New EU assignment regulation has first reading in European Parliament but serious flaws remain

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Receivables financiers, lenders taking security assignments over contractual rights, participants in the secondary loan market and others have an interest in:

- a clear and rational pan-EU rule on the law applicable to determining the property, priority and other third party effects (**third party effects**) of cross-border assignments of debts and other contractual rights (**claims**); and
- that rule not imposing excessive complexity or costs on transaction parties.

We do not currently have such a rule. Consequently, for example, when a financier takes a cross-border assignment with an EU connection it can be unclear which states' laws govern whether or how to notify or otherwise perfect the assignment so that, in all relevant EU states, it will:

- be effective among and against all relevant entities;
- have priority over rival assignments of, or other dealings in, the same claim; and
- be good in an insolvency of either the assignor or the debtor in respect of the assigned claim.

This uncertainty is partly due to:

- article 14 of the Rome I Regulation (**Rome I**), which is the main, current pan-EU legislation on the applicable law to cross-border assignment issues, either not covering at all or (depending on your reading of article 14) only partly covering, the third party effects of assignments; and
- different EU states applying different laws to determine the third party effects of cross-border assignments. For example, while at least five EU states apply the law of the assigned claim, others apply the law of the debtor's location and others apply the law governing the assignment.

Further uncertainty in this area flows from the Recast EU Insolvency Regulation (the **Recast IR**):

- potentially conflicting with article 14 of Rome I;
- being relevant in insolvency proceedings in EU members states to assignments of claims; and
- not being particularly clearly drafted.

Proposed EU regulation on third party effects of assignments

In this situation, a well-thought-out EU regulation on the law applicable to the third party effects of assignments could produce substantial time and cost savings. Unfortunately:

- neither the first draft regulation (the **Regulation**) the EU proposed on this issue in March 2018;
- nor the revised Regulation, which received its first reading before the European Parliament in mid-February 2019, is obviously well-thought-out. Unless the final form contains significant amendments, the Regulation is likely often to increase complexity and costs of cross-border assignments with an EU connection.

Key flaws

The first draft of the Regulation drew cogent criticism from the European Central Bank, ISDA, the LMA and others. And the UK government opted out of the Regulation (separately from Brexit) in response to some of this criticism. Despite this constructive feedback, the revised Regulation continues to have many failings. These include the following:

- Subject to limited exceptions, the Regulation makes the law of the assignor's habitual residence the law applicable to determining the third party effects of an assignment. In many situations, this will add complexity to an already complex area and increase transaction costs.
- An example of increased complexity and costs is the likely impact on the secondary market in syndicated loans. Here, the practice is to look only to the governing law of the loan agreement when taking and perfecting assignments of participations. In states where the Regulation will apply, however, it will also be necessary (as well as looking at the law of the loan agreement) to investigate the laws of the habitual residence of each finance party selling a participation where that sale is an "assignment" as defined in the Regulation.
- An exception for securitisations partly mitigated this sort of increased complexity and costs in the first draft of the Regulation. There were calls for the securitisation exception to be clarified (securitisation was not defined) and widened to include other types of receivables finance. Instead, the revised Regulation has gone in the opposite direction by deleting the securitisation exception.
- In relation to derivatives, the EU had intended to provide that assignments of claims under derivatives contracts would be an exception to the law of the habitual residence rule. However, that exception uses as a pivotal definition the term "financial instrument" from MiFID II. And that definition does not include all claims under transactions documented under, for example, an ISDA Master Agreement.
- Article 14 of Rome I applies the law of the assigned claim to determine how a debtor gets a good discharge for what it owes under an assigned claim. By contrast, the Regulation, in most cases, applies the law of the assignor's habitual residence to determine who has priority to an assigned claim. This conflict will sometimes make it harder to settle whether a claim and a cross-claim are mutual. Where mutuality it is harder to determine, it may be harder to know whether insolvency set-off or close-out netting will apply between a given claim and cross-claim.
- By article 10 of the Regulation, in insolvency proceedings in an EU member state of an assignor, the Recast IR will prevail over the Regulation. Partly given this problem, the EU chose the law of the assignor's habitual residence as the applicable law under the Regulation because habitual residence is broadly similar to the "centre of main interests" (or **COMI**) test under the Recast IR. Unfortunately, a party's habitual residence and its COMI will not always be in the same state.
- The habitual residence definition used in the Regulation does not recognise that an assignor might be habitually resident in one country, but acting as an assignor via a branch in another. So, the Frankfurt branch of a Singaporean entity might, for example, assign a German law claim against a German debtor under a German law assignment to a German assignee. To the surprise of the Frankfurt market, under the Regulation, the third party effects of this assignment would be governed by Singaporean (and not German) law.
- The Regulation's drafting is often unclear and sometimes unnecessarily hard to decode. For example, the

Regulation concerns assignments of "claims". The Regulation defines claims as including "non-monetary" "debts". This contradiction in terms is only resolved in the Regulation's explanatory memorandum (and not the Regulation itself), with that memorandum stating that a non-monetary debt is a right to require someone to perform a non-financial obligation.

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