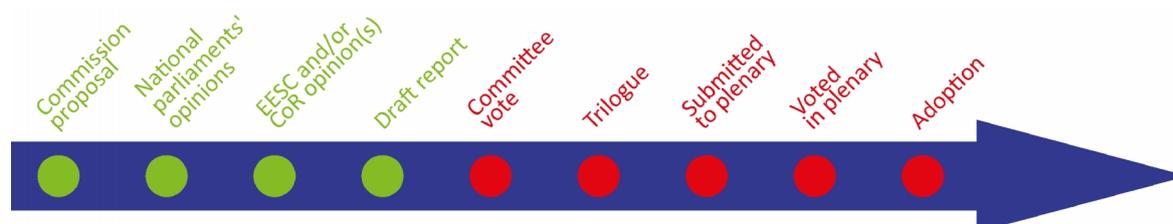


Law applicable to the third-party effects of assignments of claims

OVERVIEW

The assignment of a claim refers to a situation where a creditor transfers the right to claim a debt to another person. This system is used by companies to obtain liquidity and access credit. At the moment, there is no legal certainty as to which national law applies when determining who owns a claim after it has been assigned in a cross-border case. The new rules proposed by the Commission clarify which law is applicable for the resolution of such disputes: as a general rule, the law of the country where assignors have their habitual residence applies, regardless of which Member State's courts or authorities examine the case. This proposal will promote cross-border investment and access to cheaper credit, and prevent systemic risks.

Proposal for a Regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims		
<i>Committee responsible:</i>	Economic and Monetary Affairs (ECON)	COM(2018) 96 12.3.2018
<i>Rapporteur:</i>	Pavel Svoboda (EPP, Czech Republic)	2018/0044 (COD)
<i>Shadow rapporteurs:</i>	Mady Delvaux (S&D, Luxembourg) Kostas Chrysogonos (GUE/NGL, Greece)	Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')
<i>Next steps expected:</i>	Vote in committee	



Introduction

In contract law, a **claim** gives a person (the creditor) the right to receive a sum of money or to obtain the performance of an obligation by another person (the debtor). According to the Commission, claims can be classified in three categories:

- 'traditional claims' or receivables. If a retailer sells a product on credit, the product is acquired by the customer but the payment will only come in the future. This money to be received by the company is a traditional claim;
- claims arising from financial instruments (sometimes referred to as 'financial claims'). An investor buying a company's bond, obtains the right to either fixed or variable instalments on a specific date or dates. The investor has a financial claim; and
- cash credited to an account in a bank. An account holder depositing money in a bank (the creditor) has a claim against the bank (the debtor).

An **assignment** is a transfer of property or ownership rights from one person to another. The **assignment of a claim** is a mechanism, allowing a creditor, the *assignor*, to transfer his right to claim a debt to another person, the *assignee*.

Many well-established retailers allow consumers to purchase products on credit. For example, consumer 'A' who wants to purchase a TV but does not have the full amount in cash, can enter into a contract with retailer 'B' to pay for that TV in 10 instalments. The consumer and the retailer are the original parties to the contract, under which the TV is acquired by the consumer and the retailer has the right to obtain payment of a fixed or variable amount for a period of time from the consumer. The retailer can keep this right and manage its cash flow accordingly. It can also choose, however, to transfer that right to a third party, the assignee, e.g. a consumer credit company.

This mechanism is used by companies to obtain liquidity (factoring), gain access to credit (collateralisation), or optimise the use of their capital (securitisation).

Factoring

Factoring is a crucial source of liquidity for many firms. In factoring, a company assigns its receivables to a *factor* – often a bank – at a discount price ([generally](#) equal to interest plus service fees) and in return receives immediate cash. The factor will collect the money owed for the invoices and accept, or not, the risk of bad debts (recourse and non-recourse). The majority of users of factoring are SMEs, as they may find sourcing traditional lending more challenging.

According to the Commission proposal, Europe as a region is the world's largest factoring market, representing 66 % of the world market. According to the EU [Federation for the Factoring and Commercial Finance Industry](#), factoring industry turnover represented 10.4 % of EU gross domestic product in 2016.

Example of factoring

An SME needs immediate cash to pay its suppliers. The invoices to its customers are only due for payment in three months. The SME (assignor) therefore decides to assign its invoices to a factor, (a bank, the assignee), at a discount price in order to obtain immediate cash. The discount price at which the SME sells its invoices to the bank, accounts for the bank's fees and commission.

Collateralisation

[Financial collateral](#) is an asset provided by a borrower to a lender to secure repayment of, for instance, a loan. In the event that the borrower fails to meet its obligations, collateral minimises the risk of financial loss to the lender. In collateralisation, claims such as cash credited to a bank account (where the customer is the creditor and the bank is the debtor) or credit claims (that is, bank loans) can be used as financial collateral to secure a loan agreement (for example, a consumer can use cash

credited to a bank account as collateral to obtain credit, and a bank can use a credit loan as collateral to obtain credit). According to the Commission proposal, about 22 % of Eurosystem refinancing operations are secured by credit claims as collateral.

Example of collateralisation

An SME (assignor) wants to get a loan from a bank (assignee) to build a bigger warehouse, using the claims it has against its customers as collateral. If the SME goes bankrupt and cannot pay the credit back, the bank will be able to recover its debt by enforcing the claims that the SME had against its customers.

Securitisation

Securitisation enables the assignor, called the 'originator', to refinance a set of its claims (for example mortgage loan payments) by assigning them to a 'securitisation special purpose entity' (SSPE). The SSPE (assignee) then issues debt securities (e.g. bonds) on the capital markets, reflecting the proceeds from these claims. As payments are made under the underlying claims, the SSPE uses the proceeds it receives to make payments on the securities to the investors. For companies, securitisation can provide access to credit at a lower cost than bank loans. For banks, securitisation is a way to put some of their assets to better use and free up their balance sheets to allow for further lending to the economy.¹

Example of securitisation

A large company (assignor) assigns its receivables arising from the use by customers of its in-house credit card to a SSPE (assignee), which then issues debt securities to investors on the capital markets. These debt securities are secured by the income stream flowing from the credit card receivables that have been assigned to the SSPE. As payments are made under the receivables, the SSPE uses the proceeds it receives to make payments on the debt securities.

Third-party effects of claims

The **proprietary elements or third-party effects of an assignment of claims** refer in general to who has ownership rights over a claim and, in particular, to (i) which requirements must be fulfilled by the assignee in order to ensure that the assignee acquires legal title over the claim after the assignment (for example, registration of the assignment in a public register, written notification of the assignment to the debtor), and (ii) how to resolve priority conflicts, that is, conflicts between several competing claimants as to who owns the claim after a cross-border assignment (for example, between two assignees where the same claim has been assigned twice, or between an assignee and a creditor of the assignor in the event of an insolvency).

Ensuring the acquisition of legal title over the assigned claim is important for factors, collateral takers and originators, as other parties could claim legal title over the same claim. This would give rise to a situation in which it would need to be determined which of the two rights (of the assignee or a third party) should prevail. According to the Commission, such a situation can potentially arise (i) if a claim has been assigned twice by the assignor to different assignees, or (ii) in the event of assignor insolvency, where the assignor's creditors will want to know whether or not the assignment was effective and (therefore) the assignee has acquired legal title over the claim. In both cases, the law applicable to the third-party effects will resolve the conflict. But what is that law?

In domestic assignments of claims, the national substantive law is the one that will determine the third-party effects of the assignment of claims. However, in a cross-border assignment, several national laws can potentially apply and assignees need clarity as to which laws they must observe in order to acquire legal title over the assigned claims.

Existing situation

The national law that applies to a given situation with a cross-border element, is determined by **conflict of laws rules**. In the absence of EU conflict of laws rules, the applicable law is determined by national conflict of laws rules.

However, currently, Member States' conflict of laws rules can be inconsistent as they are based on different connecting factors to determine the applicable law: for example – according to the Commission proposal – the conflict rules of Spain and Poland are based on the *law of the assigned claim*, the conflict rules of Belgium and France are based on the law of the *assignor's habitual residence* and the conflict rules of the Netherlands are based on the *law of the assignment contract*. This inconsistency across the EU means that Member States may designate the law of different countries as the law that should govern the third-party effects of the assignment of claims. This lack of legal certainty in turn creates a legal risk in cross-border assignments which does not exist in domestic assignments. The Commission has identified three problems linked to that risk: (i) if the assignee ignores (or chooses to ignore) the legal risk, it may end facing unexpected financial losses. (ii) if the assignee decides to protect itself legally, it will incur extra costs. (iii) if the assignee chooses instead to avoid entering the assignment, there are lost opportunities and market integration at EU level is undermined.

Currently, at EU level, conflict of laws rules determine the law applicable to:

- the contractual obligations of transactions in claims and securities (e.g. the [Rome I Regulation](#));
- the proprietary effects of transactions in book-entry securities and instruments, whose existence or transfer presupposes their recording in a register, an account or a centralised deposit system.

However, no EU conflict of laws rules have been adopted on the law applicable to the proprietary effects of assignments of claims.

Parliament's starting position

The Parliament has not called specifically for action in this area.

Preparation of the proposal

In 2004, the Commission set out a [roadmap](#) (communication) for future action with a view to enhancing the safety and efficiency of post-trading arrangements across Europe. Among other things, the Commission communication advocated pursuing work in the field of legal barriers to a safe and efficient post-trading landscape. To that end, a group of legal experts – the Legal Certainty Group – was tasked with advising the Commission on whether legislation in the field of securities holding and dispositions should be improved, and if so, how it should be carried out. The Group presented its [advice](#) to the Commission in August 2008.

In that context, an [initial](#) public consultation on this issue was held between April and June 2009. It was followed in 2010 by a [second](#) consultation, which took place between February and June 2010. At the same time, a second expert group – the Securities Law Directive Member States Working Group – was set up, to conduct discussions and assist the Commission with drafting a legislative proposal in the field of securities law. This led to the planning of a directive which was listed in the Commission's Work Programme for 2010.² The [stated aim](#) was to reduce the divergence between Member States' laws on book-entry securities and, as a result, contribute to the simplification of financial market operations and to their legal safety. Despite the fact that the proposal was also

included in the Commission work programmes for [2011](#) and [2012](#), and despite Parliament [calling](#) for it, the proposal was never launched.

Instead, the 2015 Commission [action plan on building a capital markets union](#), envisaged a targeted action on securities ownership rules and third party effects of assignment of claims.

In order to consult all interested parties, in February 2017 the Commission published an [inception impact assessment](#) providing an overview of the problems to be addressed and the possible solutions. It further launched in April 2017 a [public consultation](#) on conflict of laws rules for third party effects of transactions in securities and claims and established an [expert group](#) on conflict of laws regarding securities and claims, which assisted the Commission by providing specialist advice from experts on private international law and financial markets. The [proposal for a regulation](#) was finally published on 12 March 2018. The proposal was accompanied by an [impact assessment](#), which is the subject of an [initial appraisal](#) by EPRS.

The changes the proposal would bring

Article 1 states that the regulation will apply in situations involving cross-border conflicts, to the third-party effects of assignments of claims in civil and commercial matters. The article further specifies in which cases the regulation does not apply. Article 14 further stipulates that the regulation will apply to assignments of claims concluded on or after its date of application.

Article 2 defines the main concepts on which the proposed regulation is based, namely 'assignor', 'assignee' and 'assignment', 'claim' and 'third-party effects', 'habitual residence', 'credit institution', 'cash' and 'financial instrument'.

The next article establishes the universal character of the proposed regulation by providing that the national law designated as applicable by the proposed regulation can be the law of a Member State or the law of a third country.

Article 4 provides for uniform conflict of laws rules on the third-party effects of the assignment of claims. In paragraph 1, the article lays a general rule ('the law of the country in which the assignor has its habitual residence at the material time'); in paragraph 2, it sets out two exceptions (the case of cash credited to a bank account, and claims arising from a financial instrument) based on the law of the assigned claim; in paragraph 3, it provides the possibility for the assignor and the assignee in a securitisation to choose the law of the assigned claim as the law applicable to the third-party effects of the assignment; and in paragraph 4 it lays down a rule applicable to priority conflicts between assignees arising from the application of the law of the assignor's habitual residence and the law of the assigned claim to the third-party effects of two assignments of the same claim.

According to Article 5, the law applicable to the third-party effects of assignment of claims pursuant to the regulation will govern, (a) the requirements to ensure the effectiveness of the assignment against third parties other than the debtor (registration or publication formalities); (b) the priority of the rights of the assignee over the rights of another assignee of the same claim; (c) the priority of the rights of the assignee over the rights of the assignor's creditors; (d) the priority of the rights of the assignee over the rights of the beneficiary of a transfer of contract in respect of the same claim; and (e) the priority of the rights of the assignee over the rights of the beneficiary of a [novation of contract](#) against the debtor in respect of the equivalent claim.

Articles 6 and 7 regulate cases in which the law of the forum is applied instead of the law applicable under aforementioned Article 4. The first of these cases regards overriding mandatory provisions of the law of the forum (i.e. provisions the respect for which is regarded as crucial by a Member State for safeguarding its public interests). The other is when the application of a provision of the law of any country specified by this regulation is manifestly incompatible with the public policy (ordre public) of the forum.

Articles 8 to 12: General issues of application of conflict of laws rules

These articles deal with general issues of application of conflict of laws rules in line with other Union instruments on applicable law, in particular the Rome I Regulation.

Article 8 excludes renvoi,³ by providing that the application of the law of any state specified by the regulation, means the application of the rules of law in force in that state, other than its rules of private international law.

Article 9 provides that, when a state comprises several territorial units, each of which has its own rules of law in respect of the third-party effects of assignments of claims, each territorial unit must be considered as a state for the purposes of identifying the law applicable under this regulation. Furthermore, such a Member State will not be required to apply this regulation to conflicts of laws arising only between such units.

Article 10 stipulates that the regulation will not prejudice the application of provisions of EU law that, in relation to particular matters ('lex specialis'), lay down conflict of laws rules on the third-party effects of assignments of claims.

According to Article 11, the regulation will not prejudice the application of international conventions to which one or more Member States are parties at the time when this regulation is adopted and that lay down conflict of laws rules relating to the third-party effects of assignments of claims. However, it will take precedence over conventions concluded exclusively between two or more Member States, in so far as such conventions concern matters governed by this regulation. Article 12 sets out the obligation for Member States to notify the Commission of all conventions referred to in Article 11, as well as the denunciations of such conventions, and for the Commission to publish within six months of the receipt of the notifications, the list of conventions and denunciations.

Advisory committees

The EESC has yet to issue an opinion on the matter.

National parliaments

The proposal is being examined by the parliaments of [twelve Member States](#). No reasoned opinion has yet been adopted. The subsidiarity deadline was 24 May 2018.

Stakeholders' views⁴

No stakeholder has commented on the Commission proposal to date.

Legislative process

In Parliament, the proposal has been assigned to the Legal Affairs Committee (JURI), where Pavel Svoboda (EPP, Czech Republic) was nominated rapporteur. The rapporteur published his [draft report](#) on 3 May 2018 and amendments were tabled in committee on 4 June 2018.

EP SUPPORTING ANALYSIS

Hubert Dalli, [Third party effects of the assignment of claims](#), Initial Appraisal of a European Commission Impact Assessment, EPRS, European Parliament, June 2018.

OTHER SOURCES

[Law applicable to the third-party effects of assignments of claims](#), European Parliament, Legislative Observatory (OEIL).

ENDNOTES

- ¹ For more information on securitisation, see A. Delivorias [Understanding Securitisation: Background – benefits – risks](#) EPRS, European Parliament, 2015.
- ² See Directive on Legal Certainty in Securities law in Annex II (Indicative list of possible strategic and priority initiatives under consideration).
- ³ For more information on 'renvoi', please see Stanley B. Stein, '[Choice of Law and the Doctrine of Renvoi](#)', *McGill Law Journal*, 1971.
- ⁴ This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

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