The development of secondary markets for non-performing loans and distressed assets and protection of secured creditors from borrowers' default

The Council of the Notariats of the European Union (CNUE) is the official body that represents the notarial profession vis-à-vis the European institutions.

It is with interest that the CNUE has taken note of the consultation launched by the European Commission's Directorate-General for Banking and Finance on the development of secondary markets for non-performing loans and distressed assets and on the protection of secured creditors from borrowers' default.

We understand in particular the interest that there could be in ensuring better protection of real estate lenders against default by borrowers. The mechanism that is being discussed by stakeholders, namely the creation of a new type of security called "accelerated loan security", has particularly attracted our attention.

As a preliminary point, it seems appropriate to draw attention to the somewhat vague nature of the proposal as described in Section II of the consultation document. It is unclear whether the European Commission envisages organising a new security or only a new way of enforcing security rights under national law. Assuming that it is a question of implementing a new security, this task would be extremely complex insofar as very technical provisions (and closely linked to national law on land registration, security law, transfer of ownership, etc.) would have to be proposed for the creation of a new mechanism from scratch. Whatever reform is envisaged, the new system would have to be coordinated with the 27 national laws applicable to each security or enforcement procedure.

Having said that, it seems difficult to realise that the introduction of a new mechanism to protect these creditors, namely the creation of a new type of security interest called an "accelerated loan security", would be an appropriate instrument that would take into account all the interests to be respected in the event of a debtor's default.

Indeed, the purpose of this new instrument would be to make it possible not only to dispense with the court in order to have access to enforcement, but even to dispense with any court involvement at all. In the system proposed, the creditor, i.e. the bank in most cases, would declare that the debtor is in default and would repossess, on its own authority, the property of its debtor, by means of a compulsory assignment of the property with expropriation of the defaulting debtor.

The introduction of this new type of security would therefore benefit the creditor in an unbalanced and unilateral way. The borrower would be completely unprotected. Often, however, borrowers will be small and medium-sized enterprises that deserve special protection.

We would also like to emphasise that, in accordance with the division of powers between the European Union and the Member States as laid down in the Treaty on the Functioning of the European Union (Art. 3 et seq. TFEU), substantive property law is a matter for the Member States. This division of powers is complemented by the principle of the *lex rei sitae* of private international law for contracts relating to real property rights. This principle is enshrined in Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations (Rome I). Therefore, the transfer of ownership, and the methods of forced transfer by a debtor of ownership of his/her property to a

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creditor, are subject to the rules laid down by the respective national laws for the transfer of ownership rights and expropriation, which ensure balance, security and respect for the rights of third parties in accordance with the legal traditions of the Member States. In addition, the law of security interests and the related procedures contain rules of *ius cogens*, and form a public policy in matters of property that should be respected.

The introduction of automatic transfers would undermine the security and reliability of national systems, whether it be land registration systems in which the court's intervention guarantees a constitutive registration of the transfer of ownership, or a system of publication in which the establishment of the right of ownership is the responsibility of a professional responsible for drafting the transfer act and in which publication is an essential element to avoid any conflict with the rights of third parties.

Furthermore, the legal systems of many Member States would be considerably weakened by hidden property transfers, which would constitute a major source of insecurity, and would run counter to the concern for the traceability of real estate transactions that the various national land registers currently provide. It is not only the balance of the systems created by the substantive property law in the Member States that must be respected, but also the balance currently provided by national legislation on the order of creditors which would be unprotected if an accelerated loan security allowed a transfer of ownership without any involvement of a court. This risk of automatic and hidden transfer will also compromise the possibility for an owner to grant several successive securities in respect of his/her property, subsequent creditors certainly denying the risk of their security being annulled by a transfer of ownership to a creditor of better rank. The same applies to compliance with insolvency law, which is compulsory for creditors in many countries and protects, in some cases, interests that are considered more legitimate by national legislation (e.g. that of employees, the State or social bodies).

Also, the rights of certain third parties (e.g. pre-emptive rights) could be harmed if such an instrument were introduced. The new instrument would favour situations of fraudulent encroachment on the rights of the holders of these rights (public authorities, tenants, etc.) by allowing an automatic transfer of ownership of a building by overriding the rights of these third parties.

In the consultation paper, one of the benefits mentioned is that the new accelerated loan security would allow European banks to have a rapid out-of-court procedure for recovering the value of secured loans in the event of debtor default.

However, the legal proceedings in question guarantee above all the respect for legal certainty, including the protection of the parties and verification of the balance of the agreements, especially in a relationship between a professional (banker) and non-professional (borrower) whose risks are known; moreover, it is difficult to imagine a mechanism of forced transfer of ownership, i.e. expropriation, which is not based on a binding contract or decision conferred by a public authority.

In this context, and if it is indeed a question of circumventing judicial procedures deemed too long, we would like to stress the enforceability of the notarial act, which is useful to allow enforcement measures to be carried out without the prior intervention of the court in order to give enforceability to the debtor's obligation to reimburse. This enforceability is naturally attached to the authentic instrument and forms an integral part of the acquis communautaire. In particular, it is recognised in the Unibank judgment (Judgment of the Court of 17 June 1999 in the case of Unibank A/S v.

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Flemming G. Christensen). In this case, it is possible to proceed directly to the enforcement phase with considerable time savings, while guaranteeing, through the prior intervention of a public authority, legal certainty and balance between the parties.

Finally, it should be noted that Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims allows the circulation of enforcement orders. A bank claim recorded in a notarial act constitutes an enforceable order within the meaning of this regulation and can therefore circulate throughout the EU for its immediate enforcement.

We therefore feel it is worthwhile to tap into the potential of this regulation, which responds to a real need in practice, and to ensure that it is fully implemented before introducing new measures.

In addition to increased communication from the European institutions and the Member States on the purpose and relevance of this regulation in the case of defaulting loans, we believe it is appropriate to increase the provision of training on this instrument.

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