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OGGETTO: Position paper EUF e Leaseurope - Feedback on the Commission Proposal for a Directive harmonising certain aspects of insolvency law

Si trasmette agli Associati il position paper in oggetto, che riporta le osservazioni dell'EU Federation for the Factoring and Commercial Finance Industry e di Leaseurope in merito alla proposta della Commissione Europea per una Direttiva mirata ad armonizzare taluni aspetti della disciplina dell'insolvenza aziendale.

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Feedback on the Commission Proposal for a Directive harmonising certain aspects of insolvency law

Leaseurope, the European Federation representing the leasing and automotive rental industries, and EUF, the European Federation for the Factoring and Commercial Finance Industry representing the factoring industry, welcome the opportunity to provide comments on the Commission's proposal for a Directive "harmonising certain aspects of insolvency law" that was published on 8 December 2022.

Introduction

Leaseurope brings together 44 member associations representing the leasing, long term and/or short term automotive rental industries in the 32 European countries in which they are present. The scope of products covered by Leaseurope members' ranges from hire purchase and finance leases to operating leases of all asset categories (automotive, equipment, machinery, ICT and real estate). It also includes the short-term rental of cars, vans and trucks. It is estimated that Leaseurope represents around 91% of the European leasing market.

The leasing and rental industry offers services that meets business investment and consumption needs which in turn spurs development of local industrial production and distribution. The types of institutions represented by the Federation include specialised banks, bank-owned subsidiaries, the financing arms of manufacturers as well as other, independently-owned institutions, of which a big part are SMEs.

Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 47% of all European SMEs make use of leasing which is more than any other individual form of lending) and is also popular among larger corporate¹.

The **EUF's** members and partners consist of 13 national factoring and commercial finance associations (representing in the EU [in alphabetic order] Austria, Belgium, Croatia, the Czech Republic, Denmark, France, Germany, Greece, Italy, the Netherlands, Poland, Portugal and Spain) as well as the international factoring association FCI and the UK and Norway as partners.

¹ European Commission, Survey on the Access to Finance of Enterprises Apr. – Oct. 2021; Oxford Economics, *The Use of Leasing Amongst European SMEs*, 2015.

Factoring and Commercial Finance (FCF or – for ease of reference - factoring) is based on the idea of selling/assigning a business's unpaid receivables to the Factor for a payment equivalent to the value of the invoices less a fee for offering the service and a charge for the period the invoice is financed. FCF are generic terms for a range of asset based finance services which include factoring, invoice discounting, international factoring, supplier finance/reverse factoring and asset based lending. All these products exist to provide working capital funding and financing solutions to businesses/clients, particularly SMEs, based upon the debt invoicing or receivables created by the client.

In 2021, the factoring industry in the EU provided over €274 billion of working capital financing to almost 265,000 businesses. As repeatedly shown by EUF research and surveys², factoring clients are mostly SMEs and principally businesses in the manufacturing, services and distribution sectors.

General Remarks on the Proposed Insolvency Directive

Leaseurope and EUF acknowledge that there are differences in national insolvency regimes of EU Member States. As such, Leaseurope and EUF understand, in principle, the need to increase a level of coherence between more efficient and less efficient insolvency legislative frameworks, which will likely contribute to decreasing the costs, efforts and risks in relation to cross border insolvency cases, for both debtors and creditors involved in such cases.

- ***Respect of the subsidiarity principle***

It is important to highlight that **harmonising aspects of substantive law** of insolvency proceedings **cannot and should not lead to fully converging insolvency systems**, as Member States have different starting points, different legal traditions and policy preferences.

The new Directive proposed by the Commission aims to harmonise certain aspects of substantive insolvency law. Thus, it addresses issues different from those tackled by the already adopted Directive (EU) 2019/1023 and Regulation (EU) 2015/848. Directive 2019/1023 focused on two specific types of procedure, namely pre-insolvency restructuring procedures for debtors that are in financial distress before they become insolvent (when there is only a likelihood of insolvency), and debt discharge procedures for failed entrepreneurs (post-insolvency effects). On the other hand, Regulation 2015/848 introduced uniform rules that determined in which Member State the insolvency proceedings have to be opened and which law is to be applied, for cases of cross-border insolvency. **Since the new proposal addresses core aspects of insolvency law**, such as avoidance actions., **the**

² cf. the EUF White Papers of 2016 and 2019 on Factoring and Commercial Finance at <https://euf.eu.com/what-is-euf/whitepaper-factoring-and-commercial-finance.html>

principle of subsidiarity as set out in Article 5 of the Treaty on the European Union, should be at all times respected. This implies that any measures adopted should not go beyond what is necessary in order to achieve the objectives set in the proposal. Harmonising insolvency law entails harmonising civil law, which arguably goes beyond the EU's competency in this area.

- **Protection of ownership right**

It is crucial that any measures harmonising insolvency law are designed in a prudent and balanced manner, thereby taking appropriate account of the legitimate interests of all those affected. In particular, **leasing companies retail ownership of the assets for which they provide services** and which they place at the disposal of their customers. This right to property (Article 17 of Charter of the Fundamental Rights of the European Union) should be protected. This includes **the right to separation** in insolvency proceedings, **before the insolvent estate is created**. Similarly, **factoring companies** acquire receivables in the course of their financing activities, and they **are the owners of these receivables** – as owners of an asset, they should always be treated differently from other creditors who merely have a claim.

Ownership is a right which can be invoked *erga omnes* (against everyone), hence leasing and factoring companies should be always given **the right of segregation when it comes to the asset or the receivables in question**. This is because **leased assets should not be considered part of the insolvent estate, as opposed to other creditors**. It should be up to the insolvency administrator to decide whether or not to continue serving the leasing/factoring contract by making timely payments, in order to support the insolvent property's day-to-day function.

In many EU Member States, customers are often only able to obtain relevant financing because the asset is suitable and the lessor owns it as a security. **It is crucial that the ownership of the leased asset provides sufficient security for the leasing companies** by allowing them to exercise their inherent right to segregation/separation from the insolvent estate. **Otherwise, it is likely that many leases would cease to be viable in the future**. This would mainly affect small and medium-sized enterprises. **The same applies to factoring services, as long as sufficient security is not provided for the receivables financed**. Legal certainty would be undermined and the aim of the Capital Markets Union to facilitate access to financing for operating resources, IT equipment and production machinery, especially for SMEs, would be thwarted.

As such, **it is imperative that the legislative Proposal incorporates the principle of priority satisfaction for leasing entities and factoring entities with full asset ownership over the secured creditors**. The insolvent estate should not be allowed in any way to appropriate assets which it does not own, in order to prevent creating legal uncertainty and

litigation. Satisfaction priority for leasing companies should also mean that, if the insolvency administrator decides not to continue the leasing contract, leasing companies have the right to recover the asset and to be preferred prior to the other creditors for the remaining debt.

Specific Remarks on the Proposed Insolvency Directive

- *Title II – Avoidance Actions*
Chapter 2: Specific conditions for avoidance actions – Article 6

Article 6 (3)(a) of the proposed EU insolvency directive states that “*legal acts performed directly against fair consideration to the benefit of the insolvency estate*” cannot be declared void through avoidance actions. EUF and Leaseurope understand this to refer to acts performed prior to the fact of insolvency by the (later insolvent) business in exchange for an imminent fair consideration. That consideration then becomes part of the (later insolvent) business’ assets.

Given that factoring entails the continuous purchase of receivables in exchange for the contractually agreed immediate provision of the respective purchase price, and that leasing entails continuous payments in exchange for the right of use of an asset, it is our understanding that the **forementioned exemption from all avoidance actions** apart from wilful avoidance (i.e. avoidance actions on the grounds of intentional detriment to creditors according to art. 8) **would generally also cover factoring and leasing**.

Factoring or leasing services agreed upon **prior to the debtor’s insolvency** for a fair consideration are contracted to benefit the debtor’s business. Therefore such acts should be clearly covered by the exemption provided in Article 6 of the proposal. This clarification would minimize insolvency-related risks in leasing and factoring and it would support them as two forms of financing particularly relevant for SMEs. To allow for legal certainty, Leaseurope and EUF suggest **differentiating in Article 6 of the proposed directive between the (pre-insolvency) business estate and the (post opening of insolvency proceedings) insolvency estate**. This way, the exemption will cover acts performed to the benefit of the debtor’s business before the opening of insolvency proceedings and before the insolvent estate is established.

Article 6

3. By way of derogation from paragraphs 1 and 2, Member States shall ensure that the following legal acts cannot be declared void:

(a) legal acts performed directly against fair consideration to the benefit of the ~~insolvency~~ **business** estate;

- Title IV – Pre-pack Proceedings
Chapter 2: Preparation Phase – Article 23

Article 23 of the proposed EU insolvency directive provides for a **stay of individual enforcement actions during the preparatory phase** of the pre-pack proceedings, where it facilitates the seamless and effective roll-out of the proceedings. The **protection of the property rights of the leasing companies** requires clarifying that a claim for compensation of the lessor should be allowed, in case of further use of the leasing asset during a stay of realisation.

In addition, the admissibility of the stay of individual enforcement actions should be made de-pendent on the fact that it is necessary for the smooth and effective implementation of the pre-pack procedure.

Leaseurope and EUF suggest amending Article 23 of the proposal as follows:

Article 23

Member States shall ensure that where the debtor is in a situation where insolvency is likely or where the debtor is insolvent under national law, the debtor may, during the preparatory phase, benefit from the stay of individual enforcement actions pursuant to Articles 6 and 7 of Directive (EU) 2019/1023, **provided that it contributes to** the seamless and effective roll-out of the pre-pack proceedings. The monitor shall be heard prior to the decision on the stay of individual enforcement actions.

During the stay of individual enforcement actions, the accruing interest shall continue to be owed to the creditor and any loss in value resulting from the use of an asset shall be compensated to the creditor concerned.

- Title IV – Pre-pack Proceedings
Chapter 3: Liquidation Phase – Article 27

Article 27 (1) of the proposed EU insolvency directive seeks to ensure that “*the acquirer of the debtor’s business or part thereof is assigned the executory contracts which are necessary for the continuation of the debtor’s business and the suspension of which would lead to a business standstill*”. However, the consent of the contractual counterparties’ for such a change is not deemed necessary.

Leaseurope and EUF do not support such an assignment of operationally necessary contracts **without the consent of the other contracting party** in the pre-pack procedure, as this would be an unjustifiable infringement of contractual freedom. When considering whether to continue a contractual relationship with a counterparty that finds itself in economic difficulties that may even lead up to an insolvency, the other contracting party **typically puts a special focus on analysing and handling the risks related to these difficulties**. In such a situation, any counterparty should continue to be able to avail themselves of the **option to terminate such a contractual relationship**.

For regulated financial services institutions, a forced exchange of debtors is furthermore **not possible for supervisory reasons** alone. Leasing and factoring companies are obliged to make AML and KYC checks for their contractual partners before entering into the business relationship. A transfer of credit and financial services contracts must therefore at least be made dependent on the consent of the creditor. Besides, any financial institution, leasing and factoring companies included, assess the contractual counterparty’s/debtor’s credit worthiness, before and during the contract. For this reason, the acquirer of the debtor’s business or part thereof must first be assessed by the financial institution to become the new debtor, because this transition could affect the financial risk borne by the financial institution and, in a general perspective, its financial stability. **Imposing an exchange of debtors or contractual counterparties by law is too far-reaching, disproportionate, unclear in its contents, unbalanced with regard to the interests affected and even in conflict with general principles of credit lending.**

Leaseurope and EUF reject this forced exchange of debtors and leastways suggest adding the following third subparagraph to Article 27(1):

"The second sentence of the first subparagraph shall not apply to credit and financial services contracts."

Furthermore, Article 27 (2) of the proposed EU insolvency directive provides the national court with the possibility to decide to terminate the executory contracts. Leaseurope and EUF do not support this possibility to terminate the contracts. It will be difficult for a court to judge whether termination is or is not in the debtor's interest, which creates the risk that the debtor may use this possibility to get rid of unwelcome contracts. Moreover, such a right violates the principle of equal treatment of creditors.

For leasing companies, the mere possibility that leasing contracts could be terminated in pre-pack proceedings by courts would also have a **significant impact on the refinancing options of leasing companies**. An insolvency-proof advance assignment of leasing instalments to the refinancing bank would no longer be possible under these circumstances, which would have an extremely negative effect on the banks' willingness to refinance. Against this background, it is necessary to ensure that **leases entered into by the debtor as lessor and relating to other assets assigned as security to a third party who financed their acquisition or production continue to apply with effect for the estate**.

Leaseurope and EUF propose deleting the possibility of termination in its entirety. In any case, it shall not apply to contracts yet to be performed and entered into by the debtor as lessor or lessee and other property transferred by way of security to a third party who has financed its acquisition or production.

- Title IV – Pre-pack Proceedings
Chapter 3: Liquidation Phase – Article 34

Article 34 (3) of the proposed EU insolvency directive states that *“Member States shall ensure that security interests are released in pre-pack proceedings under the same requirements that would apply in winding-up proceedings”*. In this point, we refer to our comments above regarding the right to separation and segregation of the leasing and factoring companies' claims from the general insolvency estate.

Leaseurope and EUF believe it is necessary to incorporate in the proposed Directive, including in Article 34(3), the **priority satisfaction for leasing entities and factoring entities with full asset ownership over the secured creditors**.

- Title VI – Winding up of insolvent micro-enterprises
Chapter 1 : General rules – Article 39 and 43

Considering the number of insolvencies of microenterprises in relation to the total number of business insolvencies, the provisions for simplified winding-up proceedings for insolvent microenterprises are of particular practical relevance, especially for business partners of such small and microenterprises.

As small entities and microenterprises generally tend to be financially weaker, the argument of cost efficiency *prima facie* speaks both for the introduction of simplified winding-up proceedings for microenterprises **without the appointment of insolvency practitioners** and for leaving the **debtor in possession** (cf. Art. 39 and 43). However, simplifying proceedings by not involving insolvency practitioners or another neutral party and leaving debtors in control of their assets and day-to-day operations of the business means a **shortfall in neutral support and supervision**, also with regard to the insolvent microenterprise's behaviour and actions before insolvency proceedings commenced. Leaseurope and EUF consider these means for achieving simplification and cost-efficiency to be **neither appropriate nor balanced with a view to safeguarding creditors' interests**.

To achieve the objectives of the insolvency law and ensure a balanced protection of the interests of all those concerned, it is key to provide insolvent microenterprises with a **neutral and objective person** to not only guide and support them, but also to safeguard creditors' interests throughout the insolvency proceedings. Furthermore, **creditors should be provided with the right to petition for a revocation of the debtor's control** of their assets and day-to-day operation of their business.

- Title VI – Winding up of insolvent micro-enterprises
Chapter 2 : Opening of simplified winding-up proceedings – Article 44

Please refer to our comment above regarding Article 34. The admissibility of the stay of individual enforcement actions should be made dependent on the fact that it is necessary for the smooth and effective implementation of the pre-pack procedure.

- Title VI – Winding up of insolvent micro-enterprises
Chapter 3 : List of claims and establishment of the insolvency estate – Article 46

Article 46(1) of the proposed EU insolvency directive states that *“the claims against the debtor are considered as lodged without any further action from the creditors concerned, where those claims are indicated by the debtor in”* his application for opening the winding-up proceedings.

Leaseurope and EUF warn that this **can lead to abuse of the debtor’s rights** to the detriment of the creditors’ interests. It should be left to creditors themselves to decide whether or not to lodge their claims in the schedule, especially in view of the fact that the data provided by the debtor may be inaccurate. **Leaseurope and EUF propose to delete Article 46(1) of the proposal.**

- Title VI – Winding up of insolvent micro-enterprises
Chapter 3 : List of claims and establishment of the insolvency estate – Article 48

Pursuant to Article 48(2) of the proposal on “establishment of the insolvency estate”, the **insolvency estate includes assets which were in the debtor’s possession** at the time the simplified winding-up proceedings were opened.

The link to mere possession would have the consequence, among other things, that all objects leased by the debtor and owned by the leasing company or the factoring company would also be considered as belonging to the insolvency estate. This would be incompatible with the property rights of the leasing and factoring companies, as mentioned above in our general remarks.

Leaseurope and EUF understand that this might be an editorial oversight. We suggest replacing “assets in the possession” with “assets in the ownership”.

Article 48

2. The assets of the insolvency estate shall include assets in the ~~possession~~ **ownership** of the debtor at the time of the opening of simplified winding-up proceedings, assets acquired after the submission of the request for opening of such proceedings and assets recovered through avoidance actions or other actions.

Conclusion

In conclusion, we believe that changes in insolvency law should be done only after careful review and contemplation. Insolvency law is inextricably interwoven with other areas of law, such as civil, labor and company law. As long **as the legal and economic framework conditions in the Member States have not been sufficiently harmonized**, harmonization of insolvency law could jeopardize the coherent legal systems of the EU countries. The application of the Directive on Preventive Restructuring and Insolvency needs to be first evaluated before additional rules for full harmonization are adopted.

The proposed Directive on the harmonisation of certain aspects of insolvency law should ensure that the ownership position of leasing and factoring companies is adequately protected. Clarity regarding this security will reinforce the refinancing possibilities of leasing/factoring companies, enabling thereby many leasing financing and factoring transactions for businesses in need in the future.

Furthermore, Leaseurope and EUF are of the opinion that **improvements to information, education and consultation on restructuring and insolvency matters aimed at prevention rather than cure** will contribute significantly to a more timely commencement of insolvency proceedings, especially concerning small and microenterprises.

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