ȚUCA ZBARCEA
/ASOCIATII

Issue 17, April-May 2017

Just in Case

An online publication of Țuca Zbârcea & Asociații

In this issue

Table of Contents

Intro

/ Towards a Banking Union?

Towards a Banking Union?

At the level of the European Union (EU) and in particular in the European financial sector, this year we should see further steps towards integration, with the final goal of realising a union of the European financial markets. The European Securities and Markets Authority (ESMA) has published its 2017 Supervisory Convergence Work Programme which promotes "sound, efficient and consistent supervision across the EU".

According to the programme, ESMA and competent national authorities will focus their supervisory convergence work on several priorities such as (i) the implementation of MiFID II[1]/ MiFIR; (ii) investors' protection in the context of cross-border provision of services; and (iii) convergence in the supervision of European Union CCPs (Central Counterparties).

In parallel, the European Commission has undertaken further steps towards the realisation of the banking union, by announcing certain reforms to the rules (at the level of the EU legal system) which apply to the existing pillars of the banking union: the Single Supervisory Mechanism and Single Resolution Mechanism[2].

Inevitably, all of the above should lead not only to legislative changes at the national level of each of the Member States but also to further transactions with banking assets, as banks would have to continue to adapt their businesses and balance sheets to the new capital requirements.

None of this sounds very different from the headlines of previous years, reflecting a process started by the European regulatory bodies in 2012, in response to the financial crisis. But when thinking of all these matters, it is impossible to ignore recent changes in the international context. For example, the Brexit referendum and subsequent steps[3] have created the prospect of the UK leaving the EU (although not a member of the euro area, the UK leaving the Union is likely to have major consequences on the financial markets). Along the same lines, elections in some of the largest Member States, scheduled to take place throughout the year, could further disrupt the moves towards a banking union.

On the local market, as the election year is behind us, we hope for a more predictable legislative environment than in 2016. A particular focus of last year's legislative initiatives was consumer protection vis-à-vis borrowing and other financial transactions.>

1. MIFID II must be transposed into national legislation by 3 July 2017 and must come into effect no later than 3 January 2018. In parallel, Regulation (EU) No. 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products will apply directly in each Member State from 1 January 2018

2. http://europa.eu/rapid/press-release_IP-16-3731_en.htm.

3. For example, the UK Parliament vote which granted the British government the authority to invoke Article 50 of the Lisbon Treaty, starting the formal process of leaving the EU

As we detail in the sections below, there is a new regime applicable to mortgage lending, reflecting the corresponding European directive but also including supplementary provisions, referring to the transfer and management of non-performing loans. Also, the Constitutional Court ruled on two legislative initiatives which, prior to the rulings, were subject to intense media coverage and public debate. Following the rulings, the impact of such legislation is expected to be limited, without threatening the financial stability.

All the above (and more besides) creates the possibility of the further transformation of the local banking system. We hope that the trades with bank shares and banking assets (both performing and non-performing) will continue at a good pace. To our knowledge, there is interest both on the vendors' and on the buyers' side in discussing potential trades, as several banks are being prepared for sale while others are taking steps towards cleaning up their balance sheets.

The transactions completed in the last few years should translate into better capitalisation and an increased appetite for lending, both to corporate and retail borrowers. This, in combination with enhanced liquidity and access to cheap money (although there are signs that extremely accommodative monetary policies are coming to an end) should support the growth in lending activity. Recent financing transactions, in particular club deals, are arguments in favour of this view. Further good news is that this growth comes not only in the area of real estate finance, but also in transactions that require more complicated structures, such as acquisition finance.

A final thought is related to the development of fintech companies and the alternatives they provide to traditional lending. Although this domain is still very much incipient compared with traditional banking, including in the Anglo-Saxon markets where it originates, promising technologies are being developed (such as block chain and direct payment systems) and there is a certain entrepreneurial interest in the area, in particular in crowd-funding platforms. From a legislative perspective, it is worth noting that the European Commission has announced that, for the moment, it does not intend to come up with legislative measures to regulate such crowd-founding activities[4].

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4. https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-smsg-010.pdf

Case by Case

Leveraged Buyout Structures and Private Equity. The Romanian Legal Perspective

Leveraged Buyout Structures and Private Equity. The Romanian Legal Perspective

Private equity (PE) firms are specialised investment firms that typically use leveraged buyouts (LBOs) when structuring their acquisitions.

In an LBO, a company (the Target) is acquired using a combination of equity and external debt financing, the latter being the largest component. This technique is also called "bootstrap acquisition", considering the smaller amount of own equity invested in the Target, while the repayment of the external debt is typically serviced by the Target through its cash flows.

This financing technique is economically based on the tax shield gained by the Target, which assumes that it has sufficient debt capacity and that it generates cash flows in excess of its ongoing needs and so may increase its leverage[1]. Corporate tax law allows for the deduction of interest payment (subject to thin capitalisation rules) but not dividends, thus using maximum leverage in an acquisition in which the return on assets exceeds the interest expenses, leading to a higher return on equity.

The public have previously taken a dim view of this type of leveraged transaction, perceiving it as coming at the expense of employees who suffer job cuts and salary reductions. Nowadays, the benefits for the Target company, which enhances its performance through the use of the financial and corporate governance knowledge of PE firms, are largely accepted.

The favourable credit market coupled with attractive interest rates led to a comeback for leveraged loans following the financial crisis. In the light of this renewed lending activity, a substantive part of the work of our lawyers in the Banking & Finance team is related to this type of finance structure, mainly driven by PE firms or sometimes by strategic (non-financial) investors who seek to fund >

1. This calculation is based on the Miller-Modigliani propositions, developed by the Nobel laureates Morton Miller and Franco Modigliani in their papers published in 1958 and 1961. Their "irrelevance propositions" asserted that under a restrictive set of conditions, neither a company's financing activity nor its dividend policy should be expected to affect its current market value.

the acquisition of related industry companies with a portion of debt. In the transactions where our lawyers provided legal assistance, the Target companies had a strong market position, with consistent revenue growth and stable operations which generated predictable cash flows.

Romanian law places certain restrictions on this type of operation, which need to be carefully assessed when structuring the financing transaction.

Financial Assistance and LBOs

The Romanian Companies Law[2] reflects the capital maintenance principles set forth in the Second Council Directive 77/91/EEC[3], which bans joint stock companies from acquiring their own shares. The corollary of this restriction is that the financing or guarantees for the acquisition of own shares (operations known as "financial assistance") are also expressly prohibited.

Limiting the financial assistance granted by a company (i.e. the Target) in order to acquire its own shares by a third party is established by law in many European continental countries, following implementation of the Second Council Directive 77/91/EEC. This restrictive approach by European legislators in relation to the use of financial assistance led to a close to impossible implementation of financing schemes secured by the assets of the Target and was widely criticised for bringing unjustified restrictions to the M&A market and imposing a rigid approach with a standard protection level that was not always necessary.

Since 2006, and especially during 2012, the EU financing market was significantly restructured in order to address its dynamics. One of the pillars of the reform was Directive 2006/68/EC, reinforced through Directive 2012/30/EU of the European Parliament and of the Council[4] which, among other measures, set forth a more permissive approach to financial assistance, subject to certain standards, thresholds and internal approvals known as "whitewash proceedings". Pursuant to these rules, transactions can take place under fair market conditions, under the responsibility of the management, which is required to prepare a written report, indicating among other things the risks to the liquidity and solvency of the company, and finally were to be subject to the prior approval of the general meeting of shareholders, under certain quorum and majority conditions. Moreover, companies must take into consideration that the aggregate financial assistance granted to third parties must at no time result in the reduction of net assets below the share capital.

Romania has not transposed the "whitewash proceedings" permitted by Directive 2006/68/EC and then by Directive 2012/30/EU, given that no such obligation was imposed on Member States. At a domestic level, Romanian company law expressly prohibits financial assistance granted by way of advancing funds or providing security interest rights. The penalties are very severe and directors, executive manager or legal representatives of companies that advance funds or loans for the company's shares are committing an offense punishable by prison. Furthermore, it is largely accepted in the doctrine[5] that transactions which breach the financial assistance rules are null and void. This renders inapplicable the use of LBO structures which involve financial assistance for the Romanian joint stock Target companies.

However, there are a number of structures that have developed and that are used in practice in acquisition transactions.

Use of LBOs for Limited Liability Companies

Romanian company law regulates the financial assistance restrictions only with respect to joint stock companies, in Chapter IV – Joint Stock companies >

2. Companies Law No. 31/1990, as further amended and restated.

3. Council Directive 77/91/EEC on the coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (the Second Council Directive). The Second Council Directive was amended by Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC and then replaced by Directive 2012/30/EU of the European Parliament and of the CouncilCompetition Law and Data, 10 May 2016, http://www.autoritedelaconcurrence.fr/doc/reportcompetitionlawanddatafinal.pdf.

4. Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on the coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.

5. St.D. Cărpenaru, Gh. Piperea, S. David, Legea societăților, comentariu pe articole, 5th edition, Ed. C.H. Beck, Bucharest, 2014.

Section 1 – About Shares. Limited liability companies have a separate regulation which reflects their status of "partnership" as they are owned by a limited number of shareholders (minimum one and maximum 50).

Nevertheless, various doctrinal opinions have considered certain provisions related to joint stock companies as representing corporate law principles and therefore held that they should be extended also to limited liability companies. The question would then be if such financial assistance rules represented a corporate law principle, which naturally should apply also to limited liability companies. Our view is that this extension should not apply with respect to financial assistance rules, based on the following arguments:

1. There is no indication that legislators' intention was to regulate financial assistance as a corporate principle that should extend to all companies, including partnerships. On the contrary, these rules transpose the Second Council Directive, which expressly provides that its coordination measures apply in Romania only to joint stock companies, and not to other types of companies.

2. The regulation which transposes into a criminal sanction the breach of financial assistance expressly refers as being applicable with respect to "shares" (which in Romania are issued only by joint stock companies). A limited liability company may issue only "social parts", and therefore this sanction is not applicable to this type of company. The authors may only be individuals holding the position of director, executive manager or legal representative of a joint stock company[6].

3. The High Court of Cassation and Justice has ruled that with limited liability companies, the rules provided for other types of companies may apply only if there is a specific reference norm, while "the absence of such reference norms, which are limited and of strict interpretation, to joint stock companies leads indubitably to the conclusion that the administration of a limited liability company is governed by different rules than those provided for joint stock companies"[7]. As indicated, there is no reference norm to the financial assistance rules provided for joint stock companies; therefore these rules should not be applicable to limited liability companies.

Nevertheless, as the financial assistance rules have not been tested in Romanian courts as far as limited liability companies are concerned, and owing to the gravity of the sanctions, parties tend to be very cautious when structuring LBOs that include a financial assistance element.

Merger with Debt Push-Down

The financing structure of LBOs may include the immediate merger of the Target company into the acquisition vehicle (or, if suitable, and depending on the specifics of each transaction, sometimes it is the>

6. I. Schiau, T. Prescure, Legea societăților comerciale nr. 31/1990. Analize și comentarii pe articole, 2-nd edition, Ed. Hamangiu, 2009; C. Voicu, Al. Boroi et al. Dreptul penal al afacerilor, 4th edition, Ed. CH Beck, 2008.

7. High Court of Cassation and Justice, 2nd Civil Section, Decision No. 3679 from 31 October 2013.

acquisition vehicle that is merged into the Target). This operation is also referred to as a debt push-down structure, because the acquisition financing (obtained at the level of the acquisition vehicle and generally financed by equity and not directly by the Target) is pushed down to the merged entity level. If a company does this, it could also be argued that any financial assistance issue no longer applies, as the prohibition only addresses the Target company, which ceases to exist after completion of the merger. In such a structure, the security for the acquisition finance is granted after the merger takes place.

Notwithstanding the above, the legality of a merger LBO involving a joint stock company as Target is uncertain given the obvious linkage between the merger and the financing structure. In such transactions, the merger would not be a separate, autonomous transaction but just the final part of the acquisition process. However, this risk does not apply to limited liability companies, which are not covered by the financial assistance rules.

Furthermore, the use of a merger with debt push-down needs to be carefully reviewed from a tax perspective to ensure it is done in a tax neutral manner. Under the Romanian Fiscal Code, a merger is a tax neutral event, from a corporate income tax perspective, if it meets certain requirements, in brief:

- It has economic substance and is not performed with the purpose of tax avoidance or tax evasion;
- The fiscal value of the shares received by the shareholders of the absorbed company in the absorbing entity is equal to the fiscal value of the shares held in the absorbed company prior to the merger;
- The fiscal value of any assets transferred in the merger process is preserved at the level of the absorbing company.

In other European jurisdictions (such as Switzerland and Italy) in the case of mergers with a debt push-down structure where the acquisition vehicle has been specifically incorporated for the purpose of acquiring the Target company, the deductibility of the interest has been questioned as potential tax avoidance. The key issue raised was that at the end of the acquisition process a significant debt was allocated to the Target and the interest generated by this debt was used to reduce the company's taxable income.

However, in many cases, an acquisition followed by a merger of the acquisition vehicle with debt push-down is not tax-driven at all. The primary reason for the use of the acquisition vehicle is to separate the liability for this acquisition from other investments, a fairly standard practice for PE firms. After the acquisition is completed, there is no justification for having two separate entities (the acquisition vehicle and the Target) and through the merger the costs of maintaining the acquisition company can be saved, the corporate governance is simplified and the debt/equity ratio is optimised. Therefore, it can be successfully argued that the tax benefit is not the aim of the acquisition structure and that the interest deduction is just a consequence of the application of general rules given the lack of any specific provisions for merger LBOs.

Looking to a More Permissive Future?

Given the market dynamics, it is recommended that the Romanian legislation adopts a more flexible approach in terms of allowing financial assistance, subject to clear and predictable conditions, so as to encourage LBO transactions. This is because a very strict creditor protection regime may sometimes lead to undesirable consequences, such as establishing and enhancing protection for subjects that neither need nor desire it. Currently, the financial assistance prohibition applies to joint stock companies regardless of whether or not they have creditors, or whether, hypothetically, the creditors of a financially stable company approved a transaction involving financial assistance. On the contrary, financial assistance prohibition does not cover the acquisition of the company's assets, as it solely relates to the subscription or acquisition of its shares; such limitation is hard to justify from a practical perspective, as asset deals may be as detrimental to a company and its creditors as share deals.

In order to prevent market players from engaging in various complex mechanisms to circumvent the financial assistance prohibition, and, implicitly, to stimulate the domestic economy in terms of time and cost efficiency, Romanian legislators should consider adopting a more permissive legal framework in respect of financial assistance, such as the one permitted by Directive 2006/68/EC. Moreover, by following the EU example establishing the responsibility of the management body for transactions involving financial assistance, the local regulations would also reduce moral hazard, simultaneously enhancing the corporate governance>

regime. Creditors and shareholders would benefit from clear debt information, which is an essential instrument for risk mitigation. In the long run, creditors' interest is that their debtors remain solvent on an ex post financial assistance basis, and, therefore, a creditor mutual agreement, together with a shareholder resolution passed with a high majority, would represent a viable solution for addressing the risks related to financial assistance and enhance the acquisition market.

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Focus

Recent Legislative Changes Impacting the Crediting Business and the Secondary Markets for Banking Assets

Recent Legislative Changes Impacting the Crediting Business and the Secondary Markets for Banking Assets

In a banking sector challenged by a high number of non-performing loans, which exceeds the European Union average, an impressive number of legislative initiatives have been promoted by the Romanian Parliament in recent years, particularly during 2016.

The promoters of these initiatives cited the need to adopt these measures in order to protect consumers who had taken out loans for which, for various reasons, they faced difficulties in repaying.

The proposed enactments have been the subject of intense public debate, involving the main actors of the banking system: banks, consumers' associations and the National Bank of Romania (BNR), but also legal practitioners and economists. Legal principles, economics and business rationale have been raised to support conflicting views on the benefits versus the negative effects of these laws on consumers, the banking market and other related sectors, such as the real estate market.

One particular issue has been legislators' intention to apply certain of the new legal provisions also to existing contracts, concluded prior to the entry into force of the new laws. The potential retroactivity is generally seen as weakening legal certainty, an aspect highlighted by the BNR[1], the European Central Bank[2] and the European Commission[3]. On top of the costs of implementing these measures, the legal uncertainty is expected to negatively impact the crediting business as state intervention in ongoing contracts is likely to discourage foreign investors or increase the risk attributed to Romanian jurisdiction.>

1 Please see "Romanian financial system – recent developments and perspectives" – L.Voinea, Deputy Governor of the BNR, March 2016 (available online on the BNR's official website at www.bnr.ro/DocumentInformation.aspx?idInfoClass=6896&idDocument=21872&directLink=1).

2 Please see the "Opinion of the European Central Bank of 18 December 2015 on the discharge of mortgage-backed debts through transfer of title over immovable property (CON/2015/56)" (available online on the ECB's official website at https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2015_56_f_sign.pdf).

3 Please see the "Country Report Romania 2016", 26 February 2016 (available online on the European Commission's official website at http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_romania_en.pdf).

Not all such proposed enactments have been adopted or entered into force: some have been challenged on non-constitutionality grounds, while others are still awaiting Parliament's approval. The summary of these enactments and their legislative status, as well as their impact on the banking market, is presented below. We will then make a more in-depth presentation of the recent changes governing the transfer of consumer loans and their impact on the secondary market of banking assets.

Summary of the Most Important Recent Laws

Law No. 77/2016 on datio in solutum of certain immovable assets for the settlement of obligations undertaken by credit agreements (Law 77/2016). The decision of the Constitutional Court of Romania

Law 77/2006 was adopted by Parliament in the first half of 2016 and entered into force in May 2016. Pursuant to this law, any consumer who took out credit relating to immovable residential property not exceeding EUR 250,000 has the general right to ask the financial creditor to accept the full discharge of such mortgage-backed debt through the transfer of title over one or several mortgaged immovable properties securing the credit contract[4] (*datio in solutum*).

The law stipulates that this procedure is applicable to contracts concluded after its entry into force as well as to ongoing contracts, "with a view to balancing the risks from credit contracts, as well as from the depreciation in value of immovable properties".

The law has been criticised for creating moral hazard and affecting payment discipline, owing to consumers' discretion regarding the application of the procedure, which is generally applicable to all consumers and not targeted at those in need of protection. Subsequently, requests for debt/property swaps were challenged by several Romanian banks, which argued that they breached the Constitution, mainly due to the retrospective application to ongoing contracts.

The Constitutional Court ruled on the issue on 25 October 2016, and the decision was published in Official Gazette No. 53 on 18 January 2017.

The Constitutional Court partially admitted the unconstitutionality argument and ruled that the debt/equity swap procedure set out by Law 77/2016 would be applicable to credit contracts concluded before 1 September 2011[5] only if a court of law had verified the conditions for the existence of hardship under the former Civil Code. The court further deemed unconstitutional the provisions of Law 77/2016 on real estate depreciation. Particularly relevant are several observations made by the court with respect to hardship, detailed herein below.

The Constitutional Court upheld that Law 77/2016 was intended to ensure that the contractual risk in signing loan agreements is equitably shared between the parties, in the larger context of the economic crisis, which left some debtors unable to meet their repayments. T

he court ruled that, although not explicitly mentioned, legislators' intention was to apply the hardship theory and to re-establish the contractual balance between parties affected by unforeseen circumstances that occurred with no fault from either party. However, Law 77/2016 imposed the application of hardship by effect of law to all ongoing credit contracts, without requiring courts to confirm the existence of hardship on a case by case basis.

For this reason, the Constitutional Court judged the provisions of Law 77/2016 to be constitutional only if a court of law verifies the existence of hardship for ongoing credit contracts.

The Constitutional Court of Romania's decision is relevant also because it includes a detailed analysis of the conditions applicable to hardship cases, although the former Civil Code (which applies to credit contracts concluded before 1 October 2011) did not expressly recognize the concept of hardship.

The court defined hardship as an exceptional and external event occurring while the contract is in effect, where the extent and effects of which could not have been reasonably foreseen upon the conclusion of the contract, rendering the obligations excessively burdensome. >

4. The law is expected to be applicable only to loans secured with certain immovable properties, irrespective of whether these loans were concluded before or after the entry into force of the law.

5. The entry into force of the new Civil Code.

Hardship should therefore relate only to unforeseen risk, which is on top of the risks assumed by the parties when concluding the contract, and should not entail the automatic restoration of the initial status quo or eliminating foreseen contractual risks.

The valuation of risks should consider the capacity and economic/legal background of the parties, the value of the obligations in the contract, the risks borne during the term of the contract, as well as new economic conditions which alter both the will of the parties and the social utility of the credit agreement. The valuation may lead to either the termination of the contract or to its amendment to adapt it to the new conditions, but the changes should be effective only in the future. The court called to rule upon the hardship will need to assess the existence of the unforeseen event (an objective condition), its effects on the contract, the good faith in exercising the rights and obligations of the parties (as subjective conditions), and judge in equity (which comprises both objective and subjective elements).

It is generally accepted that the negative effects of Law 77/2016 on the banking system have largely been assuaged by the Constitutional Court's ruling. In particular, the Constitutional Court decision has eased the pressure on mortgage portfolios generated during the real estate boom to 2008, for which the debt/equity swap was regarded to be one of the biggest threats. Moreover, the low incidence of uses of the law (only a few thousand consumers requested its application, despite general expectations of a much higher number) also eased the pressure on the banking system.

The initial reaction of banks was to apply more severe lending conditions and in particular a lower loan-to-value ratio. These conditions created pressure on borrowers to find additional sources to finance the acquisition and rendered real estate loans less accessible, which ultimately affected consumers. Lately, the trend has been to restore the initial credit ratings or to apply a more intricate approach, as some banks differentiate between regions when assessing loan-to-value ratio. Nevertheless, the litigation risks for lenders' historical mortgage portfolios have again risen as the Constitutional Court's decision is expected to lead to a new type of litigation based on hardship risks, for cases when an amicable solution is not reached between bank and borrower.

Government Emergency Ordinance No. 52/2016 (GEO 52/2016) on consumer credit granted for the acquisition of immovable assets and for the amendment and update of Government Emergency Ordinance No. 50/2010 (GEO 50/2010) on consumer credit (as amended and supplemented)

The main purpose of GEO 52/2016 was to implement Mortgage Credit Directive 2014/17/EU[6] and it entered into force on 30 September 2016. The draft law for its approval was passed by the Senate without amendments on 1 November 2016 and was sent to the Chamber of Deputies for approval. The Chamber of Deputies' commissions were required to provide amendments and endorsements on the draft law by 15 November 2016. There has been no further update on the procedure and no date has been set for a vote on the draft law in the Chamber of Deputies.

The entry into force of GEO 52/2016 marks the separation between the regulation of consumer credit agreements related to immovable properties (called mortgages)[7], which are governed by GEO 52/2016, and the regulation of unsecured and other types of consumer credit agreements not related to immovable properties, which remain governed by GEO 50/2010. However, GEO 50/2010 will continue to regulate mortgage credit agreements concluded prior to 30 September 2016.

Pursuant to the new rules set forth by GEO 52/2016, mortgage credit agreements are more strictly regulated both in terms of information provided during the pre-contractual phase, as well as during the term of the agreement, and the rights of the consumer.

In particular, mortgages must comply with the new rules on foreign exchange risk. With loans in>

6. Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (Directive 17). However, GEO 52/2016 exceeds the scope of Directive 17, i.e. Directive 17 concerns residential immovable properties, while GEO 52/2016 concerns any type of immovable property. This extension seems to be allowed under Directive 17, which in Recital 13 provides that "while this Directive regulates credit agreements which solely or predominantly relate to residential immovable property, it does not prevent Member States from extending the measures taken in accordance with this Directive to protect consumers in relation to credit agreements related to other forms of immovable property, or from otherwise regulating such credit agreements". Besides, consumer protection standards under GEO 52/2016 are higher than those provided by the European legislature.

7. Directive 17 does not apply to credit agreements already in existence at the time the legal provisions become effective at national level – hence the corresponding wording of GEO 52/2016 being slightly different.

foreign currency, consumers must be informed of the related risks both prior to the signing of the agreement and throughout the full term of the credit agreement, such as by receiving warnings in the event of a more than 20% depreciation of the currency. Borrowers have the right to convert the credit into an alternative currency at any time during the loan period, and banks must provide them with their available offers in such currency.

Moreover, borrowers have no restrictions if they decide to repay early or refinance their mortgages and no fees may be charged for early repayment.

For all types of consumer loans (both mortgages and unsecured loans), new supportive measures aimed at borrowers in financial difficulties and payment difficulties have been set, including as prevention measures creditors' obligation to provide adequate information and support to consumers in financial difficulties.

In this area, the provisions of GEO 52/2016 and GEO 50/2010 have been aligned to a great extent, in what concerns default interest, acceleration and enforcement in the event of late repayments. The law has therefore imposed, with respect to all consumer loans, limitations on default interest[8] and set forth specific rules on acceleration and enforcement in the event of payment delays.

GEO 52/2016 has also brought novel institutions and introduced specific regulations for the intermediaries of mortgage credit agreements and for receivables collection entities (RCEs), the latter in the case of both mortgages and unsecured consumer loans. The National Authority for Consumer Protection is the designated authority in charge of the supervision of these entities.

The regulation of the activity of RCEs has been done in conjunction with the setting of new rules which govern the transfer of non-performing loans. A more detailed analysis of the impact of the law on these operations is presented in the second part of this analysis.

The Draft Law for the Amendment of Government Emergency Ordinance No. 50/2010 on Consumer Credit[9] (the CHF Conversion Law)

The CHF Conversion Law was adopted by the Senate on 18 June 2016 and by the Chamber of Deputies on 18 October 2016, and was due to enter into force within 60 days of publication in the Official Gazette.

The CHF Conversion Law was intended to allow consumers to convert outstanding CHF-denominated credit into RON, at the historical exchange rate published by the BNR on the execution date of the credit agreement. The law was also intended to apply to credit contracts concluded prior to its entry into force, when such contracts are related to immovable properties.

The amendment of ongoing credit contracts was to be made by an addendum agreed with the original creditor. In the case of credit contracts that have been assigned or are under enforcement, the consumer may bring legal proceedings against the current creditor to convert the loan and thereby recalculate his or her debt.

The law has been criticised for its lack of clarity and for differentiating between consumers who contracted CHF loans and those who contracted loans in other currencies. Lawmakers should also have anticipated legal complications resulting from borrowers' court claims related to the conversion[10].

In response to these criticisms and the fact that the law was not targeted only at consumers facing payment difficulties, the Government set in motion an ex ante constitutionality challenge on the grounds that the provisions of the CHF Conversion Law breach constitutional norms and principles.

According to the official press release dated 7 February 2017[11], the Constitutional Court judged the CHF Conversion Law to be entirely unconstitutional, as the form of the law adopted by the Chamber of Deputies was completely different from that adopted by the Senate, the Chamber of Deputies having added provisions that were not discussed during>

8. Throughout the duration of the credit agreement (before acceleration), the default interest rate is calculated as a fixed percentage, not exceeding 3 p.p., on top of the current interest rate and applied to the due and outstanding principal (with exceptions resulting from the consumer's situation, when the default interest is limited to 2 p.p.); after acceleration, the default interest cannot be higher than 2 p.p. on top of the current interest rate and is applied to the due and outstanding principal; during enforcement, the application of any interest and default interest is specifically prohibited. In all cases, the aggregate default interest is limited to the value of the outstanding principal.

9. We reviewed this draft law in the form sent to the President of Romania for promulgation on 24 October 2016.

10. Please see "Analysis of CHF-denominated loans", February 2015, based on the presentation of M. Isărescu, Governor of the NBR, in a press conference on 30 January 2015 (available online on the BNR's official website at www.bnr.ro/DocumentInformation.aspx?idInfoClass=6897&idDocument=19456&directLink=1).

the debate conducted by the Senate[12]. Also, the CHF Conversion Law regulated hardship as being applicable by effect of law for the conversion obligation and the foreign exchange conversion rate, while according to the Court's prior case law (see above, the decision on Law 77/2016), only courts of law are competent to apply hardship, provided that hardship conditions are met.

Given that the Constitutional Court found the CHF Conversion Law not to be compliant with the Constitution, Parliament must re-examine the law and align it to the decision of the Constitutional Court.

Other Legislative Initiatives

There have been several legislative initiatives aimed at modifying the banking law provisions and taking away the qualification as writ of enforcement for the credit agreements concluded by credit institutions, as well as the ancillary security agreements and guarantees.

In this respect, we note that the draft law for the repeal of Article 120 of GEO 99/2006 was adopted by the Senate on 22 September 2015, while the Government informed the Chamber of Deputies on 8 June 2016 that this draft law did not enjoy the Government's support. The Chamber of Deputies recently rejected the draft law, on 14 February 2017.

It is expected that, if enacted, such laws would create an additional logistical burden and lead to an increase in operating and financing costs for creditors. Of particular note is that these amendments would affect not only retail loans, but also corporate loans, thus having an overall negative impact on the crediting market.

The recent brake to these initiatives, which may be attributed also to the decisions of the Constitutional Court of Romania, could be a signal that legislators are willing to investigate and assess in more depth the required measures that would ultimately protect consumers and their access to a sustainable crediting market.

Impact of the Legislative Changes on the Secondary Market for Banking Assets

In Romania, the secondary market of banking assets has become very active in the last couple of years through transactions focusing on sales of non-performing loan (NPL) portfolios and idle immovable assets (acquired in enforcement or similar proceedings) by credit institutions. Banks have been increasingly active in setting up the "NPL market", as the capital adequacy requirements entail the need for such entities to externalise their non-performing assets in order to use their capital more efficiently, to ensure credit and profitability growth and decrease funding costs.

The involvement of debt collection companies, as purchasers and/or services providers, was also a relevant feature of such transactions. The "do-it-yourself" approach used by Romanian credit institutions recorded a certain success[13], with the NPL ratio (based on EBA definition) declining significantly from 21.5% (September 2014) to 13.5% (March 2016), such success also being recognised at international level[14].

This trend and investors' participation in these transactions needed to be supported by the "stability and predictability of the national legal framework in order to align it with the EU regulatory regime"[15].

The recent changes in consumer credit legislation (GEO 50/2010 and GEO 52/2016) have had a significant impact on the retail NPL market, as they introduced a special regime for the assignment of consumer loans to RCEs, as opposed to assignment to traditional financial creditors (banks and non-banking financial institutions).

The revised consumer credit legislation regulates the transfer of non-performing retail loans to RCEs, while introducing certain differences between real estate loans and other consumer loans:

- Scope of transfer: only NPLs (both mortgages and unsecured loans) with outstanding payments of principal and/or interest due for at least 90 days and which are accelerated or under enforcement procedures may be transferred to RCEs; >

11. Available online (in Romanian only) on the official website of the Constitutional Court, https://www.ccr.ro/files/statements/COMUNICAT_DE_PRESA_7.02_.2017_.pdf.

12. Such amendments concerned (i) the lack of consent for the conversion; (ii) the foreign exchange rate applicable to the conversion (i.e., that valid at the date of the loan agreement and not at the conversion date).

13. Please see "National Bank of Romania's experience in dealing with the NPLs challenge" – F. Georgescu, First Deputy Governor of the BNR, June 2016 (available online on the BNR's official website at www.bnr.ro/DocumentInformation.aspx?idInfoClass=6896&idDocument=22512&directLink=1).

14. Please see "What lessons from Romania's early success in NPL reduction?" - F. Montes-Negret and Eric Cloutier (EBRD consultants), March 2016 (available online at http://npl.vienna-initiative.com/wp-content/uploads/sites/2/2016/05/Romania-NPL-resolution.pdf).

15. Idem 12 above.

- RCEs (both foreign and Romanian entities) that acquire retail NPLs must be registered with the National Authority for Consumer Protection. It follows that unauthorised entities or individuals may not acquire receivables arising from retail loans, irrespective of whether the transfer concerns a single loan or a single debtor;
- Loan agreements governed by GEO 52/2016 (e.g. mortgages) cease to be writ of enforcement after their transfer to an RCE, but no such effect applies to the assignment of the consumer loan agreements governed by GEO 50/2010 (e.g. unsecured loans). The writ of enforcement is a feature provided by law, for loan agreements and related security documents concluded by a credit institution or a non-banking financial institution, which enables the creditor (including its assignee) to enforce its claim directly. This means that in the case of mortgages, unless the enforcement procedure was initiated by the original lenders, RCEs are required first to file the claim against the debtor to secure a court decision (which is a lengthy procedure subject to appeal and second appeal), and then to seek enforcement against the debtor.
- RCEs may charge only legal default interest and enforcement costs (any other fees, interest and default interest provided in the original loan agreement may not be applied after the transfer);
- The debt collection activity has to comply with the rules of conduct set forth by law, aimed at protecting consumers against harassment, oppressive or abusive conduct.

It may be anticipated that the rules applicable to the assignment of retail mortgage NPLs would likely induce RCEs to request that enforcement be initiated by the original lenders prior to assignment, considering that they would not be able to initiate directly such enforcement of NPLs as writs of enforcement. Both the original lenders and the RCEs are thereby stimulated to initiate enforcement relatively shortly after the acceleration of loans, considering the limitations imposed on the calculation of interest as well as in the event of assignment.

The new legal provisions are not applicable to the assignment of corporate NPLs, which continue to be governed by the general provisions of the Romanian Civil Code regulating the assignment of receivables. Currently, there are no restrictions on the assignment of corporate NPLs to financial creditors or to regular entities not subject to a specific authorisation regime (either Romanian or foreign entities).

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News and Views

/ Digital Banking in Romania. The Time Is Now

Digital Banking in Romania. The Time Is Now

In the increasingly ubiquitous digital environment, the Digital Single Market (DSM) has become one of the priorities of the European Union (EU).

A key milestone for the DSM, Regulation (EU) No. 910/2014 on electronic identification and trust services for electronic transactions in the internal market (the eIDAS Regulation) was aimed at providing a "common foundation for secure electronic interaction between citizens, businesses and public authorities, thereby increasing the effectiveness of public and private online services, electronic business and electronic commerce" in the EU.

Under this regulation, electronic identification and electronic trust services – i.e., electronic signatures and seals, time stamps, electronic delivery services and website authentication – are intended to benefit from the EU single market, ensuring uniform legal treatment across the EU, giving electronically signed documents the same legal effects as paper-based documents with handwritten signatures.

The eIDAS Regulation specifies that the legal effects of an electronic signature (irrespective of its category) and its admissibility as evidence in court cannot be denied only because it has an electronic format or because it does not fully comply with the requirements of qualified electronic signatures.

The regulation also provides that qualified electronic signatures have the legal effects of handwritten signatures. In addition, qualified electronic signatures based on qualified certificates issued by a Member State are recognised as such in all other Member States.

Based on the provisions of the eIDAS Regulation (directly applicable in all Member States and prevailing over any contradictory national legislation) and the Romanian legislation on distance contracts, Romanian credit institutions are allowed by law to provide certain banking services[1] through online/electronic platforms[2].

Online contracting comes with certain technical constraints. >

1. The eIDAS Regulation sets out three categories of electronic signatures, depending on the degree of trust of the signatory's identity, i.e. (i) simple, (ii) advanced and (iii) qualified electronic signatures. The last category corresponds to the extended electronic signatures regulated by Romanian law.

2. Government Emergency Ordinance No. 52/2016 on consumer loans granted for the acquisition of immovable assets and for the amendment and update of Government Emergency Ordinance No. 50/2010 specifically prohibits the signing of retail mortgage contracts at a distance or outside areas designated for commercial purposes.

Electronic platforms made available by credit institutions should provide, among other things:

- A secure environment allowing the unique and trustworthy identification of clients and the safety of their personal data;
- A safe communication instrument at a distance;
- A durable medium for recording and preserving contracts (i.e. their contents and the parties' consent)[3]; and
- The technical possibility to sign the relevant contracts and ensure that such contracts are admissible as evidence in court.

Most of these aspects can be covered from a technical perspective. In respect of the last point, certain difficulties can be identified, but they do not concern the validity of contracts, rather the possibility to use certain types of information as evidence (i.e., which is relevant in the case of disputes occurring during the duration of the contract or in enforcement) – in particular since the Romanian legislation was somewhat inconsistent before the entry into force of the eIDAS Regulation. For the relevant contracts to gain the same legal effects as private deeds (acte sub semnătură privată), including from the perspective of their admissibility as evidence, electronic contracts must be made in written form, recorded on a durable medium, and signed both by the bank and the client with qualified electronic signatures (in the case of individual clients or authorised representatives of legal entities) or with electronic seals (in the case of legal entities).

A digital contract does not always incorporate the corresponding electronic signatures, its sealing being ascertained by other digital means, such as online confirmation by pressing a button in an online platform[4].

Based on the eIDAS Regulation, trust services providers such as Cryptomathic, IDnow, Connective, DocuSign and Adobe[5] offer digital solutions which can be integrated in a bank's online platform, allowing customers to apply advanced and/or qualified electronic signatures. Some EU credit institutions have already implemented solutions for the use of electronic signatures and seals, for both retail and corporate clients. Such services are in addition to the usual facilities of internet/online banking platforms, allowing customers to access banking services exclusively online, without being required to be physically present at the bank's counters.

All the possibilities above (and more besides) create the perspectives for further digitalisation of the EU banking system. To our knowledge, there is interest both on the banks' side and on the clients' side in accessing online banking products.

Entrepreneurial interest in the fintech area and the alternatives fintech companies can provide to traditional banking may also incentivise banks to adopt such new technologies.

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3. As per the Decision of the Court of Justice of the European Union in case No. C-375/15 dated 25 January 2017, a web portal meets the requirements of a durable medium if the user can record the information personally addressed to him or her, so that such information can be identically accessed and reproduced, for an appropriate period, without allowing any unilateral change of its content.
4. As per the Decision of the Court of Justice of the European Union in case No. C-322/14 dated 21 May 2015, the acceptance - by pressing a button - of the general terms of a contract concluded by electronic means represents a communication which allows the durable registration of the parties' agreement, when such technique ensures the possibility of printing and saving the text thereof before the conclusion of the contract.
5. A list of worldwide recognised electronic signatures providers may be found online at: https://www.g2crowd.com/categories/e-signature.

/ **The materials included herein are prepared for the general information of our clients and other interested persons. They are not and should not be regarded as legal advice.**

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