions. The report underlines that high NPL ratios remain an important challenge for the Union as a whole, however – overall – important progress is being made. This pace of progress should be maintained in the future, with aims to effectively address the challenge of NPLs, in terms of reducing existing stocks to sustainable levels and preventing any future accumulation.

insolvency frameworks, therefore this benchmarking exercise of such regimes should establish a reliable picture of the delays and value recovery that banks experience when faced with borrowers\textsuperscript{60}.

\textbf{4. Second Progress Report on the reduction of NPLs in Europe}

Indeed, in March 2018 the Commission adopted a ‘comprehensive package’ of complementary legislative proposals, addressing NPLs with the aim to foster financial stability in the EU\textsuperscript{61}. The aim was to enable Member States to address NPLs in a determined way and avoid excessive build-up of NPLs in the future\textsuperscript{62}.

As part of banks’ prudential requirements, banks will be required to put aside sufficient resources (own funds) to address Non-Performing Exposures when new loans become non-performing, appropriately incentivised to identify and manage impaired assets at an early stage, so as to avoid too large accumulations of NPLs\textsuperscript{63}. If loans eventually become non-performing, more efficient enforcement mechanisms for secured loans will allow banks to recover value from collateralised NPLs, subject to appropriate safeguards for debtors and with the exception of loans granted to consumers. For too high stocks of NPLs, it is imperative that efficient, competitive and transparent secondary markets be created, so that banks will be able to outsource the management or sell NPL portfolios to other operators\textsuperscript{64}. Where NPLs have become a significant and broad-based problem, Member States may set up effective national

\textsuperscript{60} Ibid, p. 13.


\textsuperscript{63} See: Second Progress Report, 3. A Comprehensive Package to address remaining and future NPLs, p. 7. See below under II.4.1.

\textsuperscript{64} See: Second Progress Report, 3. A Comprehensive Package to address remaining and future NPLs, p. 7. See below in Chapter III the analysis on the proposed Accelerated Extrajudicial Collateral Enforcement mechanism.
Asset Management Companies (AMCs) or other measures under current State aid and bank resolution rules\textsuperscript{65}.

All legislative proposals in the Commission’s package mutually reinforce each other and would not be as effective, if implemented in isolation\textsuperscript{66}. The package covers a major part of the Council’s Action Plan and aimed to create the appropriate environment for addressing existing NPLs on banks’ balance sheet and reducing the risk of their future accumulation\textsuperscript{67}. It is also acknowledged that the actions by the Commission, the ECB, the EBA and the ESRB will create important synergies\textsuperscript{68}.

Overall, significant progress has been made in risk reduction in the EU banking sector and the stock of NPLs is in decline. NPL reduction and prevention is an important step towards completing the Banking Union\textsuperscript{69}, to address financial fragmentation and establish an economically beneficial, more stable and more integrated EU banking sector.

\textsuperscript{65} See: Second Progress Report, 3. A Comprehensive Package to address remaining and future NPLs, p. 7. See below under II.4.2.

\textsuperscript{66} See: Second Progress Report, 7. A strong package with mutually reinforcing measures, p. 11: ‘Some of the proposed measures will have a stronger impact on banks’ ex-ante risk assessment at loan origination, some will foster swift recognition and better management of NPLs, and others will enhance the market value of NPLs’.

\textsuperscript{67} See: Second Progress Report, 7. A strong package with mutually reinforcing measures, p. 11.

\textsuperscript{68} See: Second Progress Report, p. 13: ‘The proposed statutory minimum coverage requirements would provide strong incentives for banks’ management to prevent the accumulation of future NPLs through better NPL management and stronger loan origination practices. This will reinforce the expected effects of the ongoing work by the ECB and the EBA on banks’ loan origination, NPL management, monitoring and internal governance practices. Work on NPL information and market infrastructure would further enhance the functioning of secondary markets for NPLs’.

4.1. The proposed Capital Requirements Regulation II
The Commission has put forward various measures in an effort to create the appropriate environment\(^{70}\) for credit institutions to deal with NPLs on their balance sheets and to prevent the risk of under-provisioning of future NPLs\(^{71}\). The amended Capital Requirements Regulation (referred to as ‘CRR II’) provides for deductions from banks’ own funds in case of insufficient provisioning for (now commonly defined\(^{72}\)) Non-Performing Exposures (‘NPEs’)\(^{73}\). The amendment introduces the so-called ‘statutory prudential backstops’, i.e. common minimum loss coverage for the amount of money banks need to set aside to cover losses caused by future loans that turn non-performing\(^{74}\).

Within this framework, credit institutions will be required to put aside sufficient own funds, in order to cover incurred and expected losses on newly originated loans that


\(^{71}\) Insufficiently provisioned NPLs often pile up on banks’ balance sheets, which in turn may cast doubt on the bank’s future profitability, solvency and thus its long-term viability. See: First Progress Report, p. 2: ‘NPLs require higher levels of provisioning. Loan provisions reduce bank profitability and reduce the bank’s regulatory capital. In the most severe cases, the necessary accounting for NPLs can put in question the viability of a bank with potential implications for financial stability’.


\(^{73}\) Non-Performing Exposures are defined in Article 47a of the CRR II.

\(^{74}\) See: Second Progress Report, pp. 11-12: ‘The prudential backstop will ensure that credit losses on future NPLs are sufficiently provisioned for, thus making their resolution easier. These effects would be complemented by more developed secondary markets for NPLs, which would strengthen demand for NPLs and raise their market value. This will allow banks to sell NPLs more easily in light of more stringent provisioning rules’.
become non-performing\textsuperscript{75}. This would appropriately incentivise banks to address insufficiently provisioned NPLs at an early stage and prevent their future excessive accumulation on banks’ balance sheets. Competent authorities of credit institutions will guide them in this\textsuperscript{76}, based on their existing bank-specific ‘Pillar 2’ powers, under the existing Capital Requirements Regulation (CRR) \textsuperscript{77}.

The Council approved position on capital requirements for banks with NPLs on their balance sheets in October 2018\textsuperscript{78}, thereafter starting negotiations with the European Parliament. The Council recognised that addressing bad loans and consolidating banks’ balance sheets is essential for the reconsolidation of public’s trust and confidence in the financial system. This objective requires solid prudential rules and effective

\textsuperscript{75} See: CRR II, Explanatory Memorandum, pp. 10-11: ‘Different coverage requirements would apply, depending on the classifications of the NPEs as ‘unsecured’ or ‘secured’. [...] Secured NPEs are in general less risky for a institution than unsecured NPEs as the credit protection securing the loan gives the lender a specific claim on an asset or against a third party without reducing his/her general claim against the defaulted borrower. [...] Recovery rates are on average significantly higher for secured NPEs than for unsecured ones. However, it takes some additional time to enforce the credit protection and, where applicable, realise the collateral. Unsecured NPEs should therefore require higher and timelier minimum loss coverage by the creditor bank than secured NPEs. However, after a certain number of years without being successfully enforced (i.e. the collateral/guarantee could not be realised), the credit protection should not be seen as effective anymore. In such case, also full coverage of the exposure amount of secured NPEs is deemed necessary’. The Explanatory Memorandum of the CRR II held that timely resolution of secured NPEs should be facilitated by the use of accelerated extrajudicial enforcement procedures for collateral, because banks using extrajudicial enforcement procedures tend to restructure, recover or dispose of their NPEs earlier and at a higher rate. Therefore, would be less affected by the need to increase their loss coverage for NPEs. Likewise, different coverage requirements would apply, depending on the nature of the collateral as ‘movable’ or immovable’, since immovable property (commercial or residential real estate) is reasonably expected to have a remaining value for a longer period of time after the loan turned non-performing.

\textsuperscript{76} See: Second Progress Report, p. 7.


monitoring tools, as provided by the proposed regulation. The Council expressed its optimism that through this new prudential backstop the Banking Union may ultimately be strengthened.

4.2. The Blueprint on Asset Management Companies
As part of the comprehensive NPL package, Member States are provided with non-binding guidance on how they can set up, where appropriate, national asset management companies (AMCs)\textsuperscript{79}. Where NPLs become a significant and broad-based problem, Member States should be able to set up national AMCs or other alternative measures\textsuperscript{80}. The permissible design of AMCs is in full compliance with EU banking legislation, i.e. with the BRRD\textsuperscript{81}, the SRMR\textsuperscript{82} and State Aid rules. The Commission’s AMC Blueprint sets out common principles for the relevant asset and participation perimeters, asset-size thresholds, asset valuation rules, appropriate capital structures, the governance and operational features, both private and public. It provides practical recommendations for the design and set-up of AMCs at the national level, building on


best practices from past experiences in Member States\textsuperscript{83}, and is fully consistent\textsuperscript{84} with other actions taken to address NPLs in Europe.

\textbf{5. Third Progress Report on the reduction of NPLs}

Recently, in November 2018, the Commission delivered the Third Progress Report on the reduction of NPLs and further risk reduction in the Banking Union\textsuperscript{85}, in which it reaffirmed the package of substantial and complementary measures to reduce risk\textsuperscript{86} and

\begin{itemize}
\item \textsuperscript{83} See: Second Progress Report, 6. A technical Blueprint for how national Asset Management Companies (AMCs) can be set up, p. 11.
\item \textsuperscript{84} Although AMCs have historically proven to be a useful tool, their usefulness is diminished, if secondary markets for NPLs are undeveloped, as one important tool of an AMC is the sale of its loans to third-party investors. The AMC and many other potential credit purchasers are highly dependent on the availability of independent companies to service and manage the loans on their behalf. Therefore, AMCs will be more effective, if supported by the Commission’s proposal on credit servicers and credit purchasers. See: 7. A strong package with mutually reinforcing measures, p. 12.
\item \textsuperscript{86} For the banking ‘risk reduction package’ proposed by the Commission, reviewing the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR), the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR), with the objective of further reducing remaining risks in the banking sector, see: EU Banking Reform: Strong banks to support growth and restore confidence, Commission - Press release, Brussels, 23.11.2016, available at: \url{http://europa.eu/rapid/press-release_IP-16-3731_en.htm}. 
Recently, the European Commission Services, the European Central Bank and the Single Resolution Board have delivered a ‘Monitoring report on risk reduction indicators’, available at: \url{https://www.consilium.europa.eu/media/37029/joint-risk-reduction-monitoring-report-to-eg_november-2018.pdf}, in which they elaborate on the main developments in the area of risk reduction in the EU banking sector. With respect to NPLs, it is noted that ‘the average NPL ratio has decreased to 4.4\% in Q2 2018. NPL ratios have decreased for almost all MS, with larger decreases for MS with high NPL ratios’ (p. 2). As to structural measures, in parallel with the legislative initiatives at European level (the NPL package), at national level ‘several EU MS have adopted or amended legislation with the aim of reducing NPLs. About half of the MS have implemented legal reforms relating to insolvency and foreclosure (CY, GR, ES, IT, IE, LV, HU, PT and SK), the cooperative or savings bank sectors (ES, IT and LT), legislation governing new sales of loans legislation (IE, CY) or the introduction of a subsidy scheme (CY)’
\end{itemize}
enhance the resilience of the European banking sector. Recent developments of NPLs are summarised in declined NPL ratios in the first half of 2018, within the overall trend of improvement over recent years. Generally, NPL ratios are approaching pre-crisis levels again and the stability in the financial system is being restored, enabling banks to enhance their internal capacity to manage and resolve NPLs. In parallel with the post-crisis regulatory improvements, banks and credit servicers have acquired substantial knowledge and experience in resolving NPLs. Nevertheless, NPLs continue to pose risks to economic growth and financial stability, mainly due to structural impediments such as slow and unpredictable debt restructuring, insolvency and debt recovery processes.

Regarding the progress in the implementation of the aforementioned Council’s Action Plan, the report stated that other objectives have been delivered, while a benchmarking exercise in loan enforcement and insolvency frameworks is still ongoing. Overall, risk reduction in the EU banking sector continues at a sustained

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87 For figures and further data, see p. 4 of the Third Progress Report.
88 See: Third Progress Report, 12. Benchmarking exercise on the efficiency of national loan enforcement (including insolvency) regimes from a bank creditor perspective, p. 11: ‘The management of NPLs would benefit from more efficient and predictable loan enforcement and insolvency frameworks. The Commission services are therefore undertaking a benchmarking exercise of national loan enforcement regimes, encompassing both individual enforcement and collective enforcement or insolvency proceedings. The objective is to obtain a reliable picture of the delays and value recovery rates that banks face when borrowers default. These outcomes are heavily influenced by judicial capacity in the respective Member States. Progress on the benchmarking exercise was presented to and discussed with Member States at meetings on 21 February and 20 June 2018, including the issue of lack of access to meaningful data’.
89 Along with the benchmarking exercise, focus has been placed upon national corporate insolvency frameworks, which have been analysed in several country reports. Since 2013, several country-specific recommendations have been adopted on insolvency issues for twelve Member States, whereas in 2018, country-specific recommendations were adopted for six Member States. In May 2019, the Commission will issue its proposals to the Council for country-specific recommendations. See: Third Progress Report, 13. Develop the focus on insolvency issues in the European Semester, p. 11.
pace and the robust downward trend of NPL ratios is very encouraging, but still a challenge in some Member States. The Action Plan should be fully implemented by all actors, in order to effectively address existing high stocks of NPLs and to prevent their future accumulation\textsuperscript{90}.

\textsuperscript{90} See: Third Progress Report, 4. Conclusions, p. 12.
III PROPOSAL FOR A DIRECTIVE ON EXTRAJUDICIAL RECOVERY OF COLLATERAL

In the light of the aforementioned Council’s Action Plan and Commission’s comprehensive legislative package\(^91\) towards addressing Non-Performing Loans and fostering financial stability in the EU, the Commission adopted a ‘Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral’\(^92\) (hereafter: the proposed Directive) addressed for further formal act to the European Parliament and the Council\(^93\).

The proposed Directive on recovery of collateral is designed to enhance the management of NPLs within more efficient and more predictable loan enforcement frameworks\(^94\) for value recovery by secured creditors. It aspires to enhance secured

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\(^91\) Effectively addressing NPLs and preventing the build-up of high stocks of NPLs in the future requires a comprehensive approach. Even though this responsibility is primarily reserved for Member States, the interconnectedness of the EU’s banking system implies the interest of the European Union to address current stocks of NPLs and to prevent their future accumulation. Especially due to potential contagion, spill-over effects from Member States with high NPL levels may be devastating for the economic growth and financial stability in the EU area. See: Recital (1) of the proposed Directive on potential spill-over effects and Recital (3) on the comprehensive approach followed at European level.


\(^93\) The Commission has called for negotiations to be finalised before the end of the current legislature. By the time of the submission of this paper (31.01.2019), the stage already reached in the ordinary legislative procedure (Article 294 TFEU) is that the responsible Committee’s decision is awaited (ECON/8/12530, with Rapporteurs appointed on 31.05.2018). The Committees for opinion, i.e. the IMCO (Internal Market and Consumer Protection) and the JURI (Legal Affairs) decided not to give an opinion. See: European Parliament/ Legislative Observatory:

\(^94\) See: ‘Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised), 101069, World Bank, Jan & May 2015, p. 4: ‘The ability of financial institutions to adopt effective credit risk management practices to resolve or liquidate Non-Performing Loans depends on having reliable and predictable legal mechanisms that provide a means for more accurately pricing recovery and enforcement costs. Where non-performing assets or other factors jeopardize the viability of a bank, or
creditors’ protection, by enabling them to recover value from collateral in a swifter manner through extrajudicial enforcement procedures for collateral. Thus, the provision of new credit flow from banks to the economy, particularly to SMEs, would be facilitated, in consistency with the CMU’s objective of facilitating access to finance for companies.

1. Legislative rationale

The need to effectively address the build-up of NPLs is imperative, since they deteriorate bank performance, they reduce the banks’ liquidity and profitability, they jeopardise banks’ viability and financial stability. In addition, NPLs occupy significant administrative and financial resources, limiting the bank’s capacity to supply affordable credit, particularly to SMEs, and they lock up capital to back unproductive assets, thus weighing down on monetary policy transmission. It is also essential that access be provided to diversified new sources of financing for EU businesses, particularly SMEs and high-growth innovative companies, and to enhanced bank finance, by improving banks’ lending capacity and by enabling them to recover value from collateral in secured loans. In that way, as mentioned above, the proposed Directive is embedded in the wider framework of strengthening Europe’s Economic and Monetary Union (EMU), as it contributes to the establishment of a resilient, transparent and more

where economic conditions create systemic crises, creditor/debtor rights and insolvency systems are particularly important to enable a country and stakeholders to respond promptly [...] Unpredictable legal mechanisms for debt enforcement, recovery, and restructuring impede competition in credit delivery’.

95 See: Recital (39) of the proposed Directive.
96 See: ‘Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised), 101069, World Bank, Jan & May 2015, p. 5: ‘These rights enable parties to rely on contractual agreements, fostering confidence that fuels investment, lending and commerce. Conversely, uncertainty about the enforceability of contractual rights increases the cost of credit to compensate for the increased risk of nonperformance or, in severe cases, leads to credit tightening’.
97 See: Explanatory Memorandum of the proposed Directive, p. 1. Also, see above under I.1.2.
98 See: Explanatory Memorandum of the proposed Directive, p. 1 and 3. Also, see above under I.1.2.
100 See above under II.1, II.1.1- II.1.3.
integrated financial system with a well-functioning Banking and Capital Markets Union\textsuperscript{101}.

Particularly with respect to the contribution of swift collateral enforcement mechanisms to the effective management and resolution of NPLs, it has been noted that ‘legal or judicial impediments to collateral enforcement influence a bank’s ability to commence legal proceedings against borrowers or to receive assets in payment of debt and will also affect collateral execution costs in loan loss provisioning estimations’\textsuperscript{102}. The current absence of a contractual-based out-of-court enforcement mechanism to facilitate the swift repossession of securities is considered to have possibly contributed to the current high stock of NPLs in banks' balance-sheets\textsuperscript{103}. Enhanced, modern and more harmonised\textsuperscript{104} EU measures enabling banks to effectively recover value from secured business loans, could minimise the cost, time and complexities of recovery processes, ultimately preventing the future build-up of NPLs and increasing cross-border corporate lending.

However, any initiative to the objective of protecting secured creditors from borrowers’ default should maintain \textit{a fair balance between debtors' and creditors' interests}\textsuperscript{105} and \textit{not be to the detriment of the current level of debtors' protection},

\textsuperscript{101} See: Recital (2) of the proposed Directive.
\textsuperscript{104} ‘Extrajudicial mechanisms are available only in some Member States. Drawing inspiration from 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, in particular within the euro-area’. See: Consultation Document, p. 10.
\textsuperscript{105} For creditor/debtor rights and the creditor-friendly trend in this balance, see: ‘Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised), 101069, World Bank, Jan & May 2015, p. 12: ‘A modern credit-based economy should facilitate broad access to credit at affordable rates through the widest possible range of credit products (secured and unsecured) inspired by a complete, integrated and
particularly natural persons, households in financial difficulties and consumers. Theoretically, collateral-givers would benefit from an easier access to finance\textsuperscript{106}, if they are willing to agree upon this extrajudicial mechanism, while banks will benefit from their enhanced power to recover and realise value from unpaid loans, safeguarding their priority right faster than in ordinary in-court enforcement and reducing their credit risk. Nevertheless, in the author’s opinion, the proposed mechanism seems as an effort to enhance secured creditors’ protection\textsuperscript{107}, without even taking into consideration borrowers’ rights (although the proposed Directive declares itself without prejudice to borrowers’ rights\textsuperscript{108}), and further empowering the already negotiation-wise powerful parties: credit institutions. This is because the contractual term on the extrajudicial collateral enforcement mechanism could easily turn from ‘an opportunity to broader access to credit’ to ‘a prerequisite for any access to credit’. The transfer and minimisation of the contractually undertaken credit risk from banks indeed could be a fair objective to pursue, so that systemic risk of banks’ failure and potential spill-over effects are diminished. Nevertheless, the undertaking of market and credit risk (particularly the risk of price fluctuations and debtors’ default) lies in the hard core of the provision of credit and is accordingly assessed in banks’ exposures and prudential capital requirements. Therefore, it seems unfair to burden prospective borrowers with another requirement for bank lending, probably already stipulated as a clause in general contractual terms of the credit agreement, when the purported

\footnotesize{\textsuperscript{106} However, drawing arguments from our experience from the recent recurrent recessions, it could be supported that the ongoing economic problems in the EU are not caused by a lack of lending, but by a lack of demand, which could be boosted by increasing public investment and by fostering employment and wage growth.}

\footnotesize{\textsuperscript{107} See: Explanatory Memorandum of the proposed Directive, p. 6 and Recital (39).}

\footnotesize{\textsuperscript{108} See: Recital (24) of the proposed Directive: ‘To avoid a reduction in debtor or borrower protection [...]’. Also, see: Recital (21), Article 2 para. 5(a) and Explanatory Memorandum of the proposed Directive, p. 7.}
objective of all European actions is the shift from public to private risk-sharing\textsuperscript{109}. By its effects, the proposed mechanism seems rather to allocate the risk upon the public (all the prospective borrowers in this case) than to private credit actors. Further analysis will follow with respect to the balance between creditors’ and debtors’ interests in this Chapter.

2. Objectives pursued through the proposed Directive\textsuperscript{110}

The objective of preventing the future accumulation of NPLs and enhancing secured creditors’ protection shall be achieved in two ways under the proposed Directive. One mechanism, on which the present legal analysis focuses, is the enhancement of efficient debt recovery procedures through the establishment of a distinct common accelerated extrajudicial collateral enforcement procedure\textsuperscript{111} (hereafter: the AECE).

When enforcement procedures to foreclose collateral are inefficient or ineffective, banks are exposed to a higher risk of accumulation of NPLs\textsuperscript{112}. So far, banks wish to recover value of NPLs\textsuperscript{113} through consensual or legal enforcement, as provided for in national legislation, and to enforce collateral in secured loans, under national pre-insolvency, insolvency and debt recovery procedures. However, judicial enforcement

\textsuperscript{109} See: Recital (2) of the proposed Directive.

\textsuperscript{110} See: Explanatory Memorandum of the proposed Directive, p. 3.

\textsuperscript{111} See: Recital (40) of the proposed Directive, where it noted that domestic expedited and efficient extrajudicial enforcement procedures for value recovery from collateral —if any— do not provide sufficient incentives for cross-border transactions and are not always adequately efficient. Thus, the objective of the proposed Directive is to make available a distinct common mechanism for effective cross-border value recovery procedures.

\textsuperscript{112} See: Consultation Document, p. 10.

\textsuperscript{113} See: Commission Staff Working Document: Impact Assessment ‘Accelerated Extrajudicial Collateral Enforcement” (Part 2/2), SWD/2018/76/final, 14.03.2018, accompanying the document “Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral” (COM/2018/135/ final), p. 1: ‘The microeconomic benefits of the use of collateral are impaired (ex-ante banks tend to lend less and/or at higher lending rates and ex-post banks accumulate on their books a large stock of bad loans for which recovery of value from collateral is difficult)’.
proceedings may be time-consuming, costly, suboptimal in terms of recovery rates and with unpredictable outcomes\textsuperscript{114}. During pending judicial proceedings, banks remain exposed to losses, legal uncertainty and reduced liquidity, with their human and financial resources tied up, thus unable to proceed to lending activities to viable customers.

Hence, the proposed Directive envisages a more efficient and expedited method for banks and other authorised entities issuing secured loans to swiftly recover the value from secured loans in the event of business borrower’s default, out of court, without being forced to wait for the result of judicial enforcement proceedings. This more efficient accelerated extrajudicial collateral enforcement procedure would be available when agreed upon in advance by both lender and borrower, in the loan agreement. It will not be applicable for consumer credit and is designed in consistency with preventive restructuring (pre-insolvency) or insolvency proceedings. Also, the priority attached to competing security rights\textsuperscript{115} in the same collateral is not affected by the enforcement of one of those rights under the AECE mechanism. Since under the envisaged procedure the bank would have the right to acquire ownership of the encumbered assets or to initiate public auction and/or private sale to satisfy its secured claims through the proceeds of the sale, without judicial intervention, the predictability and the timeframe of enforcement are enhanced, to the benefit of the NPL resolution strategy.

The other mechanism envisaged in the proposed Directive is the further development of efficient secondary markets for NPLs, with the adequate human resources and expertise to properly manage a portfolio of distressed loans. The proposed Directive removes undue impediments to credit servicing by third parties and to the transfer of credit. Third party specialised credit servicers to whom the servicing of NPLs is outsourced, have to conform with the proposed common set of rules in order to operate within the Union. The proposed common standards aim at ensuring their

\textsuperscript{114} See: Recital (41) of the proposed Directive.

\textsuperscript{115} See Article 27 (Competing security rights) of the proposed Directive.
proper conduct and supervision across the Union, at stimulating competition among credit servicers and at harmonising the market access. The facilitated accessibility and the reduced costs of credit servicing, further reduce the cost of entry for credit purchasers to whom credit agreements are sold.

Overall, the accelerated extrajudicial collateral enforcement aspires to enhance the efficient management of NPLs\(^\text{116}\), as it could improve conditions for collateral enforcement\(^\text{117}\) and for outsourcing NPLs to third parties. Indeed, the AECE itself is a swift mechanism for value recovery, which would reduce costs for resolving NPLs and improve recovery rates\(^\text{118}\). It is also mutually reinforcing with efficient secondary markets for NPLs, as shorter resolution and increased recovery rates increase the value of NPLs and the bid prices in possible NPL transactions\(^\text{119}\). Moreover, it is easier to price a collateralised NPL than an unsecured one in secondary markets, thus credit purchasers will prefer NPLs with the AECE feature. This would give additional incentives for credit institutions to use this feature at the origination of new loans. Furthermore, the harmonisation and convergence in EU secured loan enforcement systems would make credit more readily available; ultimately the attractiveness of the EU and the Member States as investment destinations for third-country investors

\(^{116}\) See: Recital (6) of the proposed Directive.

\(^{117}\) See: “Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised)”, 101069, World Bank, Jan & May 2015, p. 16, A7 and A8 as to conditions for effective enforcement of security rights over immovable and movable assets: ‘Enforcement systems should provide efficient, cost-effective, transparent and reliable methods (including both judicial and non-judicial) for enforcing a security right. Enforcement proceedings should provide for recovery of possession of the encumbered asset, the possibility of proposing the acquisition of the asset by the secured creditor in total or partial satisfaction of the secured debt, and the prompt realisation of the rights obtained in secured assets, designed to enable recovery in a commercially reasonable manner. The proceeds should be distributed according to the priority rules of the applicable substantive law’ [italics by the author].

\(^{118}\) The recovery rate is the percentage of the distressed loan’s face value, which can be recovered by a bank or a NPL investor.

\(^{119}\) See: Recital (7) of the proposed Directive.
could be increased and the emergence of pan-European NPL investors could further improve market liquidity\textsuperscript{120}.

3. **Legal basis**\textsuperscript{121}

The establishment and proper functioning of the internal market is set out as Union objective under Article 26 TFEU, for the achievement of which the Union is competent to adopt adequate measures. More specifically, Article 114 TFEU confers the European Parliament and the Council the competence to adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

By now, there have not been available expedited and effective procedures in all Member States for out-of-court loan enforcement, to which banks could resort in case of default of business borrowers who have granted collateral as security for their loans. Indeed, value recovery from collateral posed by a borrower in a different Member State is presently regulated by rules different from the rules of the creditor’s home Member State. Apart from the legal uncertainties in the applicable value recovery regime, ordinary in-court loan enforcement in creditor’s Member State may be inefficient, costly, time-consuming and certainly diverse within the EU. Low recovery rates from secured loans and burdensome costs of legal advice discourage creditors from cross-border credit supply or increase the cost of bank lending for companies, particularly SMEs. Thus, free movement of capital is hindered to a great extent, with direct adverse effect on the functioning of the internal market.

Addressing the fragmentation of the single market into national markets with divergent funding opportunities for companies is pursued through the proposed efficient out-of-court collateral enforcement procedures. The proposed Directive makes available a distinct common expedited procedure for extrajudicial value recovery from secured loans in all Member States in case of a business borrower’s

\textsuperscript{120} See: Recital (7) of the proposed Directive.

\textsuperscript{121} See: Explanatory Memorandum of the proposed Directive, pp. 7-11.
default. In that way, it aspires to contribute to better management of NPLs through this effective debt recovery procedure, to encourage cross-border, readily available bank lending and to ameliorates the outcomes of enforcement proceeding in cross-border transactions, enhancing legal and procedural certainty. The proposed convergence in EU secured loan enforcement systems will contribute to the efficient functioning of EU capital markets, thus improving their attractiveness as investment destinations for third-country investors, and to the proper functioning of the single market, in accordance with the Articles 26 and 114 TFEU.

For the adoption of the proposed Directive, the Ordinary Legislative Procedure (ex co-decision procedure, COD) is followed under Article 294 TFEU\textsuperscript{122}, after consultation with the European Economic and Social Committee\textsuperscript{123}. EU action for completing the internal market falls under the shared competence\textsuperscript{124} between the Union and the Member States, and it must be appraised in the light of the subsidiarity principle of Article 5(3)

\textsuperscript{122} Article 294 TFEU (ex Article 251 TEC): ‘1. Where reference is made in the Treaties to the ordinary legislative procedure for the adoption of an act, the following procedure shall apply. 2. The Commission shall submit a proposal to the European Parliament and the Council. 3. The European Parliament shall adopt its position at first reading and communicate it to the Council. 4. If the Council approves the European Parliament’s position, the act concerned shall be adopted in the wording which corresponds to the position of the European Parliament [...]’.

\textsuperscript{123} See: Opinion of the EESC, mainly points 1.15 and 4.3.1. In a plenary session in July 2018, the EESC adopted its opinion, welcoming the Commission’s package to tackle NPLs. As to the proposed AECE procedure, the EESC notes that, since the enforcement process is already efficient in many Member States, focus is correctly put on the strengthening of judicial procedures across the whole EU. The EESC expresses its doubts, also held by some Member States, about the effectiveness of the proposed AECE in significantly accelerating the enforcement process in Member States where procedures in the courts are already handled in a short period of time. Finally, the EESC recognises that out-of-court procedures may be beneficial for creditors and agrees upon the restrictions on the applicability of the proposed AECE, as the AECE is available only for loan agreements between creditors and business borrowers, with the specific exclusion of consumers engaged in non-professional activities, non-profit-making companies, financial collateral arrangements and immovable residential property which is the primary residence of a business borrower.

\textsuperscript{124} Article 4 TFEU para. 1. and 2(a).
In this case of shared competence, the Union shall act only if and in so far as the objectives of the Proposal cannot be sufficiently achieved by the Member States, in the framework of their national legal systems, but can rather, by reason of its scale or effects, be better achieved at Union level. Also, the content and form of EU action should not exceed what is necessary to achieve the objectives of the Treaties, under the principle of proportionality (Article 5(4) TEU). As Directive, it enables Member States to choose form and methods required to deliver the pursued objectives, as it is binding only as to the pursued results. In that way, the proposed Directive is

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125 Article 5 TEU, para. 3.
126 See: Recital (1) of the proposed Directive. Also, see: Explanatory Memorandum of the proposed Directive, pp. 9-10 (conclusions on ‘Subsidiarity’ summarised by the author): High stocks of NPLs, the deteriorated market perceptions of the European banking sector as a whole and the negative externalities incurred have indicated the failure of individual Member States to effectively address the accumulation of NPLs, even within the framework of an EU/IMF economic adjustment programme, although they have recognised the seriousness of the problem. This failure may be attributed to the market fragmentation and legal diversity. Therefore, it has been evident that the pursued objectives cannot be achieved at all (or at least sufficiently) by individual Member States. Divergence and amplification of problems require for EU-level intervention for the resolution of such critical issues that affect banks’ soundness, credit provision and the overall economic growth. Therefore, for reasons of enhancing the economic growth and financial stability and reducing financial fragmentation, all these objectives can be better achieved at Union level, both by reasons of their scale and effects, and given the failure of Member States to sufficiently deliver the pursued objectives.
127 Article 5 TEU, para. 4.
128 Article 288 TFEU (ex Article 249 TEC): ‘A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. [...]’.
129 See: Commission Staff Working Document: Impact Assessment ‘Accelerated Extrajudicial Collateral Enforcement’ (Part 2/2), SWD/2018/76/final, 14.03.2018, accompanying the document “Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral” (COM/2018/135/final), p. 2 (‘Solutions’ summarised by the author): This second impact assessment, dealing with the AECE, considered three policy options, on top of the baseline scenario of no EU action. The first option referred to non-regulatory action based on existing international harmonisation initiatives of extrajudicial collateral enforcement procedures, so the assessed tool was Commission’s Recommendation to Member State to deploy such procedures. The second option, which was ultimately preferred upon evaluation and consideration of its impacts, was minimum harmonisation of extrajudicial collateral enforcement procedures, through a Directive. This
designed to deliver the pursued objectives and to provide a ‘level playing field’\textsuperscript{130}, enabling secured creditors to agree with the borrower upon an extrajudicial procedure for value recovery from the provided collateral, while enhancing financial stability and funding opportunities for companies, particularly SMEs. At the same time, consistency with ‘civil, commercial, property, insolvency and public laws’ shall be ensured\textsuperscript{131}, since the proposed Directive shall be without prejudice to already applicable provisions\textsuperscript{132}.

4. **Overview of specific provisions of the proposed Directive**

After the above brief analysis on the objectives pursued through the proposed extrajudicial enforcement procedure and its significance, an overview of its functioning is of outmost interest.

\textsuperscript{130} See: Recital (42) of the proposed Directive: ‘Existing enforcement procedures within the Union sometimes result in a lack of level-playing field for credit institutions and companies across the Union with regard to access to credit, particularly for SMEs which depend on bank credit more than larger companies. [...] This contributes to a lack of confidence in the ability to enforce collateral in different Member States and may lead to higher borrowing costs corresponding to place of establishment and irrespective of their real creditworthiness. Therefore, a common new procedure is required for the single market, the Banking Union and the Capital Markets Union and it is necessary to ensure that credit institutions and undertakings which are authorised to issue credit by concluding secured credit agreements in all Member States have the ability to enforce those agreements through effective and expedited extrajudicial enforcement procedures’ [italics by the author].

\textsuperscript{131} See: Explanatory Memorandum of the proposed Directive, p. 5 and 10: ‘Given the inherent links between collateral enforcement and Member States’ civil, property, commercial, pre-insolvency, insolvency and public laws, the envisaged rules on this distinct common extrajudicial collateral enforcement mechanism would need to be able to be implemented in a way that is consistent with those Member States’ laws’. Also, see: Recital (50) and Article 32 of the proposed Directive.

\textsuperscript{132} For an analysis of whether and to what extent such consistency is actually achieved, see below under III.4. and Chapter IV.
4.1. Scope of application
As already mentioned, a common framework is established for a ‘supplementary\textsuperscript{133} common Accelerated Extrajudicial Collateral Enforcement (AECE) mechanism, in respect of secured credit agreements concluded between creditors and business borrowers which are secured by collateral\textsuperscript{134}.

The scope of application\textsuperscript{135} of the AECE covers only secured credit agreements\textsuperscript{136} concluded between creditors\textsuperscript{137}, primarily credit institutions, and business borrowers\textsuperscript{138} (i.e. borrowers granted credit for the purposes of their trade, business or profession) which are secured by any movable and immovable assets (rights in rem\textsuperscript{139}) owned by the business borrower and posed as collateral to the creditor, in order to secure repayment of credit claims\textsuperscript{140}.

\textsuperscript{133} See: Recital (40) and Explanatory Memorandum of the proposed Directive, p. 10: As collateral enforcement is inextricably linked to ‘Member States’ civil, property, commercial, pre-insolvency, insolvency and public laws’, the proposed ‘distinct common extrajudicial collateral enforcement mechanism’ shall be implemented in consistency with national provisions and only as a ‘supplementary mechanism’, not interfering ‘with national extrajudicial enforcement systems for the type of collateral covered in the Proposal’.

\textsuperscript{134} Article 1 (Subject matter), point (c).

\textsuperscript{135} Article 2 (Scope).

\textsuperscript{136} Article 3, point (6): ‘ “secured credit agreement” means a credit agreement concluded by a credit institution or another undertaking authorised to issue credit, which is secured by either of the following collateral; (a) a mortgage, charge, lien or other comparable security right commonly used in a Member State in relation to immovable assets; (b) a pledge, charge, lien or other comparable security right commonly used in a Member State in relation to movable assets’.

\textsuperscript{137} Article 3, point (2).

\textsuperscript{138} Article 3, point (4): ‘ “business borrower” means a legal or natural person, other than a consumer, who has concluded a credit agreement with a creditor’.

\textsuperscript{139} Only rights in rem are covered, in contrast to personal rights (rights in personam), such as guarantee or a surety-ship.

\textsuperscript{140} See: Consultation Document, p. 14: ‘A credit economy should broadly support all manner of modern forms of lending and credit transactions and structures, with respect to utilising movable assets as a means of providing credit protection to reduce the costs of credit’.
The proposed Directive does not regulate the formalities for *vesting a security interest*, such as the format for its creation (private or notarised document), its publicity or registration in public registries or any intervention of public authorities. All these elements are still regulated within *national property law frameworks*. Neither does it interfere with the core characteristics of security interests, such as its accessory nature or the parties’ fiduciary relationship with special rights and obligations for each party\(^{141}\).

The scope of application seems *rather broad ratiome personae*, since the proposed mechanism could be made available to *any secured professional creditor* (credit institution, credit purchaser or *any legal person issuing credit in the course of its trade*), therefore the protective rationale of improving banks’ liquidity, profitability, viability and financial stability is missing. Credit institutions, operating with certain prudential requirements and subject to supervision, are indeed vessels of monetary policy transmission and perform a systemic role, in contrast to ‘any legal person issuing credit’, for which harmonisation and facilitation of debt recovery is not so imperative. *Nor a deviation of the principle of equal treatment* could be easily consolidated for such legal persons, as there are no grounds justifying their preferential treatment. Besides, the proposed Directive has as its declared objective to encourage bank lending and to establish a resilient, transparent and more integrated banking sector, therefore *its scope of application should be restricted to banks* and not cover other actors, operating outside the banking system. This extension of the scope is deliberate but also conscious, since the proposed mechanism could be explicitly applicable only to ‘credit institutions’ of Article 3, point (1) and not ‘creditors’ in general, thus it is subject to our critique.

\[^{141}\] Namely, the borrower can usually redeem the encumbered assets free of the security interest by paying off the loan, whereas the secured creditor has a duty of good care in relation to the assets provided as security. For core characteristics of security interests, see: Keijser, T. (2015), *Transactions in Securities*, in: Goode, R., Kronke, H. & McKendrick, E., *Transnational Commercial Law: Texts, Cases and Materials*, 2nd Ed., Oxford University Press, 2015, Ch. 15, p. 440, para. 15.47.
Furthermore, the scope of application is also *broad ratione materiae*, since it could cover even loans with loan payments past due *for less than 90 days*. Although the Explanatory Memorandum and Recitals refer to NPLs, the term ‘Non-Performing Loans’ is nowhere mentioned in the text of the Directive itself, so there is space for *arbitrary interpretation and extension of its application* to loans not categorised as NPLs. Neither the *enforcement event* is defined in the Directive, rather it is left to parties’ discretion to agree upon its occurrence. *Legal certainty and transactions security are greatly endangered* in this way, although the proposed Directive could have provided that the enforcement event shall be conceived as an event rendering the debt ‘overdue and chargeable’ under national provisions. Of course, with a systematic interpretation, the scope of application could be limited to NPLs, but the objective of harmonisation, convergence and legal certainty is by no means achieved.

The AECE will not be available\(^\text{142}\) in secured credit agreements concluded between creditors and ‘*consumer borrowers engaged in non-professional activities*’\(^\text{143}\) or ‘non-profit-making companies’, neither in credit agreements secured by ‘financial collateral arrangements’\(^\text{144}\) and ‘*immovable residential property, which is the primary residence of a business borrower*’\(^\text{145}\).

\(^{142}\) Article 2 (Scope) para. 5.


Restricting the scope of application to *corporate loans* enhances (or at least *preserves the same level of*) the protection of consumers and households, in consistency with safeguards for consumers and other Union policies\textsuperscript{146}. Besides, creditors’ rights are well preserved, since business borrowers are usually able to pledge more valuable and diverse movable and immovable assets as collateral and have an established operational structure, beneficial for cooperation with the creditor at the stage of enforcement. Moreover, the exclusion of consumers is in accordance with the principle of proportionality (Article 5(4) TEU), as the proposed Directive aspires to effectively strike the balance between creditor’s and business borrower’s interests.

Regarding this restriction on the scope of the accelerated debt recovery instrument to loans to businesses and corporates, it is surprising that the EBF has supported\textsuperscript{147} that generally speaking, an accelerated collateral enforcement mechanism ‘should be considered for all the categories of credit’, in order to *facilitate access to finance for consumers* as well and to reduce loss for creditors. Thankfully, the EBF did not

\textsuperscript{145} It is surprising that Article 28 of the Mortgage Credit Directive, whose primary objective is consumer protection and which is applicable to consumers and home owners, provides that ‘Member States shall not prevent the parties to a credit agreement from expressly agreeing that return or transfer to the creditor of the security or proceeds from the sale of the security is sufficient to repay the credit’. The Directive takes for granted the possibility that, based on the parties’ will, the credit agreement can provide the return or the transfer of the security to the creditor or the possibility for the creditor to proceed to the sale, *without any preclusion related to the nature of the collateral or to the category of borrower for this possibility*, but it considers the clause *an added value for both parties*.

\textsuperscript{146} See: Explanatory Memorandum of the proposed Directive, pp. 4-5: The proposed Directive is consistent with Article 169 TFEU, secondary legislation and Union rules on consumer protection in the area of financial services. Also, see: Recital (43) of the proposed Directive.

\textsuperscript{147} See: EBF comments on the EC consultation on the development of secondary markets for NPLs and protection of secured creditors, EBF_028384, 19.10.2017 [hereafter: EBF comments], pp. 12-13 (question 36).
recommend such extended application for the purposes of the proposed Directive.\textsuperscript{148} The EBF also held that ‘accelerated loan securities mechanisms are already in place in Member States – on a contractual basis - with regard to the loans covered by the Mortgage Credit Directive'.\textsuperscript{149} It is our opinion that, since the proposed mechanism aims at enhancing bank credit to corporates and entrepreneurs, its applicability should be restricted explicitly to these categories, at least at European level. Otherwise, its extension to other categories of borrowers could be used arbitrarily on behalf of creditors, who may insist on its contractual agreement as a prerequisite to provide credit to the negotiation-wise weaker parties, i.e. consumers and home owners.\textsuperscript{150}

The main residence of the business owner is also excluded from the scope of application, based on social and economic considerations of protecting sole entrepreneurs,\textsuperscript{151} as it enables the continuation of borrower’s business and the future enhancement of business borrower’s credibility. Indeed, the specific creditor seems to be deprived of another source from which it could recover value, i.e. the borrower’s main residence, but the sole entrepreneur in financial difficulties is given the chance to

\textsuperscript{148} Ibid, p. 12: ‘Nevertheless, we consider that this Commission proposal should be limited to businesses and corporates. Indeed, the proposal responds to the overall objective of the Capital Markets Union, which is to create better access to finance for businesses and corporates in the EU’. Also, in p. 13: ‘We think that accelerated loans security instruments should be considered for all the categories of credit, but we believe that this Commission Proposal should be limited to businesses and corporates because it is in the context of the CMU [...]’.

\textsuperscript{149} Ibid, p. 13.

\textsuperscript{150} See: Consultation Document, p. 12: ‘On social equity grounds, the case for a more harmonised European approach for secured loans seems potentially more difficult to make for households, especially in case of first-owned houses which are the usual family domicile, or consumers particularly if primary family residences are at stake. These considerations are less present in the case of small businesses and corporates. It therefore seems appropriate to exclude some categories of collateral givers (e.g. natural persons, householders, consumers, non-professional borrowers) and 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)’ [italics by the author].

\textsuperscript{151} Ibid. Also, see: Recital (43) of the proposed Directive.
continue the business, to restore its ability to meet its obligations and repay other loans, before they become non-performing. In that way, the proposed Directive is in conformity with the principle of proportionality and shares common objectives with the Restructuring Proposal\textsuperscript{152}, namely the prevention of the future accumulation of NPLs and increased opportunities for honest entrepreneurs to be given a fresh start and avoid insolvency. It is also in consistency with national pre-insolvency proceedings, which aim at the continuation of business borrower’s business and for this reason the main residence of business owner is protected.

The proposed Directive declares itself in full consistency with borrower rights, personal data protection rights\textsuperscript{153} and national civil law provisions governing the assignment of contracts\textsuperscript{154}. The wording of the Explanatory Memorandum here is very interesting and possibly problematic.\textsuperscript{155} The intention was probably to state that this proposal is without prejudice to borrower rights, but one could conclude that the proposal does not even take into consideration borrower rights or at least that it neglects and does not try to be in consistency with such rights.

4.2. Conditions for use of the AECE
Title V (Articles 23-33) of the proposed Directive refers exclusively to the Accelerated Extrajudicial Collateral Enforcement (AECE) as a voluntary instrument\textsuperscript{156} agreed between the secured creditor and business borrower, which the secured creditor may exercise only once the cumulative conditions set out in Article 23\textsuperscript{157} are met.

\textsuperscript{152} See below under IV.2.2.
\textsuperscript{153} See: Article 36 (Personal data protection) and Recitals (30) and (54) of the proposed Directive.
\textsuperscript{154} See: Explanatory Memorandum of the proposed Directive, p. 7: ‘Borrower rights [...] are not within the scope of this proposal’.
\textsuperscript{155} Consistency with borrower rights here refers to the framework of credit servicers’ and credit purchasers’ operation and not to traditionally recognised borrower rights during the enforcement procedure. For the latter, the following analysis will highlight some aspects of the proposed mechanism, possibly detrimental to borrowers’ interests.
\textsuperscript{156} See: Recital (44) of the proposed Directive
\textsuperscript{157} See: Article 23 (Conditions for the voluntary use of Accelerated Extrajudicial Collateral Enforcement) in Annex I.
The AECE mechanism at first reading seems sufficiently formalistic\textsuperscript{158} and protective of borrower’s interests, since it requires its previous contractual conclusion in an agreement in writing or in a notarised format (if so provided by the Member State) by the creditor and business borrower; prior provision of precise information to the business borrower about its application and consequences\textsuperscript{159}, and prior notice in writing of the creditor’s intention to realise the assets through this AECE mechanism along with other information. The AECE will not be available, if the business borrower has executed full payment\textsuperscript{160}, as stipulated in the creditor’s notification and within the given time period.

It has already been stated\textsuperscript{161} that, whereas the proposed mechanism is based on the contractual freedom of the parties, at the moment of the conclusion of the respective term, banks are the negotiation-wise powerful parties and can impose on prospective borrowers -in need for finance- any term that favours their interests. However, in non-

\textsuperscript{158} Since (mandatory) enforcement/execution of claims results in drastic intervention to constitutionally guaranteed borrower’s rights (property, personality), strict and typical procedural requirements are established. Such procedural requirements may be either general or specific (enforceable title, certain and cleared claim, legalisation of the enforcing creditor). See: Nikas, N. (2012), Manual of Enforcement Law, Sakkoulas Publications, 2012, p. 117 [translation from Greek to English by the author]. Also, see: Keijser, T. (2017), Financial collateral arrangements in the European Union: current state and the way forward, Uniform Law Review, Vol. 22 (1), 01.03.2017, p. 284 for the ‘traditional’ enforcement procedures and their mandatory set of requirements (prior notice, involvement of a court or another independent party), strict procedures guaranteeing maximum proceeds and restitution of any positive surplus). Likewise, see: Keijser, T. (2015), Ch. 15, p. 440, para. 15.47, where it is stated that disposal of assets is only possible for the secured creditor only upon borrower’s default and in accordance with strict procedures, which guarantee maximum proceeds (usually requiring for the involvement of a court, a notary or a court bailiff).

\textsuperscript{159} See: Recital (44) of the proposed Directive.

\textsuperscript{160} See: Article 23 para. 1: ‘Member States have the discretion to envisage that, in cases where a business borrower has paid at least 85% of the amount of the secured credit agreement, the period for the execution of full payment before the use of the AECE mechanism may be extended by at least six months’. The last discretion is in accordance with the proportionality principle of Article 5(4) TEU.

\textsuperscript{161} See above under III.1, p. 32.
consumer credit agreements, such terms could not be declared \textit{null and void as abusive general terms of contract} under European legislation, as they could be void or voidable in consumer loans\textsuperscript{162}, given the recently restricted European definition of the term ‘consumer’\textsuperscript{163}. Therefore, the only opportunity of their annulation is provided under national law\textsuperscript{164}. Indeed, the contractual clause on the use of the AECE mechanism, excessively restricting business borrowers’ contractual freedom\textsuperscript{165} and disproportionately favourable to creditors, could easily turn from ‘an opportunity to

\textsuperscript{162} It is to our surprise that the EBF criticises debtors’ right to oppose or to revoke unfair and abusive terms concluded with more powerful party, the bank creditor. See: EBF comments, p. 15 (question 39): ‘Moreover, in our view, in certain EU Member States, one of the main obstacles to efficient enforcement of collateral are the current privileges granted to the debtor, as the weakest party, which tend to weaken negotiations for its future possibility of opposition or revocation’.


\textsuperscript{164} For instance, in Greece, the clause on the use of the AECE mechanism could be void pursuant Article 178 of Civil Code (legal acts against morality are void) and Article 179 of Civil Code (a legal act is void especially, when it excessively restricts a person’s freedom or when the one party takes advantages of the other party’s need, affliction or inexperience and avails himself or a third person with benefits apparently disproportionate to his offer). Abusive exercise of rights is also controlled under Article 281 of Civil Code (prohibition of the abusive exercise of rights, when this exercise is contrary to good faith, commercial customs and the social or economic objective of the right).

\textsuperscript{165} It has even been proposed that ‘banks should have the possibility to disregard the accelerated loan security clause’ even if this clause was agreed with the borrower in the credit contract and to decide to activate the traditional enforcement procedures. This would allow banks to decide, from time to time, whether to use the accelerated loan security clause or the traditional enforcement procedures. The borrower \textit{should not have any option to choose which of the possible remedies the lender will use}, see: EBF comments, p. 12 (question 35) [italics by the author]. Such a recommendation reflects the tendency of \textit{enhancing the already more powerful position of banks}, to the detriment of borrowers’ interests and legal certainty. Of course, creditors could initiate judicial enforcement proceedings, disregarding this supplementary enforcement procedure, if for some reason they consider it better to obtain a court decision as enforceable title. Besides, it is upon creditor’s discretion to decide which of its claims to enforce and how, among the various legally provided procedures. However, initiation of traditional judicial proceedings after the commencement of the extrajudicial mechanism could be regarded as \textit{abusive behaviour} on behalf of the creditor.
broader access to credit’ to ‘a prerequisite for any access to credit’, unilaterally imposed and not voluntarily agreed upon.

The agreement (or clause in the credit agreement) between the secured creditor and business borrower on the use of the AECE constitutes a directly enforceable title\(^\text{166}\), in order to enable direct execution of the collateral through the AECE mechanism, without the need to obtain an enforceable title from the court. In that way, the AECE will be indeed an expedited (without the delays but also without the adequate safeguards of judicial intervention) and effective (beneficial for banks only) instrument to recover value from collateral\(^\text{167}\). However, this provision will be problematic when transposed to national legislation, since in most Member States’ jurisdictions only public documents\(^\text{168}\), i.e. court decisions, arbitral awards and notarial documents, are recognised as directly enforceable titles\(^\text{169}\). Therefore, we estimate that most Member

\(^{166}\) Article 23: ‘For the purposes of paragraph 1, the agreement referred to in paragraph 1(a) shall include a directly enforceable title’.

\(^{167}\) See: Recital (46) of the proposed Directive.

\(^{168}\) The enforceable title constitutes primary and unswerving requirement for the intervention to the personality and property of the debtor through enforcement. Enforceable title is the public document, which ensures that a specific claim can be realised through the enforcement procedure. The content and extent of the enforcement procedure and persons legitimised to initiate it are determined in the enforceable title. In that way, the state intervention is delimited and the relation of enforceability is determined, i.e. the debtor’s public law obligation and the respective creditor’s claim vis-à-vis the state for enforcement. See: Nikas, N. (2012), p. 124 [translation from Greek to English and italics by the author].

\(^{169}\) See: Article 904 of the Greek Code of Civil Procedure (grCCP): 1. Enforcement may possible only under an enforceable title. 2. Enforceable titles are: a) final (of second instance) decisions, as well as decisions of every Greek court declared provisionally enforceable; b) arbitral awards; c) records of Greek courts containing a settlement or determination of judicial costs; d) notarial documents; e) payment orders, issued by Greek courts and performance orders for the return of the use of leased property; f) foreign titles declared enforceable; g) orders and deed recognised by law as enforceable titles [translation from Greek to English by the author]. Even the point (g) refers to public documents, although with this provision the principle of ‘numerus clausus’ of enforceable titles is made more relative. This discretion to declare various orders and deed as enforceable titles is reserved only for the legislator and not for the administrative authorities of the contracting parties. See: Nikas, N. (2012), p. 239 [translation from Greek to English by the author].
States will require the notarised format of such an agreement, particularly with regard to immovable property pledged as collateral, for which national provisions usually dictate the notarised format for every transaction relating to immovable

\(^{170}\) From a comparative law perspective, in Greece the legislative decree 17.7/13.08.1923 on ‘specific provisions for publicly listed companies’ (adopted almost a century ago) recognised as enforceable title the document (private document for movable collateral, notarised for immovable) containing the credit agreement - between a credit institution (and other publicly listed companies, under certain prerequisites) and a business borrower- and the pledging of collateral (movable or immovable property).

The objective of this legislative decree was the acceleration and simplification of the debt recovery procedure, so that banks could satisfy their claims more easily. This accelerated debt recovery is – also in Greece - available upon agreement, based on contractual freedom of the parties, and aims at the encouragement of banks to provide credit and to finance productive investments, to the benefit of the whole economy of the state (bare in mind, however, the destroyed economy of Greece at the time, after consecutive wars and heavy migration flows, thus the respective state budget policy that had to be followed). The main feature of the introduced procedure is exactly the absence of an executory judgment (as enforceable title). Any subsequent declaration of debtor’s insolvency (after the provision of collateral to the bank) does not affect the validity of the security, even though created during the suspect period (which is a clear deviation from general provisions of the Bankruptcy Code). The enforcement event is stated as the time when the loan becomes ‘overdue and chargeable for any reason’, upon which the creditor is entitled to proceed to enforcement (Article 53 para. 1). For the initiation of enforcement, an order for payment, consisting of a summary of the credit agreement and description of the collateral, together with a notification on the outstanding sum of the debt, must be notified to the debtor and any holder/occupant of the collateral and then registered to the public registry (this registration counts as execution) (Article 57). After the registration, the creditor orders the notary to initiate public auction, where the notary has the role of the auction administrator (Article 59).

Only limited publicity is required for the commencement of the mandatory execution and no deadlines have to be followed. However, if the order for payment lacks the required information, the enforcement may be annulled, upon proof of debtor’s procedural damage. This deviation from the provisions of Code of Civil Procedure is, in the author’s opinion, of questionable consistency with the constitutional principle of equality, as credit institutions are treated favourably in comparison with other creditors, and the constitutional guarantees of the right to property, for the protection of which the Code of Civil Procedure has adopted certain safeguarding provisions. In any case, this extrajudicial collateral enforcement mechanism provided for banks is a national regime, where all aspects of legality and constitutionality have been weighed, in accordance with the national legal culture and the objectives to be pursued by that time. Besides, banks still prefer to obtain a court-ordered enforceable title, either in the form of a court decision or a payment order, issued by courts. Therefore, an extension to European level would be problematic from several perspectives.
property and its registration of rights in rem in public registries\textsuperscript{171}. Besides, such formal requirements of a court-issued enforcement title aim at providing legal certainty and at the \textit{substantive}\textsuperscript{172}–apart from the procedural-review of execution procedure.

The business borrower should be precluded\textsuperscript{173} from disposing of the assets pledged as collateral, as of receipt of the creditor’s written notification, and should be subject to a general duty to cooperate and to furnish all relevant information. These requirements are typical of the \textit{fiduciary relationship} between the secured creditor and the borrower\textsuperscript{174}. For business borrower’s protection\textsuperscript{175}, it should be afforded ‘reasonable time for execution of payment, averting enforcement’\textsuperscript{176}, and the creditor should make reasonable efforts to avoid the use of the AECE mechanism. These recommendations towards the avoidance of the proposed mechanism probably stand as \textit{recognition of the burdensome and unfair (to the business borrower) character of the procedure}.

The contractual nature of the AECE mechanism might ensure flexibility as to its structure, accordingly adapted to the different national legal frameworks and the specific needs of the banking system. Therefore, the architecture of the possible accelerated loan security requires \textit{careful balancing of creditors’- borrowers’ interests}, within the framework of Member States’ allowed discretion, to minimise any possible

\textsuperscript{171} See: ‘Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised)’, 101069, World Bank, Jan & May 2015, p. 13, A.4. Registry for Property and Security Rights over Immovable Assets: ‘There should be efficient, transparent, and cost-effective registration systems with regard to property rights and security rights in the grantor’s immovable assets’. The typically required \textit{registration} of ‘mortgages, hypothecs and other charges or encumbrances over immovable assets’ serves this objective of \textit{transparency} and is set to \textit{the protection of third parties}.

\textsuperscript{172} For instance, the \textit{certainty and clearance of the claim to be enforced}, as we mentioned above in fn 158.

\textsuperscript{173} Article 23 para. 2.

\textsuperscript{174} See: Keijser, T. (2015), Ch. 15, p. 440, para. 15.47.

\textsuperscript{175} See: Recital (45) of the proposed Directive: ‘In order to protect business borrowers, it is appropriate to ensure that the necessary measures are in place to ensure that creditors afford borrowers a reasonable period of time for execution of payment to avert this kind of enforcement’.

\textsuperscript{176} Article 23 para. 3.
impact on national private law (property law, pre-insolvency and insolvency law) and public law (for instance, registration system when several and different security rights are created over the same assets). As to this last point, the proposed Directive does not require any registration of the agreement or of the notice for the initiation of the enforcement, thus it should be left to national legislation to regulate such registration, especially for immovable property.
4.3. Collateral enforcement\textsuperscript{177} under proposed Directive

Member States must ensure the realisation of collateral under the AECE mechanism\textsuperscript{178}, by putting in place at least one enforcement procedure to be used for the purpose of the AECE. The collateral should be enforceable pursuant to the AECE mechanism, through public auction\textsuperscript{179} or/and private sale\textsuperscript{180}, which are commonly used to realise

\textsuperscript{177} The initial thought was the automatic ‘retention or transfer of the ownership’ of the encumbered assets pledged as collateral to the creditor, \textit{i.e.} the creation of ‘a new type of contractual security right’. See: Consultation Document, pp. 11-12: ‘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. Having acquired the ownership over the encumbered assets, the bank could therefore be in the position to \textit{foreclose the collateral} (\textit{i.e.} to execute directly the security right) via an out-of-court enforcement, \textit{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’ [italics by the author]. The automatic ownership transfer of the encumbered assets from debtors to banks, which is described in the Consultation Paper, is different from the satisfaction of a claim through an accelerated enforcement procedure and raises even more questions on the consistency of the proposed mechanism with national private and public laws. Namely, the creation of a new EU security right would be too complex and \textit{would unacceptably interfere excessively with national property law, transfer of ownership, publicity requirements and insolvency}. The designation of security rights should by default be reserved for individual Member States. Thankfully, this option was criticised and not followed (but for accounting reasons and not for the possible inconsistency with national legislation), see: EBF comments, p. 11 (question 34): [retaining or acquiring ownership of the encumbered assets] ‘could mean that the bank would have to \textit{consolidate newly acquired assets on their balance sheets to the detriment of e.g. capital allocation requirements}. A different option could be that the ownership of the encumbered asset was \textit{not transferred}, but rather that \textit{the asset was sold either through a private sale or an auction with proceeds going directly to the lender}. In this way, the lender would be satisfied \textit{while keeping the assets off the balance sheet}'. For the options that were explored, see above in fn 129.

\textsuperscript{178} See: Article 24 (Enforcement) in Annex I.

\textsuperscript{179} The public auction should be carried out only when the conditions of Article 25 are met cumulatively. See: Article 25 (Public Auction) in Annex I.
collateral in general, for each type of security right and collateral, given the multiple links of collateral enforcement with private and public laws. Under some national frameworks, where the extrajudicial enforcement procedure is exercised by means of appropriation of the assets, the right of the creditor to retain the asset shall be governed by the applicable national law.

The appointment of a notary, bailiff or other public official is questionable as to the extent it will ensure the protection of borrower’s rights, since the appointed person will only administer the enforcement procedure and ensure compliance with procedural requirements, whereas any possible substantive deficiencies of the enforcement title (the contractual agreement of the parties) will not have been reviewed by a court.

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180 The private sale should be carried out only when the conditions of Article 26 are met cumulatively. See: Article 26 (Private Sale) in Annex I.

181 See Recital (47): ‘In Member States which have already established extrajudicial enforcement procedures, those procedures are interlinked with elements of national civil, commercial, property, insolvency and public laws, and the type of enforcement procedure that may be used depends on the type of the asset provided as collateral, with procedures for immovable assets often entailing stricter procedural elements and minimum judicial oversight. Therefore, Member States should have flexibility in deciding upon the type of enforcement procedure which is made available to secured creditors for the purpose of this accelerated extrajudicial collateral enforcement: public auction or private sale, or, under some national frameworks, the appropriation of the asset.

182 Article 24 para. 3: ‘Where Member States establish the extrajudicial enforcement procedure by means of appropriation, the right of the creditor to retain the asset in or towards satisfaction of business borrower’s liability shall be governed by the applicable laws in each Member State. Member States shall ensure that in the case of appropriation the positive difference to be paid out to the business borrower shall be the difference between sum outstanding of the secured credit agreement and the valuation of the asset’.

183 Particularly in the case of immovable assets, for which procedural elements are usually stricter and there is at least minimum judicial oversight.

184 Strict procedures guaranteeing maximum proceeds are typical mandatory requirements of ‘traditional’ enforcement procedures. See: Keijser, T. (2017), p. 284. Also, see: Keijser, T. (2015), Ch. 15, p. 440, para. 15.47, where it is stated that in ‘traditional’ enforcement regimes, disposal of assets is only possible for the secured creditor only upon borrower’s default and in accordance with strict procedures, which guarantee maximum proceeds (usually requiring for the involvement of a court, a notary or a court bailiff).
Before the realisation of collateral, the creditor must organise a valuation of the assets\(^{185}\), in order to determine the reserve price and guide price, in cases of public auction and private sale respectively. Such valuation is carried out *upon agreement of the parties on the independent valuer to be appointed*, specifically for the purposes of the realisation of the collateral after the enforcement event, and should be *fair, realistic and challengeable* by the business borrower before courts\(^{186}\). Should no agreement be reached upon the appointment of a valuer, the valuer shall be appointed by a decision of a judicial court.

It is not clarified whether the agreement on the valuer to be appointed should be concluded *before or upon the enforcement event*. Such *pre-enforcement agreement*\(^{187}\) could as *abusive* as the agreement on the voluntary use of the AECE mechanism itself, as at that time the negotiation-wise powerful party is the credit provider. We rather tend to think that the agreement on the valuer should take place *after the enforcement event*, as the valuation itself, so that the borrower is given the opportunity to object to the appointment of a valuer dependent on the creditor, who anyway organises the valuation and thus may ensure a valuation outcome favourable to it. Besides, the judicial appointment of the valuer, in case of parties’ disagreement, will take place also *post-enforcement*.

The valuation procedure would be more consistent with ‘traditional’ enforcement procedures and would offer more safeguards of fairness and objectivity, should it require the *involvement of an independent public administrator*, such as a notary, a

\(^{185}\)Article 24 para. 4.

\(^{186}\)Article 28 (Right to challenge the enforcement): ‘Member States shall ensure that the business borrower has the right to challenge the use of this accelerated extrajudicial collateral enforcement mechanism before a national court where [...] the valuation of the assets has not been conducted in accordance with the national provisions transposing Article 24(4)’.

\(^{187}\)It is a common practice that banks collaborate with ‘independent valuers’ for the valuation of the initial price of the collateral, to the services of whom they would be willing to resort also for the valuation of the collateral for the purpose of its realisation. However, *the independence and objectivity of such valuers is questionable*. 

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court-bailiff or even courts, which would organise the valuation and appoint a genuinely independent valuer. Of course, this would be contrary to the extrajudicial character of the enforcement, but only partially, since the enforcement title would still be contractual-based and without judicial intervention. Besides, the criterion of fair valuation in a commercially reasonable manner can be invoked only post-enforcement and will be unfavourable to borrowers in terms of proof, since they must prove the facts they invoke (as a typical procedural rule), while the creditor organises the valuation and holds (or may counterfeit) all the relevant information. Therefore, despite the few safeguards, the valuation remains under creditor’s control and several questions of partiality may be raised.

4.4. Right to challenge the enforcement

The business borrower has the right to challenge the use of the AECE before a national court, where the sale of collateral has not been conducted in accordance with the respective provisions about appropriation, public auction and private sale, or where the valuation of the assets has not been properly conducted. The right to challenge the realisation of the encumbered assets is an expression of the fundamental right to fair trial, thus it would have still been available to business borrowers, even without its explicit provision in the proposed Directive. Pre-enforcement challenge of the

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188 See: Keijser, T. (2015), Ch. 15, p. 440, para. 15.47, where it is stated that in ‘traditional’ enforcement regimes, disposal of assets is in accordance with strict procedures, which guarantee maximum proceeds (usually requiring for the involvement of a court, a notary or a court bailiff).

189 Valuation and realisation of assets should be carried out in a commercial manner (eg. with proper publicity in advance) primarily in order to deliver the best value (and to protect the business borrower for abusive behaviour on behalf of the creditor). Besides, ‘creation of such a security by borrowers should not be more expensive or more cumbersome in terms of publicity and registry costs than other securities/collaterals’. See: EBF comments, p. 11 (question 34).

190 See: Article 28 (Right to challenge the enforcement) in Annex I.

191 See: Opinion of the EESC p. 43–49, points 1.15 and 4.3.1: ‘The EESC highlights, in a positive sense, the obligation of Member States to ensure a business borrower’s right to challenge the use of the out-of-court enforcement procedure before a national court, in accordance with the fundamental right to a fair trial (Article 47 of the Charter of Fundamental Rights of the European Union), particularly in case of unfair or abusive contractual terms or when national provisions on the sale or valuation of collateral have been violated’.
agreement itself on the use of the AECE mechanism should be always possible under national legislation on grounds related to the enforceable title, such as unfair or abusive contractual terms\textsuperscript{192}, whereas post-enforcement challenge envisaged in the proposed Directive mainly refers to the violation of the procedural requirements for the realisation of assets and the valuation of collateral (valuer’s independence, fair and realistic valuation) \textsuperscript{193}. Again, the post-enforcement challenge of the enforcement procedure will be unfavourable to the borrower in terms of proof and probably financial constraints, as the creditor organises the valuation and is the most powerful party. Besides, particular measures ordered by national courts before which the borrower challenges the enforcement, such as suspension, opposition and other interim measures, may vary significantly among Member States, thus there will still be divergent levels of borrower rights protection and divergent timeframes for the conclusion of this extrajudicial enforcement procedure.

4.5. Restitution and settlement
The creditor will be required to pay the business borrower any positive difference\textsuperscript{194} between the sum outstanding of the loan agreement and the proceeds of the sale of the asset, in public auction or private sale\textsuperscript{195}. Also, in case of appropriation\textsuperscript{196}, the creditor should be required to pay the borrower similarly any positive difference between the sum outstanding of the secured credit agreement and the valuation of the asset for the purpose of the appropriation. Restitution of any surplus was envisaged to ensure that the secured creditor only recovers what it is due by the business borrower under the credit agreement\textsuperscript{197}.

\textsuperscript{192} Only in this way, any substantive deficiencies of the contractual agreement on the AECE mechanism could be identified, since this agreement constitutes a directly enforceable title, without any judicial intervention, and its validity has not been validated by a court prior to its enforcement.

\textsuperscript{193} Article 24 para. 5.

\textsuperscript{194} See: Article 29 (Restitution of the exceeding amount) in Annex I.

\textsuperscript{195} It is typical also in ‘traditional’ enforcement procedures that any possible surplus value must be paid to the borrower. See: Keijser, T. (2017), p. 284; Keijser, T. (2015), Ch. 15, p. 440, para. 15.47.

\textsuperscript{196} Article 24 para. 3.

\textsuperscript{197} See Recital (48) of the proposed Directive.
For business borrower’s protection, where less than the sum outstanding of the secured credit agreement is recovered through the AECE, Member States may provide for the settlement of all liabilities, pursuant to respective parties’ agreement that the realisation of collateral by means of AECE is sufficient to repay the credit.

4.6. Transfer of secured credit agreement to third parties
Where a secured credit agreement, providing for the right to use AECE, is transferred by the credit institution or its subsidiary to any third party, that third party acquires the right to use this AECE in case of the business borrower’s default, under the same terms and conditions as the secured credit institution.

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198 See: Consultation Document, p. 12: ‘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’ [italics by the author].

199 See: Article 30 (Settlement of the outstanding amount) in Annex I.

200 See the critique expressed in: EBF comments, p. 10 (question 34): ‘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, could encourage borrowers to act irresponsibly and increase speculative behaviour among borrowers, especially when asset values decrease. While any proceeds from a sale of pledged assets should be subtracted from the outstanding debts, the debtor should still be responsible for remaining payments. Furthermore, full debt discharge may result in being counterproductive, since it does not promote a responsible entrepreneurship model (moral hazard which may also drive up the price of credit, to compensate for this risk). With regards to such a provision, the debtor should remain responsible for the outstanding payments’. We disagree with this critique, since decrease in assets values is part of the risks undertaken by the creditor, when providing credit. Besides, social and economic considerations of business borrower’s protection may support the argumentation in favor of the settlement of all liabilities.

201 See: Article 31 (Transfer of secured credit agreements to third parties) in Annex I.

202 See: Explanatory Memorandum of the proposed Directive, pp. 4-5: The proposed Directive is consistent with Union rules on consumer protection in the area of financial services, as the existing consumer protection rules will continue to apply, irrespective of who subsequently purchases or services the credit, irrespective of the legal regime in force in the Member State of the credit purchaser or the credit servicer and irrespective of any assignment of the creditor’s rights to a third party. Also, See: Recital (49) of the proposed Directive.
IV CONSISTENCY WITH OTHER DEBT RECOVERY FRAMEWORKS IN EUROPE

The proposed extrajudicial enforcement procedure introduces a new debt recovery framework in Europe, which deviates from core characteristics and ‘traditional’ enforcement principles, as elaborated in the previous Chapter. Potentially, the proposed mechanism could be greatly disruptive to the traditional individual and collective enforcement procedures already in place. Therefore, it will be established through a Directive, so that consistency with the national legislation could be possible, when provisions are transposed into Member States’ legal orders. As a general rule, the proposed Directive shall be without prejudice to already applicable provisions, so that consistency with civil, commercial, property and insolvency laws could be ensured. Hence, in this Chapter, we analyse the extent to which this declared consistency with the already existing enforcement regimes may be achieved.

1. National pre-insolvency and insolvency proceedings

The Proposal aspires to ensure full consistency and complementarity with pre-insolvency and insolvency proceedings, which are initiated under Member States’ national laws and regulations and aim at value recovery from any collateral pledged to secure loans, in case of business borrower’s default. Pre-insolvency and insolvency

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203 Whereas some of its aspects could be regulated upon the transposition of the proposed Directive into national legislations and whereas some safeguards have already been set, ensuring its consistency with national provisions (such as the stay of individual enforcement actions), other practical problems remain unaddressed. For instance, if ‘banks to foreclose their collateral by means of a privileged out-of-court tool, then the value of the debtor’s residual assets will be de facto reduced’. See: Consultation Document, p. 13. Therefore, the Commission has underlined the need of a very careful designation of its structure, when transposed into national legislation, so that it will be ‘coherent and consistent with the functioning of pre-insolvency and insolvency frameworks’ (p. 13).

204 For the design of national pro-insolvency and insolvency systems, see: ‘Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised)’, 101069, World Bank, Jan & May 2015, p. 3 et seq., where it is highlighted that transparency, accountability, efficiency reliability and predictability of national insolvency frameworks are promoted as fundamental to sound credit relationships and enhanced availability of credit. Unpredictable legal mechanisms for debt enforcement, recovery, and
proceedings constitute mechanisms to enforce unsecured and secured credit claims upon debtor’s default by means of collective action, under special regulations and principles suitable for the their collective character, as opposed to individual enforcement and execution²⁰⁵ (either judicial or extrajudicial).

Consistency with existing national insolvency proceedings shall be ensured thanks to the principle that the out-of-court enforcement of collateral would be possible as long as a stay of individual enforcement actions²⁰⁶ -in accordance with applicable national laws- is not applicable, meaning that the proposed AECE mechanism would only be available as long as the debtor is only in default towards the bank but before entering into restructuring or insolvency proceedings (before being judicially declared in financial distress)²⁰⁷. Consequently, where insolvency proceedings are initiated in

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²⁰⁵ Ibid, p. 5 and 12: ‘The legal framework for secured lending should address the fundamental features and elements for the creation, recognition, and enforcement of security rights in all types of assets—movable and immovable, tangible and intangible—including inventories, receivables, proceeds, and future property and, on a global basis, including both possessory and non-possessory rights […]. A modern, credit-based economy requires affordable, transparent and reasonably predictable mechanisms to enforce unsecured and secured credit claims by means of individual action (e.g., enforcement and execution), i.e. by efficient mechanisms outside of insolvency, or through sound collective action and proceedings (e.g., insolvency). These rights enable parties to rely on contractual agreements, fostering confidence that fuels investment, lending and commerce. Conversely, uncertainty about the enforceability of contractual rights increases the cost of credit to compensate for the increased risk of nonperformance or, in severe cases, leads to credit tightening’ [italics by the author].

²⁰⁶ For the rationale behind the stay of individual enforcement actions in pre-insolvency and insolvency proceedings, see: Ibid, p. 19: ‘A stay of actions by secured creditors also should be imposed in liquidation proceedings to enable higher recovery of assets by sale of the entire business or its productive units, and in reorganization proceedings where the collateral is needed for the reorganization. The stay should be of limited, specified duration, strike a proper balance between creditor protection and insolvency proceeding objectives, and provide for relief from the stay by application to the court based on clearly established grounds when the insolvency proceeding objectives or the protection of the secured creditor’s interests in its collateral are not achieved. Exceptions to the general rule on a stay of enforcement actions should be limited and clearly defined’ [italics by the author].

²⁰⁷ See the critique expressed on this restriction of the applicability of the AECE in EBF comments, pp. 14-15 (question 38): ‘This aspect would significantly weaken the value of the security and would
respect of a business borrower, the realisation of collateral pursuant to the AECE mechanism is subject to a stay of individual enforcement actions in accordance with applicable national laws. Procedural requirements for the grant, continuation or renewal and termination of the stay are left to national legislation.

Apart from the stay of individual actions, other aspects of property and insolvency law are not affected by the proposed Directive, in accordance with the principle of proportionality (Article 5, para. 4 TEU). Formalities for vesting a security interest, such as the format for its creation (private or notarised document), its registration or any intervention of public authorities, are reserved for national property law provisions. Similarly, the determination of assets forming part of the ‘estate’, conditions for set-off, the effects of the insolvency on current contracts (performance, termination, acceleration), the ranking of claims, the voidness, voidability and unenforceability of legal acts detrimental to the general body of creditors and actio

discourage banks holding such security from supporting restructuring efforts for a debtor’s potentially viable business. Furthermore, it would likely limit the viability, effectiveness and relevance of the accelerated loan security severely, since such collateral is generally most relevant in times of financial distress for the borrower. If the full effect of the collateral is to be realised, the accelerated loan security should be enforceable even when a debtor enters into an insolvency or preventive restructuring proceeding. Avoidance actions should still apply to this type of collateral in order to safeguard the rights of other creditors. However, it is rather unlikely that such an advantage for secured creditors can be integrated into the national insolvency regimes of most Member States without disruptions’ [italics by the author]. We only agree with the last position, namely that the proposed extrajudicial mechanism is already a great disruption to traditional individual and collective enforcement procedures, with limited safeguards of legitimacy, thus its inapplicability during a stay of individual enforcement actions within insolvency and pre-insolvency proceedings partially alleviates its disruptive effects and is wisely envisaged.

208 See: Article 32 para. 2 (Restructuring and insolvency proceedings) and Recital (50) of the proposed Directive in Annex I.

209 See: Explanatory Memorandum of the proposed Directive, p. 3: ‘It is designed so as to not affect preventive restructuring or insolvency proceedings’ [italics by the author].

210 See: Keijser, T. (2015), Ch. 15, p. 440, para. 15.47.

211 Secured claims may be subordinated to claims of preferential creditors, such as claims for unpaid wages of government taxes, according to the applicable national law.
pauliana\textsuperscript{212}, the retroactive effect of the declaration of insolvency for the fixation of the insolvent estate, the validity of securities vested during the suspect period, the partial satisfaction of secured creditors after the initiation of insolvency proceedings, the distribution of proceeds from the realisation of assets, the insolvency administrator’s duties and powers and other procedural aspects of the administration of insolvency are still governed by national provisions\textsuperscript{213}.

Thus, it should be left to national law, whether secured creditors have preferential access to the collateral under the accelerated debt recovery mechanism, even once insolvency proceedings are open\textsuperscript{214}. The priority attached to competing security rights in the same collateral should not be affected by their enforcement under traditional national procedures\textsuperscript{215}. The proposed extrajudicial collateral enforcement mechanism is also designed in consistency with the already nationally established hierarchy of creditors in insolvency\textsuperscript{216}.


\textsuperscript{213} See: Explanatory Memorandum of the proposed Directive, p. 3: ‘Restructuring and insolvency proceedings prevail over the accelerated extrajudicial collateral enforcement procedure set out with this proposal’ [italics by the author].

\textsuperscript{214} See: Recital (50) of the proposed Directive.

\textsuperscript{215} See: Article 27 (Competing security rights) in Annex I.

\textsuperscript{216} See: Explanatory Memorandum of the proposed Directive, p. 3: ‘It is designed so as to not affect preventive restructuring or insolvency proceedings and not to change the hierarchy of creditors in insolvency’. Also, see: Consultation Document, p. 13.

However, nowhere in the text of the proposed Directive is it explicitly stated that the hierarchy of creditors claims in insolvency will not (or shall not) be affected by the proposed mechanism.
2. Harmonised pre-insolvency and insolvency proceedings

2.1. Consistency with the Regulation on cross-border insolvency proceedings

2.1.1. The Regulation (EU) 2015/848

Since June 2017, Regulation\footnote{217} (EU) 2015/848\footnote{218} has replaced Council Regulation (EC) 1346/2000\footnote{219} to enhance the already effective administration of cross-border insolvency proceedings. The need for \textit{greater convergence in insolvency law and restructuring proceedings} across Member States has been systematically acknowledged\footnote{220}, as inefficient and divergent insolvency laws make it harder to assess and manage credit risk. Upgrading insolvency regimes towards best practices, thus enhancing legal certainty and encouraging the timely restructuring of borrowers in financial distress, could contribute to the success of strategies to address NPLs.

Regulation 2015/848 deals with issues of jurisdiction, applicable law in restructuring and insolvency procedures already existing in Member States, recognition and enforcement of insolvency decisions throughout the EU, as well as coordination of cross-border insolvency proceedings. It covers many types of insolvency procedures, including preventive/pre-insolvency procedures for companies and certain personal insolvency procedures, provided that they fulfill certain conditions.

\footnote{217} According to Article 288 TFEU, this Regulation shall have general application and direct applicability, being binding in its entirety in all Member States. There is no need for its implementation by domestic legislation; in fact, its domestication by its transposition into national legislation is not permissible. See: Goode, R. (2015), p. 508, para 17.25.
\footnote{218} Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), OJ L 141, 05.06.2015 (‘Cross-border Insolvency Regulation’).
\footnote{220} Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions ‘Towards the completion of the Banking Union’, COM/2015/587/Final, 24.11.2015.
The Regulation applies to *public collective insolvency proceedings*, including interim proceedings\(^{221}\), in which -for the purpose of rescue, adjustment of debt, reorganisation or liquidation- a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed, or the assets and affairs of a debtor are subject to control or supervision by a court, or a temporary stay of individual enforcement proceedings is granted by a court or by operation of law, in order to allow for negotiations between the debtor and its creditors\(^{222}\). Insolvency proceedings include the proceedings listed in Annex A of the Regulation\(^{223}\).

### 2.1.2. Stay of insolvency proceedings

The Regulation provides in several cases the possibility for a court to order a *stay*\(^{224}\) of insolvency *(opening or enforcement)* proceedings\(^{225}\), without prejudice to the rights in rem of creditors or third parties.

When a temporary stay of individual enforcement proceedings has been granted in the main insolvency proceedings, the court may temporarily stay\(^{226}\) the opening of

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\(^{222}\) See: Article 1 (Scope) of the Cross-Border Insolvency Regulation: ‘[...] ‘Where the proceedings referred to in this paragraph may be commenced in situations where there is only a likelihood of insolvency, their purpose shall be to avoid the debtor’s insolvency or the cessation of the debtor’s business activities’.

\(^{223}\) See: Article 2, point (4) of the Cross-Border Insolvency Regulation, which refers to Annex A. Such proceedings are primarily winding-up proceedings, in which the debtor’s assets are collected in and realised and subsequently the proceeds are distributed in accordance with the applicable insolvency law; and restructuring or re-organisation proceedings of the debtor’s company as public collective proceedings. See: Goode, R. (2015), Ch. 17, p. 509, para. 17.26.

\(^{224}\) See: Recital (69) of the Cross-Border Insolvency Regulation.

\(^{225}\) Under the Cross-Border Insolvency Regulation, insolvency proceedings may be *main proceedings* (opened within the territory of the centre of debtor’s main interests with universal effects, i.e. extending to all the debtor’s assets worldwide- Article 3 para. 1) and *territorial proceedings* (opened in another Member State where the debtor has an establishment and limited to local assets- Article 3 para. 2). Territorial proceedings may be *secondary proceedings* (opened after the opening of main proceedings) and *independent proceedings* (opened prior to main proceedings). See: Goode, R. (2015), p. 509, para. 17.27.
secondary insolvency proceedings, to preserve the efficiency of the latter and to allow for negotiations between the debtor and its creditors on a restructuring plan. A total or partial stay of the process of realisation of assets may be ordered for up to three months (with possibility of continuation or renewal) by the court that opened the secondary insolvency proceedings, upon request from the insolvency practitioner in the main insolvency proceedings. It is among the powers of the insolvency practitioner, appointed in insolvency proceedings opened in respect of a member of a group of companies, to request a stay of any measure related to the realisation of the assets in the proceedings opened with respect to any other member of the same group, under certain conditions, in order to facilitate the effective administration of the proceedings.

2.1.3. Consistency with the proposed extrajudicial mechanism

The law of the ‘State of the opening of proceedings’ (lex concursus), i.e. national legislation, determines the effects of the insolvency proceedings on proceedings brought by individual creditors, the distribution of proceeds from the realisation of assets, the ranking of claims and the satisfaction of secured creditors after the initiation of insolvency. Similarly, the insolvency practitioner may exercise all the

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226 See: Recital (45) of the Cross-Border Insolvency Regulation: ‘Second, this Regulation should provide for the possibility that the court temporarily stays the opening of secondary insolvency proceedings, when a temporary stay of individual enforcement proceedings has been granted in the main insolvency proceedings, in order to preserve the efficiency of the stay granted in the main insolvency proceedings. The court should be able to grant the temporary stay if it is satisfied that suitable measures are in place to protect the general interest of local creditors. In such a case, all creditors that could be affected by the outcome of the negotiations on a restructuring plan should be informed of the negotiations and be allowed to participate in them’. Also, see: Article 38 (Decision to open secondary insolvency proceedings) of the Cross-Border Insolvency Regulation.

227 See: Article 46 (Stay of the process of realisation of assets) of the Cross-Border Insolvency Regulation.

228 See: Article 60 para. 1(b) and 2 (Powers of the insolvency practitioner in proceedings concerning members of a group of companies) of the Cross-Border Insolvency Regulation.

229 See Article 36 and Article 7 (Applicable law) of the Cross-Border Insolvency Regulation: ‘1. Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened (the “State of the opening of proceedings”). 2. The law of the State of the opening of proceedings shall determine
powers conferred on it by lex concursus (Article 21 para. 3) with certain limitations\textsuperscript{230}. Therefore, the proposed AECE mechanism should not interfere with these issues, on which national legislators have exclusive regulatory competence\textsuperscript{231}.

Most importantly, consistency of the AECE mechanism with cross-border insolvency proceedings is ensured thanks to the approach followed by the proposed Directive, that the out-of-court enforcement of collateral would be possible as long as a stay of individual enforcement proceedings, in accordance with applicable laws, is not applicable. Where cross-border insolvency proceedings are initiated pursuant to Regulation 2015/848, the realisation of collateral pursuant to the AECE mechanism is subject to a stay of individual enforcement actions\textsuperscript{232}. This principle is line with the fact that in collective insolvency proceedings the debtor is divested of its assets and an insolvency practitioner is appointed, or the assets and affairs of a debtor are subject to court control or supervision, so the debtor (though willing to) could not satisfy its creditors through any individual enforcement procedure.

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\textsuperscript{230} See: Article 21 para. 3 (Powers of the insolvency practitioner) of the Cross-Border Insolvency Regulation: ‘In exercising its powers, the insolvency practitioner shall comply with the law of the Member State within the territory of which it intends to take action, in particular with regard to procedures for the realisation of assets. Those powers may not include coercive measures, unless ordered by a court of that Member State, or the right to rule on legal proceedings or disputes’.

\textsuperscript{231} See: Explanatory Memorandum of the proposed Directive, p. 3: ‘It is designed so as to not affect preventive restructuring or insolvency proceedings […]. Restructuring and insolvency proceedings prevail over the accelerated extrajudicial collateral enforcement procedure set out with this proposal’ [italics by the author].

\textsuperscript{232} See: Article 32 para. 2 of the proposed Directive in Annex I.
2.2. Consistency with the Restructuring Proposal

2.2.1. The Restructuring Proposal\textsuperscript{233}

In November 2016, the Commission proposed a Directive on preventive restructuring frameworks, second chance for entrepreneurs and measures to increase the efficiency of restructuring, insolvency and discharge procedures (the ‘Restructuring Proposal’)\textsuperscript{234}. The Restructuring Proposal requires Member States to ensure that their national preventive restructuring procedures comply with certain minimum principles of effectiveness.

Measures proposed in the Restructuring Proposal aim at facilitating the effective restructuring and insolvency proceedings and at establishing harmonised preventive restructuring procedures\textsuperscript{235}, so that viable companies and entrepreneurs in financial


\textsuperscript{234} From a comparative law perspective, in Greece there has been established an ‘Extrajudicial Mechanism for Settlement of Business Debts (Law 4469/2017, published on the Government Gazette, FEK A’ 62/03.05.2017, as amended by the Law 4587/2018, published on the Government Gazette A’ 218/24.12.2018). This mechanism allows the business debtor (a company or sole entrepreneur) to renegotiate and restructure (adjust) its debts in money towards its creditors (which form a group of creditors), with the objective to extrajudicially settle its obligations, while ensuring the viability and continuation of its business. This mechanism is more an extrajudicial dispute resolution procedure (facilitated by an ad hoc appointed coordinator), aiming at the effective debt restructuring with a mutually accepted settlement; it is not a strict ‘re-structuring’ or ‘re-organisation’ proceeding, since the business borrower should not be on the verge of insolvency but, on the contrary, its business should have profitable balance sheets and the borrower should present a business plan for the viable continuation of its business, in order to encourage its creditors to enter into negotiations with confidence. For this reason, any record of settlement has to be validated by the court to be rendered an enforceable title (Article 12). However, also in this case, all individual and collective enforcement actions –including interim measures- ex lege freeze for 90 days, commencing from the date when creditors were invited to participate in negotiations with their business debtor (Article 90).

\textsuperscript{235} See: Explanatory Memorandum of the Restructuring Proposal, pp. 18-19 and Recital (12): By establishing harmonised preventive restructuring proceedings, barriers to cross-border investment will be lifted and capital market development in the EU will be fostered.
difficulties could have a second chance and avoid insolvency and destruction of going concern value\textsuperscript{236}. For natural persons, including sole entrepreneurs, the proposal provides for a second chance through ‘debt discharge’, in order to enable them a fresh start and incentivise entrepreneurship. In that way, it aims at effectively striking the balance between creditor’s interest for satisfaction of its credit claims (by inspiring confidence that entrepreneurs will meet their payment obligations) and business borrower’s interest for a second chance to viably continue its business and avoid insolvency.

2.2.2. Consistency with the proposed extrajudicial mechanism

The initiative on the AECE declares itself in full consistency and complementarity with the Restructuring Proposal. The Restructuring Proposal, among other objectives, aspires to contribute to the prevention of future accumulation of NPLs and to tackle their existing high stocks\textsuperscript{237}. By improving the possibility for entrepreneurs and companies in financial difficulty to adopt a successful restructuring plan, more

\textsuperscript{236} See: Explanatory Memorandum of the Restructuring Proposal, ‘Objective of the proposal’, pp. 5-6: ‘The aim is for all Member States to have in place key principles on effective preventive restructuring and second chance frameworks, and measures to make all types of insolvency procedures more efficient by reducing their length and associated costs and improving their quality [...]'. Along with key principles, more targeted rules are necessary to make restructuring frameworks more efficient. Rules on company managers’ duty of care when nearing insolvency also play an important role in developing a culture of business rescue instead of liquidation, as they encourage early restructuring, prevent misconduct and avoidable losses for creditors. Equally important are rules on early warning tools. [...] Individuals should not be deterred from entrepreneurial activity or denied the opportunity of a second chance. Above all, the proposal aims to enhance the rescue culture in the EU. The rules on business restructuring and rights of shareholders will predominantly contribute to "prevention", the rules on avoidance, insolvency practitioners and judicial or administrative authorities to “value recovery” and the rules on second chance to “debt discharge”’ [italics by the author].

\textsuperscript{237} See: Explanatory Memorandum of the Restructuring Proposal, ‘Objective of the proposal’, pp. 5-6: ‘More specifically, such frameworks aim to [...] prevent the build-up of Non-Performing Loans, facilitate cross-border restructurings, and reduce costs and increase opportunities for honest entrepreneurs to be given a fresh start’ [italics by the author].
companies indeed could be able to avoid insolvency and turn their Non-Performing Loans into performing\(^{238}\).

Most importantly, the proposed AECE aims at establishing effective out-of-court enforcement procedures for collateral, *without prejudice to the Restructuring Proposal\(^{239}\)*, in accordance with the principle of proportionality (Article 5(4) TEU). That means that, where a preventive restructuring proceeding is initiated in respect of the business borrower, the realisation of the collateral under the AECE shall be subject to a stay of individual enforcement actions. Out-of-court collateral enforcement shall be available as long as a *stay of individual enforcement actions*, in accordance with the Restructuring Proposal, *is not applicable.*

Indeed, under the Restructuring Proposal, creditors -including secured and preferential creditors of a company or entrepreneur under restructuring proceedings- may be subject to a *stay of individual enforcement actions*\(^{240}\). The stay is conceived as a

\(^{238}\) See: Communication to complete the Capital Markets Union, p.4.

\(^{239}\) See: Article 32 para. 1 (Restructuring and insolvency proceedings) and Recital (50) of the proposed Directive in Annex I. Also, see: Explanatory Memorandum of the proposed Directive, p. 3: ‘It is designed so as to not affect preventive restructuring or insolvency proceedings [...]. Restructuring and insolvency proceedings prevail over the accelerated extrajudicial collateral enforcement procedure set out with this proposal’ [italics by the author].

\(^{240}\) See: Article 6 (*Stay of individual enforcement actions*) of the Restructuring Proposal: ‘1. Member States shall ensure that debtors who are negotiating a restructuring plan with their creditors may benefit from a stay of individual enforcement actions if and to the extent such a stay is necessary to support the negotiations of a restructuring plan. 2. Member States shall ensure that a stay of individual enforcement actions may be ordered in respect of all types of creditors, including secured and preferential creditors. The stay may be general, covering all creditors, or limited, covering one or more individual creditors, in accordance with national law. 3. Paragraph 2 shall not apply to workers’ outstanding claims [...]. 4. Member States shall limit the duration of the stay of individual enforcement actions to a maximum period of no more than four months. 5. Member States may nevertheless enable judicial or administrative authorities to extend the initial duration of the stay of individual enforcement actions or to grant a new stay of individual enforcement actions, upon request of the debtor or of creditors. [...]. 7. The total duration of the stay of individual enforcement actions, including extensions and renewals, shall not exceed twelve months’ [italics by the author].
temporary suspension of the creditor’s right to enforce a claim against a debtor\textsuperscript{241}, ordered by a judicial or administrative authority\textsuperscript{242}. Debtors who are negotiating a restructuring plan with their creditors may benefit from such a stay of limited duration (which can be extended or renewed under certain conditions, without exceeding twelve months in total\textsuperscript{243}) to the extent it is necessary to support negotiations of a restructuring plan\textsuperscript{244}.

\textsuperscript{241} See: Article 7 of the Restructuring Proposal (\textit{Consequences of the stay of individual enforcement actions}): ‘1. Where the obligation of the debtor to file for insolvency under national law arises during the period of the stay of individual enforcement actions, that obligation \textit{shall be suspended for the duration of the stay}. 2. A general stay covering all creditors \textit{shall prevent the opening of insolvency procedures} at the request of one or more creditors […]'. 4. Member States shall ensure that, during the stay period, creditors to which the stay applies may not withhold performance or terminate, accelerate or in any other way modify executory contracts to the detriment of the debtor for debts that came into existence prior to the stay. Member States may limit the application of this provision to \textit{essential contracts}, which are necessary for the continuation of the day-to-day operation of the business. 5. Member States shall ensure that creditors may not withhold performance or terminate, accelerate or in any other way modify executory contracts to the detriment of the debtor by virtue of a contractual clause providing for such measures, solely by reason of the debtor’s entry into restructuring negotiations, a requested for a stay of individual enforcement actions, the ordering of the stay as such or any similar event connected to the stay […]'. 7. Member States \textit{shall not require debtors to file for insolvency procedures if the stay period expires without an agreement on a restructuring plan being reached}, unless the other conditions for filing laid down by national law are fulfilled’ [italics by the author].

\textsuperscript{242} See: Article 2 para. (4) of the Restructuring Proposal.

\textsuperscript{243} See: Recital (19) of the Restructuring Proposal: ‘A debtor should be able to request the judicial or administrative authority for a \textit{temporary stay of individual enforcement actions} which should also suspend the obligation to file for opening of insolvency procedures where such actions may adversely affect negotiations and hamper the prospects of a restructuring of the debtor’s business. […] Member States should ensure that any request to extend the initial duration of the stay is made within \textit{a reasonable deadline} so as to allow the judiciary or administrative authorities to deliver a decision within due time. […] In the interest of legal certainty, the total period of the stay \textit{should be limited to twelve months}’ [italics by the author].

\textsuperscript{244} See: Recital (18) of the Restructuring Proposal: ‘The debtor should also \textit{not be under obligation or under threat of opening of other types of insolvency procedures}, in particular liquidation procedures, for the period of the stay, so it \textit{can continue operating its business}’ [italics by the author].
In all these cases of a stay of individual enforcement actions pursuant to the Restructuring Proposal, the proposed extrajudicial enforcement procedure will not be available, in order to enable the debtor to effectively negotiate a restructuring plan with creditors and avoid insolvency. Rescue and early prevention provisions of the Restructuring Proposal are rules of avoidance of insolvency procedures, hence 'debt discharge' takes the precedent over 'value recovery', which will be applicable only after the finalisation of the stay period of the Restructuring Proposal, either as in-court or as out-of-court collateral enforcement procedure.

3. Enforcement under the Financial Collateral Directive

3.1. The Financial Collateral Directive

The Financial Collateral Directive (FCD) introduced a European regime for the cross-border provision and enforcement of collateral in repurchase and securities lending agreements, in which the financial collateral takes the form of cash, financial instruments, namely securities, or credit claims.

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246 See: Communication from the Commission ‘Financial services: building a framework for action’, COM/98/625/Final, 28.10.1998, which highlighted the proper regulation of cross-border collateralised transactions and the mutual compatibility of relevant provisions as one of the factors contributing to the establishment of an integrated European market for financial services.

247 The financial collateral, from an economic point of view, is characterised by its function of recovery and of tradeability, which enhances liquidity. In the FCD, the financial collateral is transferred in repo, securities lending and derivatives transactions, which both have the recovery and tradeability function.

For the two functions of financial collateral and the suggested interpretation of the scope of the FCD, see: Keijser, T. (2006), Financial Collateral Arrangements: The European Collateral Directive considered
The FCD aimed at facilitating the development of a liquid cross-border cash and securities market in the EU\textsuperscript{252}, in complementarity with the \textit{Settlement Finality Directive}\textsuperscript{253} on the finality of payments of book-entry cash and securities in designated settlement systems. Both Directives aim ultimately at enhancing the optimal function of the financial market in the European Union\textsuperscript{254}. The creation of a minimum regime relating to the financial collateral was considered not to be sufficiently achieved by individual Member States, therefore, by reason of the scale and effects, it was deemed to be better achieved at Community level, in accordance with the principles of subsidiarity and proportionality\textsuperscript{255}.

\textsuperscript{248} See Article 1 para. 4 (a) of the FCD.

\textsuperscript{249} See: Recital (18) of the FCD: ‘It should be possible to provide cash as collateral under both title transfer and secured structures respectively protected by the recognition of netting or by the pledge of cash collateral. Cash refers only to money which is represented by a credit to an account, or similar claims on repayment of money (such as money market deposits), thus explicitly excluding banknotes’. Also, see: Article 2 para. 1(d) of the FCD for the definition of cash.

\textsuperscript{250} See: Article 2 para. 1(e) of the FCD for the definition of financial instruments.

\textsuperscript{251} See: Article 2 para. 1(o) of the FCD for the definition of credit claims.

\textsuperscript{252} For the objective of boosting liquidity through the upsurgen financial collateral transactions, see: Keijser, T. (2015), Ch. 15, p. 439, para. 15.44.


\textsuperscript{254} See: Recital (19) of the FCD: ‘This Directive provides for a right of use in case of security financial collateral arrangements, which increases liquidity in the financial market stemming from such reuse of ‘pledged’ securities. This reuse however should be without prejudice to national legislation about separation of assets and unfair treatment of creditors’ [italics by the author].

\textsuperscript{255} See: Recital (22) of the FCD.
3.2. Enforcement of collateral under the Financial Collateral Directive and comparison with the proposed extrajudicial mechanism

The FCD relates to ‘financial collateral arrangements’\textsuperscript{256}, i.e. title transfer or security\textsuperscript{257} financial collateral arrangements, under which a collateral-provider transfers full ownership/ full entitlement or provides a security interest to a collateral-taker respectively for the purpose of securing the performance (or covering an exposure held due to the assumption) of a financial obligation.

3.2.1. Enforcement event and commencement of the enforcement

The enforcement of financial collateral arrangements under the FCD is available \textit{upon the occurrence of an enforcement event}\textsuperscript{258}, as agreed between the parties, which entitles the collateral-taker to realise or appropriate the financial collateral or a close-out netting provision comes into effect. This provision of the \textit{contractual agreement on the enforcement event} resembles the provision of the AECE mechanism, as in both cases collateral enforcement is available to the creditor \textit{on a voluntary basis}, i.e. only upon specific prior agreement between the parties, either the collateral-provider and

\textsuperscript{256} See: Article 2 para. 1 of the FCD: ‘(a) “financial collateral arrangement” means a title transfer financial collateral arrangement or a security financial collateral arrangement whether or not these are covered by a master agreement or general terms and conditions; (b) “title transfer financial collateral arrangement” means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations; (c) “security financial collateral arrangement” means an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established’.

\textsuperscript{257} In security collateral arrangements, a security interest –\textit{other than full ownership}– is provided from the collateral-provider to the collateral-taker to secure the performance of financial obligation. See: Keijser, T. (2015), Ch. 15, p. 440, para. 15.46 [italics by the author].

\textsuperscript{258} See: Article 2 para. 1(l) of the FCD: ‘“enforcement event” means an event of default or any similar event as agreed between the parties on the occurrence of which, under the terms of a financial collateral arrangement or by operation of law, the collateral taker is entitled to realise or appropriate financial collateral or a close-out netting provision comes into effect’.

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the collateral-taker or the secured creditor and the business borrower. However, the FCD provides greater legal certainty, as it sets at least an indicative definition of the enforcement event.

3.2.2. Ways of enforcement.

Within the framework of the FCD, the collateral-taker can realise any financial collateral provided under terms of the security financial collateral arrangement in the following ways: for financial instruments, the collateral-taker is entitled to proceed to sale or to appropriation by setting off their value against or by applying their value in discharge of the relevant financial obligations; for cash collateral, the collateral-taker is entitled to set off the amount against or apply it in discharge of the relevant financial obligations; for credit claims, the collateral-taker is entitled to proceed to sale or to appropriation by setting off their value against or by applying their value in discharge of the relevant financial obligations. Appropriation of the financial instruments or credit claims is possible only if contractually agreed upon by the parties in the security financial collateral arrangement, along with their valuation.

Apart from sale and appropriation, another (liberalised and non-formalistic) way of prematurely ending the relationship between the collateral-provider and the collateral-taker is the effect of a close-out netting contractual arrangement, which

\[\text{259} \] Indeed, as elaborated above under III.4.2, according to Article 23 of the proposed Directive, the AECE mechanism must have been contractually agreed upon in writing by the creditor and business borrower in advance, with specification of the enforcement event and the period of time in which the business borrower may execute payment, following that event, in order to avert the execution under the AECE. In addition, prior the conclusion of this agreement, the business borrower must have been clearly informed about the application and consequences of the AECE.

\[\text{260} \] See: Article 4 para. 1 of the FCD (Enforcement of financial collateral arrangements).

\[\text{261} \] See: Article 4 para. 2 of the FCD (Enforcement of financial collateral arrangements).

\[\text{262} \] See: Article 2 para. 1(n) of the FCD: ‘“close-out netting provision” means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise: (i) the obligations of the parties are accelerated so as to be immediately due and expressed as an obligation to pay an amount
results in a final net amount payable by one party, with respect to each financial collateral. Close-out netting is ‘the early termination of transactions or obligations’ upon the occurrence of an enforcement event, where the valuation in a single ‘termination currency’ (so that all valued transactions be made commensurable) results in ‘the netting for the determination of the final net obligation of one party to pay the termination amount to the other party’.

3.2.3. Abolition of formal requirements

The FCD abolishes formal requirements for the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement or the

representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or (i) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party’ [italics by the author]. Also, see: Article 2 para. 1(I), 5 para. 5, 6 para.2 and 7 of the FCD.


264 The further analysis of the close-out netting provisions goes beyond the purposes of the present paper. For a more elaborate discussion, see: Keijser, T. (2015), Ch. 15, p. 446-449, para. 15.70-15.78. In para. 15.170, Keijser makes reference to the constituent elements of close-out netting, as described by: Peeters M. (2014), On Close-out Netting, in: Keijser, T. (ed.), Transnational Securities Law, Oxford University Press, 2014, Ch. 3. Keijser, T. (2015) in Ch. 15, p. 446, para 15.72 mentions the objectives pursued through the liberal enforceability of close-out netting provisions, namely the limitation of counter-party risk to a net exposure of one party (instead of the gross exposures of each party) and the mitigation of systemic risk (prevention of contagion of one party’s default to other market participants, not yet insolvent). However, Keijser, T. (2015), Ch. 15, p. 447-449, para. 15.77- 15.78 also mentions Peeters’ arguments on the contribution of the broad scope and unconstrained enforceability of close-out netting provisions to the increase of systemic risk (in terms of increased liquidity ‘subsidised’ by the parties, increased risks of runs and fire sales, and regulatory arbitrage increasing systemic risks) or other undesirable outcomes (as to some firm-specific and illiquid assets, which should not be realised unrestrictedly; and reduction in market discipline). For further analysis on the systemic vulnerabilities and systemic fragility, also see: Mokal, R. (2016), Liquidity, Systemic Risk, and the Bankruptcy Treatment of Financial Contracts, 10 Brooklyn Journal of Corporate, Financial and Commercial Law, 07.01.2016 (rev.), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2694285.

265 See: Recital (10) of the FCD: ‘For the same reasons, the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement, or the provision of financial collateral...
provision of financial collateral\textsuperscript{266}, but only \textit{after} the provision (dispossession) of the financial collateral and \textit{on condition} that this provision can be evidenced in writing or in a durable medium and the financial collateral arrangement can be evidenced in writing or any legally equivalent manner\textsuperscript{267}. This temporally limited and conditional abolition of requirements for performance of legal acts aims at striking a fair balance between market efficiency and protection of the contracting and third parties\textsuperscript{268}, particularly against the risk of fraud and from this perspective is appraised.

\begin{itemize}
\item under a financial collateral arrangement, \textit{should not be made dependent on the performance of any formal act} such as the \textit{execution} of any document \textit{in a specific form} or \textit{in a particular manner}, the \textit{making} of any filing with an official or public body or registration in a public register, advertisement in a newspaper or journal, in an official register or publication or in any other matter, \textit{notification} to a public officer or the \textit{provision} of evidence in a particular form \textit{as to the date of execution} of a document or instrument, the \textit{amount} of the relevant financial obligations or any other matter [...] For the purpose of this Directive, acts required under the law of a Member State as conditions for transferring or creating a security interest on financial instruments, \textit{other than book entry securities}, such as endorsement in the case of instruments to order, or \textit{recording} on the issuer’s register in the case of registered instruments, \textit{should not be considered as formal acts’} [italics by the author].
\item See: Article 3 para. 1 (Formal Requirements) of the FCD: ‘Member States \textit{shall not require that the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement or the provision of financial collateral under a financial collateral arrangement be dependent on the performance of any formal act}. Without prejudice to Article 1(5), when credit claims are provided as financial collateral, Member States shall not require that the creation, validity, perfection, priority, enforceability or admissibility in evidence of such financial collateral be dependent on the performance of any formal act \textit{such as the registration or the notification of the debtor of the credit claim provided as collateral}. However, Member States \textit{may require the performance of a formal act, such as registration or notification, for purposes of perfection, priority, enforceability or admissibility in evidence against the debtor or third parties [...]’ [italics by the author].
\item See: Article 3 para. 2 (Formal Requirements) of the FCD: ‘Paragraph 1 is \textit{without prejudice} to the application of this Directive to financial collateral \textit{only once it has been provided} and if that provision \textit{can be evidenced in writing and where the financial collateral arrangement can be evidenced in writing or in a legally equivalent manner’ [italics by the author]. Also, see: Articles 1 para. 5 (application of the FCD once the financial collateral has been provided), 2 para. 2 (meaning of the term ‘provision of collateral’) and 2 para. 3 (meaning of the term ‘in writing’) and Recital (11) of the FCD. Also, see: Keijser, T. (2015), Ch. 15, p. 440, para. 15.48- 15.49.
\item See: Recital (10) of the FCD: ‘[...] This Directive must however provide a \textit{balance between market efficiency and the safety of the parties to the arrangement and third parties}, thereby avoiding inter alia
At this point, the FCD differs from the proposed mechanism: whereas the FCD abolishes formal requirements for the provision of the financial collateral and the enforceability of the financial collateral arrangement (only after dispossession and under certain conditions), the proposed Directive is totally silent on this issue and reserves the maintenance or abolition of formal requirements for the national legislator. This differentiation is logical, since the FCD harmonises the whole framework of financial collateral arrangements, while the proposed Directive focuses only on the establishment of a common extrajudicial enforcement mechanism, not interfering with national provisions on issues other than the enforceability of the relevant agreement and the enforcement procedure itself.

3.2.4. Formalities for the enforcement

The realisation of the financial collateral and the effect of a close-out netting provision is subject only to the contractual terms agreed in the financial collateral arrangement, as the FCD provides for rapid, non-formalistic enforcement\(^{269}\) in a liberal regime, deviating from (actually, disapplying\(^{270}\)) the ‘traditional’ formalistic enforcement

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\(^{270}\) See: Keijser, T. (2015), Ch. 15, p. 442, para. 15.54. Also, see: Gullifer, L. (2012), What should we do about Financial Collateral?, Current Legal Problems, Vol. 65 (1), 01.01.2012 January 2012, pp. 409-10, where the special character of financial collateral is highlighted and its potential to reduce systemic risk on the financial markets. However, it is noted that, when it is used to cover for an exposure, it should be treated as any other collateral and default rules on registration, enforcement and insolvency should apply. Disapplication should be justified and be possible ad hoc to certain types of collateral arrangements, only when the cost of applying such rules outweighs the value of the rules.
procedures\textsuperscript{271}, for reasons of financial stability, liquidity and limitation of possible contagion effects of a party’s default\textsuperscript{272}. Indeed, enforcement under the FCD does not require any prior notice of collateral-taker’s intention to enforce collateral or operate the close-out netting provision; approval of the terms by court, public officer or other person; the elapse of any additional time period; or the realisation by public auction or any other prescribed manner\textsuperscript{273}.

At this point, the FCD differs from the proposed extrajudicial collateral enforcement, which requires for prior notice of creditor’s intention to enforce collateral; the elapse of reasonable time, in which the business borrower may execute full payment to avert execution; the realisation of collateral by means of public auction and/or private sale; and the valuation of the assets to be realised by an independent valuer\textsuperscript{274}. Should the realisation of collateral take place with disregard to these formalistic procedural

\textsuperscript{271} Strict ‘traditional’ enforcement procedures protect the security provider, by preventing abuse and optimising proceeds at the time of enforcement, pursuant to the fiduciary relationship between the collateral provider and collateral taker. However, the FCD follows a liberal enforcement approach, without any formal requirements for the realisation of the pledged financial collateral. For the differences between traditional and liberal approach, see: Keijser, T. (2006), p. 279 et seq.

\textsuperscript{272} Indeed, rapid and direct enforcement under the FCD promotes liquidity of the financial markets and limits contagion effects on the counterparties of a defaulting market participant, thus reducing the systemic risk. See: Keijser, T. (2006), p. 284, with arguments that could be presented in favour of the liberal approach followed by the FCD. Namely, since financial collateral arrangements are usually concluded between professional market participants of equal power position, a reasonable valuation mechanism may be agreed upon, thus there is no need for protection of the weaker party. Besides, the enforcement may be conducted in a commercially reasonable manner in accordance with national legislator’s discretion. However, Keijser is skeptical towards this deviation from the traditional formalistic enforcement, in the case of SMEs, which are less powerful than major financial institutions and not ‘professionals’ in financial collateral arrangements with the necessary expertise to assess the commercial reasonableness (if the standard is imposed and only post-enforcement). For these reasons, he proposes the non-application of the FCD to SMEs, under Article 1 para. 3. The same concerns are expressed in: Keijser, T. (2015), Ch. 15, p. 442, para. 15.55. Also, see: Gullifer, L. (2012), pp. 409-10, who supports only ad hoc disapplication of formalities, when justified by good countervailing policy reasons.

\textsuperscript{273} See: Article 4 para. 4 of the FCD (Enforcement of financial collateral arrangements) of the FCD.

\textsuperscript{274} See: Articles 23 para. 1, 24 para. 2, 25 and 26 of the proposed Directive.
requirements, the business owner is entitled to challenge the enforcement a posteriori, in accordance with the Article 28 of the proposed Directive.

The differentiation is logical, since financial collateral arrangements are usually concluded between market participants of equal negotiating power, without the need of protective formalities, and the (optional) standard of commercial reasonableness for the valuation of the financial collateral275, wherever imposed, may give grounds for an ex post challenge of the enforcement. On the other side, the extrajudicial enforcement mechanism will be available for secured credit agreements between market participants of by default extremely unbalanced power position, therefore protection of the weaker party, i.e. the business borrower, against creditor’s potentially abusive behavior should be ensured through such formal requirements, as in other ‘traditional’ enforcement procedures. The extent to which business borrower’s rights are in essence safeguarded (at least pre-enforcement) has been analysed already in Chapter III and is intensely questioned.

3.2.5. Restitution of the surplus
The issue of the collateral-provider’s right to surplus value upon enforcement is not dealt with in the FCD, rather than it continues to be determined under the national applicable law276. On the contrary, in the case of realisation of collateral under the AECE mechanism, the creditor shall be required to pay the business borrower any positive surplus277, as in ‘traditional’ enforcement procedures. The proposed Directive hereby explicitly protects the business borrower, by ensuring that the secured creditor only recovers what it is due under the credit agreement and restitutes any positive difference, in consistency with the typical characteristics of their fiduciary relationship.

275 See: Article 4 para. 6 of the FCD: ‘This Article and Articles 5, 6 and 7 shall be without prejudice to any requirements under national law to the effect that the realisation or valuation of financial collateral and the calculation of the relevant financial obligations must be conducted in a commercially reasonable manner’.
277 See: Article 29 of the proposed Directive in Annex I.
3.3. Relationship with pre-insolvency and insolvency proceedings

The enforcement of a financial collateral arrangement\textsuperscript{278} and a close-out netting provision\textsuperscript{279} should take effect, \textit{notwithstanding the commencement or continuation} of insolvency or pre-insolvency proceedings for the collateral-provider or collateral-taker. In other words, the enforcement under the FCD \textit{is not hindered by a freeze period}, since a stay of individual actions exercising any security right would hinder liquidity of financial markets, thus posing a systemic risk, taken into consideration that usually the major market participants entering into financial collateral arrangements may influence the liquidity of financial markets\textsuperscript{280}.

The FCD also envisages \textit{the disapplication of certain insolvency provisions}\textsuperscript{281}, namely \textit{the automatic retroactive effect of the declaration of insolvency} to the start of the day this declaration (‘\textit{timing claw back}’ or ‘\textit{zero hour rules}’\textsuperscript{282}). The validity and enforceability of ‘\textit{margin maintenance}’ (\textit{top-up arrangements}) and ‘\textit{substitution

\textsuperscript{278} See: Article 4 para. 5 of the FCD: ‘Member States shall ensure that a financial collateral arrangement can take effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker the realisation’.

\textsuperscript{279} According to Article 7 of the FCD, a close-out netting provision should be able to take effect in accordance with its terms, \textit{notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures and/or notwithstanding any purported assignment, judicial or other attachment or other disposition of or in respect of such rights, without any requirements for its activation.}


\textsuperscript{281} See: Article 8 of the FCD (Certain insolvency provisions disapplied): ‘1. Member States shall ensure that a financial collateral arrangement, as well as the provision of financial collateral under such arrangement, may not be declared invalid or void or be reversed on the sole basis that the financial collateral arrangement has come into existence, or the financial collateral has been provided: (a) on the day of the commencement of winding-up proceedings or reorganisation measures, but prior to the order or decree making that commencement; or (b) in a prescribed period prior to, and defined by reference to, the commencement of such proceedings or measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such proceedings or measures’.

\textsuperscript{282} See: Keijser, T. (2015), Ch. 15, p. 443, para. 15.59.
arrangements", remains also unaffected from the retroactive effect of the declaration of insolvency. The FCD even provides for the enforceability of the financial collateral arrangement on the day of, but after the commencement of insolvency and pre-insolvency proceedings, should the collateral-taker have not been aware of this commencement.

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283 See: Keijser, T. (2015), Ch. 15, p. 443, para. 15.60.

284 See: Recital (16) of the FCD: ‘[...] The intention is merely that the provision of top-up or substitution financial collateral cannot be questioned on the sole basis that the relevant financial obligations existed before that financial collateral was provided, or that the financial collateral was provided during a prescribed period. However, this does not prejudice the possibility of questioning under national law the financial collateral arrangement and the provision of financial collateral as part of the initial provision, top-up or substitution of financial collateral, for example where this has been intentionally done to the detriment of the other creditors (this covers inter alia actions based on fraud or similar avoidance rules which may apply in a prescribed period)’ [italics by the author].

285 See: Article 8 para. 3 of the FCD: ‘Where a financial collateral arrangement contains: (a) an obligation to provide financial collateral or additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations, or (b) a right to withdraw financial collateral on providing, by way of substitution or exchange, financial collateral of substantially the same value, Member States shall ensure that the provision of financial collateral, additional financial collateral or substitute or replacement financial collateral under such an obligation or right shall not be treated as invalid or reversed or declared void on the sole basis that: (i) such provision was made on the day of the commencement of winding-up proceedings or reorganisation measures, but prior to the order or decree making that commencement or in a prescribed period prior to, and defined by reference to, the commencement of winding-up proceedings or reorganisation measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such proceedings or measures; and/or (ii) the relevant financial obligations were incurred prior to the date of the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral’.

286 See: Article 8 para. 2 of the FCD: ‘Member States shall ensure that where a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided on the day of, but after the moment of the commencement of, winding-up proceedings or reorganisation measures, it shall be legally enforceable and binding on third parties if the collateral taker can prove that he was not aware, nor should have been aware, of the commencement of such proceedings or measures’ [italics by the author].
The far-reaching reform the FCD has brought about to the insolvency law\textsuperscript{287}, in correlation with its broad scope of application has been criticised in academic literature\textsuperscript{288}. Apart from the disapplication of the aforementioned insolvency rules, the FCD leaves unaffected the general national provisions on protection of the general body of creditors from fraud\textsuperscript{289}. As general remark, the FCD deviates from national provisions on insolvency and pre-insolvency proceedings to a great extent, disrupting general protective principles. In contrast, the proposed extrajudicial mechanism is designed without prejudice to national insolvency law, as the proposed Directive reserves almost all issues for the national legislator and is in consistency with the general rule of the stay of individual enforcement actions, for which case the proposed mechanism will be inapplicable.

3.4. Consistency of the Financial Collateral Directive with the proposed Directive

The proposed Directive is consistent with the FCD, with the meaning that their application is \textit{mutually exclusive}: value recovery under the AECE is available if contractually agreed upon only in secured credit agreements concluded between


\textsuperscript{288} See: Keijser, T. (2006), pp. 324-325, where the critique also refers to the contradiction of the FCD with the pari passu rule (which aims at protecting the interests of the joint creditors of the insolvent estate against the single interest of an individual creditor), since the FCD favours the counterparty of the insolvent party, to the detriment of all other creditors. Indeed, under the FCD the interests of the joint creditors sometimes concede to the interest of a single creditor, thus entailing the risk of serious abuse, as the insolvent collateral provider may arbitrarily make effective payments to individual creditors of his choice even after the declaration of insolvency, who are protected if they have acted in good faith. Also, see: Keijser, T. (2017), p. 286; Keijser, T. (2016), pp. 318-321 and p. 324 (proposed amendments to the FCD and the SFD, namely provisions for the non-enforceability of legal acts after the declaration of insolvency, retroactive force of the declaration of insolvency and applicability of the moratorium). Also, see: Gullifer, L. (2012), pp. 409-10, on restrictions that should be imposed on the disapplication of registration, enforcement and insolvency rules.

\textsuperscript{289} See: Article 8 para. 4: 'Without prejudice to paragraphs 1, 2 and 3, this Directive leaves unaffected the general rules of national insolvency law in relation to the voidance of transactions entered into during the prescribed period referred to in paragraph 1(b) and in paragraph 3(i)'. Also, see: Keijser, T. (2015), Ch. 15, p. 443, para. 15.62.
creditors and business borrowers, with the explicit exclusion of credit agreements secured by financial collateral arrangements\textsuperscript{290}. Thus, the proposed Directive governs the out-of-court enforcement of types of collateral (immovable and movable assets) other than the financial collateral, falling within the scope of the FCD.

\textsuperscript{290} See: Article 2 para. 5 of the proposed Directive in Annex I.
Concluding Remarks

The present paper has examined various legal aspects of the proposed common accelerated extrajudicial collateral enforcement mechanism, in the light of the institutional documents of its inspiration, the objectives it pursues, its designed structure and its consistency with other -national or harmonised- collateral enforcement procedures.

As concluding remark, it could be stated that the proposed mechanism has a broad scope and is greatly disruptive to ‘traditional’ individual or collective enforcement procedures and national property laws, overturning the fair balance between creditor’s and debtor’s rights. Ad hoc deviation from default formalities and rules on enforcement should be justified by well-founded countervailing policy reasons, namely when the cost of applying such rules outweighs the value of the rules, in this case when the burdens of obtaining a judicially issued enforceable title on behalf of secured creditors outweighs (in terms of costs, time and complexities) the need for sufficient protection of borrower rights²⁹¹. We have great difficulty to believe that court intervention is so burdensome to credit institutions, with an elaborate technical and financial infrastructure, that it justifies the sacrifice of borrower rights and legal certainty.

In fact, although the proposed mechanism was conceived as an initiative to ensure creditor’s protection without prejudice to the business borrower’s rights, by effect it does not even take into consideration borrower interests on various occasions. Furthermore, the ‘accelerated’ element seems to endanger every notion of legal certainty and the European acquis on the right to property and fair trial, as the space left to judicial review of and court intervention to the enforcement procedure is very narrow and only a posteriori. Besides, its expedited commencement –without judicial intervention- could accelerate business borrowers’ default, with devastating systemic

effects on entrepreneurship, which the proposed Directive supposedly aims to enhance\textsuperscript{292}.

The (potentially very broad) scope of application of the proposed Directive, the contractual nature of the mechanism and the direct enforceability of the parties’ agreement, the commencement of the enforcement and the valuation procedure have been subject to our critique, since arbitrary, abusive and unfair behaviour on behalf of the creditor will be possible, without sufficient safeguards for the business borrower.

It could be said symbolically that the extrajudicial enforcement mechanism may have been conceived as ‘deus ex machina’ to ‘save’ the performance of distressed loans, but ultimately it has been designed as a ‘Trojan horse’, with which credit institutions pursue to ‘conquer’ business borrowers’ property, covertly and without appropriate safeguards, so as to have their profits maximised again.

Maybe the solution for the effective resolution of high stocks of NPLs and the prevention of their future accumulation lies in a more delicate and balanced harmonisation of debt recovery through the enhancement of the already existing enforcement procedures in terms of time, costs, recovery rates, and complexities and not the introduction of a radically new extrajudicial mechanism at European level. Of course, individual Member States could provide for out-of-court procedures, to the extent that this is compatible with their legal culture, social considerations and economic objectives\textsuperscript{293}.

\textsuperscript{292} Argument inspired from the argumentation on the risks that the enforcement under the FCD entails, in: Keijser, T. (2015), Ch. 15, p. 445, para. 15.67.

\textsuperscript{293} For the design of national pro-insolvency and insolvency systems, see: ‘Principles for Effective Insolvency and Creditor/Debtor Rights Systems (Revised)’, 101069, World Bank, Jan & May 2015, p. 3 et seq., where it is highlighted that national insolvency frameworks depend on structural, institutional, social, and human fundamental values and national legal tradition. Therefore, their effectiveness is assessed based on the resolution of national problems and needs, within the country’s broader cultural, economic, legal, and social context.
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294 In chronological order, from the oldest to the most recent ones.
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Annex I. The proposed Directive


THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 53 and Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee,

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) The establishment of a comprehensive strategy to address the issue of non-performing loans (NPLs) is a priority for the Union. While addressing NPLs is primarily the responsibility of credit institutions and Member States, there is also a clear Union dimension to reduce current stocks of NPLs, as well as to prevent any excessive build-up of NPLs in the future. Given the interconnectedness of the banking and financial systems across the Union where credit institutions operate in multiple jurisdictions and Member States, there is significant potential for spill-over effects between Member States and the Union at large, both in terms of economic growth and financial stability.

(2) An integrated financial system will enhance the resilience of the Economic and Monetary Union to adverse shocks by facilitating private cross-border risk-sharing, while at the same time reducing the need for public risk-sharing. In order to achieve these objectives, the Union should complete the Banking Union and further develop a Capital Markets Union (CMU). Addressing high stocks of NPLs and their possible future accumulation is essential to completing the Banking Union as it is essential for ensuring competition in the banking sector, preserving financial stability and encouraging lending so as to create jobs and growth within the Union.

(3) In July 2017 the Council in its "Action Plan to Tackle Non-Performing Loans in Europe" called

295 There have been included only the Recitals and Articles relevant for the analysis of the present paper.
upon various institutions to take appropriate measures to further address the high number of NPLs in the Union. The Action Plan sets out a comprehensive approach that focuses on a mix of complementary policy actions in four areas: (i) bank supervision and regulation (ii) reform of restructuring, insolvency and debt recovery frameworks, (iii) developing secondary markets for distressed assets, and (iv) fostering restructuring of the banking system. Actions in these areas are to be taken at national level and at Union level where appropriate. The Commission announced a similar intention in its "Communication on completing the Banking Union" of 11 October 2017, which called for a comprehensive package on tackling NPLs within the Union.

(4) This Directive, together with other measures which the Commission is putting forward, as well as the action taken by the ECB in the context of banking supervision under the Single Supervisory Mechanism (SSM) and by the European Banking Authority will create the appropriate environment for credit institutions to deal with NPLs on their balance sheets, and will reduce the risk of future NPL accumulation.

(6) This Directive should enable credit institutions to better deal with loans once these become non-performing by improving conditions to either enforce the collateral used to secure the credit or to sell the credit to third parties. The introduction of accelerated collateral enforcement as a swift mechanism for the recovery of collateral value would reduce the costs for resolving NPLs and would hence support both credit institutions and purchasers of NPLs in recovering value. Moreover, when credit institutions face a large build-up of NPLs and lack the staff or expertise to properly service them, one viable solution would be to either outsource the servicing of these loans to a specialised credit servicer or to transfer the credit agreement to a credit purchaser that has the necessary risk appetite and expertise to manage it.

(7) The two solutions for credit institutions to deal with NPLs provided for by this Directive are mutually reinforcing. The shorter time for enforcement and the increased recovery rates, as expected with accelerated extrajudicial collateral enforcement increases the value of an NPL. In turn, this would raise bid prices in NPL transactions. A further effect is that selling NPLs will be less complicated if the loan is collateralised. The reason for this is that price determination is simpler for a collateralised NPL than an unsecured one in a secondary market transaction because the value of the collateral sets a minimum value of a NPL. With a more liquid and better functioning secondary market for NPLs where investors would show greater interest for NPLs incorporating the accelerated enforcement feature, there would be additional incentives for credit institutions to use accelerated extrajudicial collateral enforcement at the time of issue of the new loans. Moreover, the harmonisation achieved by this Directive would foster development of pan-Union NPL investors, thus further improving market liquidity.

(21) In addition, this Directive does not reduce the scope of application of Union consumer

(30) An important prerequisite for the taking up of the role by credit purchasers and credit servicers should be that they can access all relevant information and Member State should ensure that this is possible, while at the same time observing Union and national data protection rules.

(39) In the Council's "Action Plan to Tackle Non-Performing Loans in Europe", a legislative initiative was put forward to enhance the protection of secured creditors by providing them with more efficient methods of value recovery from secured credit through an accelerated extrajudicial collateral enforcement procedure.

(40) Expedited and efficient out-of-court enforcement mechanisms which enable secured creditors to recover value from collateral in case of borrower’s default are not available in some Member States, which means that in those Member States secured creditors are only able to enforce collateral in court, which can be lengthy and costly. Where available, the scope and efficiency of the extrajudicial enforcement procedures vary from one Member State to another. For that reason it is necessary to establish a distinct common mechanism available in all Member States. That mechanism should not, however, replace existing national enforcement measures including those that do not require the involvement of courts.

(41) The inefficiency of some Member States' extrajudicial enforcement procedures is an important factor for low recovery rates where business borrowers default on secured credit agreements. The length of some existing procedures entails additional costs for secured creditors and loss of value of the assets provided as collateral. In the Member States which have not established extrajudicial enforcement procedures for various types of collateral, secured creditors face often lengthy judicial enforcement processes.

(42) Existing enforcement procedures within the Union sometimes result in a lack of level-playing field for credit institutions and companies across the Union with regard to access to credit, particularly for SMEs which depend on bank credit more than larger companies. Uneven recovery rates across Member States lead to differences in the availability of bank credit for SMEs because the credit institutions' lending capacity decreases as NPLs accumulate on their balance sheets, due to prudential requirements and internal resources which need to be dedicated to dealing with NPLs. This contributes to a lack of confidence in the ability to enforce collateral in different Member States and may lead to higher borrowing costs corresponding to
place of establishment and irrespective of their real creditworthiness. Therefore, a common new procedure is required for the single market, the Banking Union and the Capital Markets Union and it is necessary to ensure that credit institutions and undertakings which are authorised to issue credit by concluding secured credit agreements in all Member States have the ability to enforce those agreements through effective and expedited extrajudicial enforcement procedures.

(43) In order to protect consumers, credit agreements provided to consumers should be excluded from the scope of the accelerated extrajudicial enforcement mechanism provided for in this Directive. Equally, in order to protect sole entrepreneurs, this mechanism should not apply to credit agreements secured by collateral in the form of real estate which is the main residence of the sole entrepreneur.

(44) Since this accelerated extrajudicial collateral enforcement mechanism is a voluntary instrument which is subject to agreement between the secured creditor and the business borrower, it is necessary that the borrower be informed about the consequences and of the conditions under which this accelerated procedure may be used by the creditor. Therefore the conditions should be established in a written agreement, or in a notarised format where national law so provides, between the creditor and the borrower.

(45) In order to protect business borrowers, it is appropriate to ensure that the necessary measures are in place to ensure that creditors afford borrowers a reasonable period of time for execution of payment to avert this kind of enforcement.

(46) In order to ensure that this accelerated extrajudicial collateral enforcement mechanism is an expedited and effective instrument to recover value from collateral, the agreement by which the secured creditor and the business borrower agree upon it should comprise a directly enforceable title, which is a clause in the agreement that enables direct execution of the collateral through AECE without the need to obtain an enforceable title from the court.

(47) In Member States which have already established extrajudicial enforcement procedures, those procedures are interlinked with elements of national civil, commercial, property, insolvency and public laws, and the type of enforcement procedure that may be used depends on the type of the asset provided as collateral, with procedures for immovable assets often entailing stricter procedural elements and minimum judicial oversight. Therefore Member States should have flexibility in deciding upon the type of enforcement procedure which is made available to secured creditors for the purpose of this accelerated extrajudicial collateral enforcement: public auction or private sale, or, under some national frameworks, the appropriation of the asset.
(48) In order to ensure that the secured creditor only recovers what it is due by the business borrower under the credit agreement, Member States should ensure that the secured creditor is obliged to pay the business borrower any positive difference between the sum outstanding of the secured credit agreement and the proceeds of the sale of the asset (following public auction or private sale) or, in the case of appropriation between the sum outstanding and the valuation of the asset performed for the purpose of the appropriation. It is appropriate that where Member States provide for the realisation of collateral by means of appropriation, the positive difference to be paid out to the borrower should be the difference between the sum outstanding of the secured credit agreement and the valuation of the asset. Where less than the sum outstanding of the secured credit agreement is recovered through this accelerated enforcement, Member States should not prevent the parties to a secured credit agreement from expressly agreeing that the realisation of collateral by means of AECE is sufficient to repay the credit.

(49) Member States should ensure that where a secured credit agreement which provides for the accelerated extrajudicial collateral enforcement set out in this Directive is transferred by the creditor to a third party, that third party would acquire the right to avail himself of the accelerated extrajudicial collateral enforcement under the same terms and conditions as the secured creditor.

(50) In order to ensure consistency with pre-insolvency and insolvency rules, Member States should ensure that where a preventive restructuring proceeding, as provided for in the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring and second chance, is initiated in respect of the business borrower, the realisation of the collateral pursuant to an AECE is subject to a stay of individual enforcement actions in accordance with applicable national laws transposing that Directive. In the case of any insolvency proceedings which are initiated in respect of the business borrower, the realisation of the collateral pursuant to an AECE should also be subject to a stay of individual enforcement actions in accordance with applicable national laws. It should be left to national law whether secured creditors have preferential access to the collateral under this accelerated mechanism even once insolvency proceedings are open.

(51) Given the limited availability of data on the number of extrajudicial procedures used by credit institutions to recover value from collateral in case of borrower's default, national competent authorities which supervise credit institutions should be required to collect information on the number of secured credit agreements which are enforced through AECE and the timeframes for such enforcement. In order to gain a better understanding of the effectiveness of the exercise of AECE within the Union, Member States should provide annual statistical data on these matters to the Commission starting from one year after the
date of application of this Directive.

(52) Without prejudice to pre-contractual obligations under Directive 2014/17EU, Directive 2008/48/EC and Directive 93/13/EEC, and in order to ensure a high level of consumer protection, the consumer should be presented, in due time and prior to any modifications to the terms and conditions of the credit agreement, with a clear and comprehensive list of any such changes, the timescale for their implementation and the necessary details as well as the name and address of the national authority where he or she may lodge a complaint.

(54) Both the provisions of Regulation (EU) 2016/679 of the European Parliament and of the Council and Regulation (EC) No 45/2001 of the European Parliament and of the Council apply to the processing of personal data for the purposes of this Directive. In particular, where personal data is processed for the purposes of this Directive, the precise purpose should be specified, the relevant legal basis referred to, the relevant security requirements laid down in Regulation (EU) 2016/679 complied with, and the principles of necessity, proportionality, purpose limitation and proportionate data retention period respected. Also, personal data protection by design and data protection by default should be embedded in all data processing systems developed and used within the framework of this Directive. Equally, administrative cooperation and mutual assistance between the competent authorities of the Member States should be compatible with the rules on the protection of personal data laid down in Regulation (EU) 2016/679 of the European Parliament and of the Council, and in accordance with national data protection rules implementing Union legislation.

(56) In accordance with the Joint Political Declaration of 28 September 2011 of Member States and the Commission on explanatory documents, Member States have undertaken to accompany, in justified cases, the notification of their transposition measures with one or more documents explaining the relationship between the components of a directive and the corresponding parts of national transposition instruments. With regard to this Directive, the legislator considers the transmission of such documents to be justified,

H ave adopted this Directive:

Title I. Subject matter, scope and definitions

Article 1. Subject matter

This Directive lays down a common framework and requirements for:

(a) credit servicers acting on behalf of a credit institution or a credit purchaser in respect of a credit agreement issued by a credit institution or by its subsidiaries;

(b) credit purchasers of a credit agreement issued by a credit institution or by its subsidiaries;

(c) a supplementary common accelerated extrajudicial collateral enforcement
mechanism in respect of secured credit agreements concluded between creditors and business 
borrowers which are secured by collateral.

Article 2. Scope

2. Articles 3, 23 to 33 and 39 to 43 of this Directive shall apply to secured credit agreements 
concluded between creditors and business borrowers which are secured by any movable and 
immovable assets owned by the business borrower and which have been posed as collateral to a 
creditor in order to secure repayment of claims arising from the secured credit agreement.

3. This Directive does not affect the protection granted to consumers, pursuant to Directive 
transposing them, with regard to credit agreements falling within its scope.

5. Articles 3, 23 to 33 and 34 to 43 of this Directive shall not apply to:

(a) secured credit agreements concluded between creditors and borrowers who are consumers 
as defined in point (a) of Article 3 of Directive 2008/48/EC;

(b) secured credit agreements concluded between creditors and business borrowers who are 
non-profit making companies;

(c) secured credit agreements concluded between creditors and business borrowers which are 
secured by the following categories of collateral: (i) financial collateral arrangements as defined 
in Article 2(1)(a) of Directive 2002/47/EC; (ii) immovable residential property which is the 
primary residence of a business borrower.

Article 3. Definitions

For the purpose of this Directive, the following definitions shall apply:

(1) 'credit institution' means a credit institution as defined in point (1) of Article 4(1) of 
Regulation (EU) No 575/2013;

(2) 'creditor' means a credit institution or any legal person who has issued a credit in the course 
of his trade, business or profession, or a credit purchaser;

(3) 'borrower' means a legal or natural person who has concluded a credit agreement with a 
creditor;

(4) 'business borrower' means a legal or natural person, other than a consumer, who has 
concluded a credit agreement with a creditor;

(5) 'credit agreement' means an agreement as originally issued, modified or replaced, whereby a 
creditor grants or promises to grant a credit in the form of a deferred payment, a loan or other 
similar financial accommodation;

(6) 'secured credit agreement' means a credit agreement concluded by a credit institution or 
another undertaking authorised to issue credit, which is secured by either of the following
collateral; (a) a mortgage, charge, lien or other comparable security right commonly used in a Member State in relation to immovable assets; (b) a pledge, charge, lien or other comparable security right commonly used in a Member State in relation to movable assets;

TITLE V. Accelerated Extrajudicial Collateral Enforcement

Article 23. Conditions for the voluntary use of Accelerated Extrajudicial Collateral Enforcement

1. Member States shall ensure that this accelerated extrajudicial collateral enforcement mechanism may be exercised by a creditor where all of the following conditions are fulfilled:
   (a) the mechanism has been agreed in writing, or in a notarised format if so provided by the Member State, by the creditor and business borrower and that agreement specifies the enforcement event and the period of time in which the business borrower may execute payment following that event in order to avert the execution of this accelerated extrajudicial collateral enforcement;
   (b) the business borrower has been clearly informed about the application and consequences of this accelerated extrajudicial collateral enforcement prior to the conclusion of the agreement referred to in point (a);
   (c) within 4 weeks of the enforcement event, or such later point in time where so negotiated by the creditor and the business borrower, the creditor has notified the business borrower, in writing, of all of the following:
      (i) the creditor’s intention to realise the assets through this accelerated extrajudicial collateral enforcement mechanism to satisfy the contractual obligations of the secured credit agreement;
      (ii) the type of enforcement measure to be applied as referred to in Articles 25 and 26;
      (iii) the time period for the execution of payment before the use of the accelerated extrajudicial collateral enforcement mechanism referred to in point (a);
      (iv) the default amount of the secured credit agreement due pursuant to the contractual obligations of the secured credit agreement;
   (d) the business borrower has not executed the full payment as stipulated in the creditor’s notification referred to in point (c).

For the purposes of paragraph 1, the agreement referred to in paragraph 1(a) shall include a directly enforceable title.

For the purposes of paragraph 1(a), Member States may establish that in cases where a business borrower has paid at least 85% of the amount of the secured credit agreement, the period referred to therein may be extended by at least six months.

2. Member States shall ensure that the business borrower is not permitted to dispose of the
assets pledged as collateral as of receipt of the notification referred to in paragraph 1(c) and is subject to a general duty to cooperate and to furnish all relevant information where this accelerated extrajudicial collateral enforcement mechanism is exercisable in accordance with paragraph 1.

3. Member States shall ensure that the creditor affords the business borrower a reasonable period of time for execution of payment and makes reasonable efforts to avoid the use of this accelerated extrajudicial collateral enforcement mechanism.

Article 24. Enforcement

1. Member States shall ensure that collateral may be realised pursuant to this accelerated extrajudicial collateral enforcement mechanism.

2. Member States shall provide for at least one or both of the following means to realise the collateral as referred to in paragraph 1 for each type of security right and collateral: (a) public auction; (b) private sale.

3. For each of these means, Member States may provide that a notary, bailiff or other public official is appointed where appropriate to ensure an efficient and expedited distribution of sale proceeds and transfer of the collateral to an acquirer, or safeguard the borrower’s rights.

4. Where Member States establish the extrajudicial enforcement procedure by means of appropriation, the right of the creditor to retain the asset in or towards satisfaction of business borrower’s liability shall be governed by the applicable laws in each Member State. Member States shall ensure that in the case of appropriation the positive difference to be paid out to the business borrower shall be the difference between sum outstanding of the secured credit agreement and the valuation of the asset.

5. For the purposes of the realisation referred to in paragraph 2, Member States shall ensure that the creditor organises a valuation of the assets, in order to determine the reserve price in cases of public auction and private sale, and that the following conditions are met:

(a) the creditor and the business borrower agree on the valuer to be appointed;
(b) the valuation is conducted by an independent valuer;
(c) the valuation is fair and realistic;
(d) the valuation is conducted specifically for the purposes of the realisation of the collateral after the enforcement event;
(e) the business borrower has the right to challenge the valuation before a court in accordance with Article 29.

6. For the purposes of point (a), where the parties cannot agree upon the appointment
of a valuer for the purposes of realising the collateral referred to in paragraph 2, a valuer shall be appointed by a decision of a judicial court, in accordance with the national law of the Member State in which the business borrower is established or is domiciled.

**Article 25. Public auction**

1. Member States shall ensure that the realisation of collateral by means of public auction is conducted in accordance with the following elements:
   (a) the creditor has publicly communicated the time and place of the public auction at least 10 days prior to that auction;
   (b) the creditor has made reasonable efforts to attract the highest number of potential buyers;
   (c) the creditor has notified the business borrower, and any third party with an interest in or right to the asset, of the public auction, including its time and place, at least 10 days prior to that auction;
   (d) a valuation of the asset has been conducted prior to the public auction;
   (e) the reserve price of the asset is at least equal to the valuation amount determined prior to the public auction;
   (f) the asset may be sold at a reduction of no more than 20% of the valuation amount where both of the following apply: (i) no buyer has made an offer in line with the requirements referred to in points (e) and (f) at the public auction; (ii) there is a threat of imminent deterioration of the asset.

2. Where the asset has not been sold by public auction, Member States may provide for the realisation of the collateral by private sale.

3. Where a Member State provides for a second public auction, points (a) to (e) of paragraph 1 shall apply but the asset may be sold at a further reduction, as determined by Member States.

**Article 26. Private sale**

1. Member States shall ensure that the realisation of collateral by means of private sale is conducted in accordance with the following elements:
   (a) the creditor has made reasonable efforts, including adequate public advertising, to attract potential buyers;
   (b) the creditor has notified the business borrower, and any relevant third party with an interest in or right to the asset, of its intention to sell the asset at least 10 days prior to offering the asset for sale;
   (c) a valuation of the asset has been conducted prior to the private sale, and or a public
auction in accordance with point (c) of Article 25(1);
(d) the guide price of the asset is at least equal to the amount established in the valuation referred to in point (c), at the time of offering the asset for private sale;
(e) the asset may be sold at a reduction of no more than 20% of value where both of the following apply: (i) no buyer has made an offer in line with the requirements referred to in points (d) and (e) within 30 days; (ii) there is a threat of imminent deterioration of the asset.

2. Where the asset has not been sold by private sale within 30 days of offering the asset for sale, Member States shall ensure that the creditor publicly advertises the sale for an additional period of at least 30 days before concluding any sale.

3. Where a Member State provides for a second attempt at private sale, points (a) to (d) of paragraph 1 shall apply but the asset may be sold at a further reduction, as determined by Member States.

Article 27. Competing security rights
Member States shall provide that the priority attached to competing security rights in the same collateral is not affected by the enforcement of one of those rights by means of the national provisions transposing this Directive.

Article 28. Right to challenge the enforcement
Member States shall ensure that the business borrower has the right to challenge the use of this accelerated extrajudicial collateral enforcement mechanism before a national court where the sale of the assets provided as collateral has not been conducted in accordance with the national provisions transposing Articles 24(3), 25 and 26, or the valuation of the assets has not been conducted in accordance with the national provisions transposing Article 24(4).

Article 29. Restitution of the exceeding amount
Member States shall ensure that the creditor is required to pay the business borrower any positive difference between the sum outstanding of the secured credit agreement and the proceeds of the sale of the asset.

Article 30. Settlement of the outstanding amount
Without prejudice to articles 19 to 23 of the Directive (EU) 20XX/XX of the European Parliament and of the Council, in cases where the amount realised after the use of this accelerated extrajudicial collateral enforcement mechanism is an amount lower than the sum outstanding of the secured credit agreement, Member States may provide for the settlement of all
liabilities under that agreement, in accordance with applicable national laws.

Article 31. Transfer of secured credit agreements to third parties
Member States shall ensure that where a secured credit agreement which provides for the right to use accelerated extrajudicial collateral enforcement is transferred by the credit institution or its subsidiary to any third party, that third party shall acquire the right to use this accelerated extrajudicial collateral enforcement mechanism in case of the business borrower's default under the same terms and conditions as the credit institution.

Article 32. Restructuring and insolvency proceedings
2. Member States shall ensure that where insolvency proceedings are initiated in respect of a business borrower, the realisation of collateral pursuant to national laws transposing this Directive is subject to a stay of individual enforcement actions in accordance with applicable national laws.

Article 33. Data collection
1. Member States and, in the case of credit institutions competent authorities which supervise credit institutions, shall, on an annual basis, collect information from creditors on the number of secured credit agreements which are enforced through this accelerated extrajudicial collateral enforcement and the timeframes for such enforcement.
2. Member States and, in the case of credit institutions, competent authorities which supervise credit institutions, shall, on an annual basis, collect the following information from creditors:

(a) the number of proceedings pursuant to the national provisions transposing this Directive initiated, pending and realised, including: (i) the number of proceedings in respect of movable assets, (ii) the number of proceedings in respect of immovable assets.
(b) the length of the proceedings from notification to settlement, arranged by means of realisation (public sale, private sale, or appropriation);
(c) the average costs of each proceedings, in EUR;
(d) the settlement rates.
3. Member States shall aggregate the data referred to in paragraph 2 and compile statistics from that aggregate data for the full calendar year beginning DATE [OP: Please insert a date of the January 1 following adoption of this act].
4. The statistics referred to in the first subparagraph shall be communicated to the Commission on annual basis and by 31 March of the calendar year following the year for which data is collected.

TITLE VI. Safeguards and duty to cooperate

Article 34. Modification of the credit agreement

Without prejudice to the obligations to inform the consumer pursuant to Directive 2014/17/EU, Directive 2008/48/EC and Directive 93/13/EEC, Member States shall ensure that prior to modifying the terms and conditions of a credit agreement either by consent or by operation of law, the creditor communicates the following information to the consumer:
(a) a clear and comprehensive description of the proposed changes;
(b) the timescale for the implementation of those changes;
(c) the grounds of complaint available to the consumer regarding those modifications;
(d) the time period available for lodging any such complaint;
(e) the name and address of the competent authority where that complaint may be submitted.

Article 41. Transposition

1. Member States shall adopt and publish, by 31 December 2020 at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions.

2. They shall apply those provisions from 1 January 2021. However, Articles 4(1), 7, 9 to 12 shall apply from 1 July 2021.

3. When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

4. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 42. Entry into force

This Directive shall enter into force on the 20th day following that of its publication in the Official Journal of the European Union.

Article 43. Addressees

This Directive is addressed to the Member States.
Annex II. Council’s Action Plan

In Council’s Action Plan of July 2017, the Council called upon various institutions to take appropriate measures to further address high stocks of NPLs. More specifically,

i) The Council invited the Commission to issue an interpretation of existing supervisory powers regarding banks' provisioning policies for NPLs under Council Regulation EU No 1024/2013 on prudential supervision of credit institutions (Article 16: Supervisory powers) and under the CRD IV (Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, Article 104: Supervisory powers). Within the framework of the ongoing review of the CRR/CRD IV, the Commission was called upon to set prudential backstops applicable to newly originated loans, in the form of compulsory prudential deductions from own funds. Therefore, the Commission adopted a Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for Non-Performing Exposures, COM/2018/134/ final, 14.03.2018, Procedure reference 2018/0060 (COD).


vi) The Commission is called upon to develop a ‘blueprint’ for the potential set-up of national asset management companies (AMCs), which would set out common principles for the relevant asset and participation perimeters, asset-size thresholds, asset valuation rules, appropriate capital structures, the governance and operational features, both private and public. See: Commission Staff Working Document AMC Blueprint, accompanying the document ‘Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank -Second Progress Report on the reduction of Non-Performing Loans in Europe’, SWD/2018/072/Final, 14.03.2018.

vii) The Commission was called upon to develop, by summer 2018, a European approach to foster the development of secondary markets for NPLs, in particular to remove impediments to the transfer of NPLs by banks to non-banks and to their ownership by non-banks, while safeguarding consumers’ rights, as well as to simplify and potentially harmonise the licensing requirements for third-party loan servicers and to take legislative initiative in this respect, as appropriate. See: Proposal for a Directive of the European Parliament and of the Council on
viii) The Commission was called upon to publish, before the end of 2017, the results of the benchmarking exercise on the efficiency of national loan enforcement (including insolvency) regimes from a bank creditor perspective, providing comparable metrics, as precise as possible, for recovery rates, recovery times and recovery costs across Member States. Progress on the benchmarking exercise was presented to and discussed with Member States experts at the September and December 2017 meetings of the expert group on NPLs, including the issue of lack of access to meaningful data. See: Commission Staff Working Document, accompanying the document ‘Communication from the Commission to the European Parliament, the Council and the European Central Bank- First Progress Report on the reduction of Non-Performing Loans In Europe’, SWD/2018/033/Final, 23.01.2018, where it is noted that the management of NPLs would benefit from more efficient and predictable loan enforcement and insolvency frameworks, therefore this benchmarking exercise of such regimes shall establish a reliable picture of the delays and value recovery that banks experience when faced with borrowers.