10 May 2016

LAW ON DEBT DISCHARGE TO ENTER INTO FORCE ON 13 MAY 2016

After controversial debates, Law no. 77/2016 on discharge of mortgage-backed debts through transfer of title over immovable property (the "**Law on Debt Discharge**") was finally published in the Official Gazette on 28 April 2016 and will enter into force on 13 May 2016.

The "debt discharge" (*darea in plata*) allows for the discharge in full of any loans contracted by a natural person and secured by a mortgage arrangement, including any accessories in connection therewith. The law exempts the governmental backed programme "Prima Casa" and loans exceeding EUR 250,000 (RON equivalent, calculated at the exchange rate made public by the National Bank of Romania on the date on which the relevant loan agreement was concluded) (the "**Ceiling**").

As matter of concern for law practitioners and European bodies alike, the Law on Debt Discharge applies to credit agreements concluded both after its entry into force as well as to all outstanding credit agreements. Also, given the wide scope of the Law on Debt Discharge, it will apply to both performing and non-performing loans as well as to commercial loans granted to natural persons. Making the debt discharge mandatory for creditors and available to all debtors, irrespective of their financial status and their capacity to continue servicing their debt, is likely to increase risks in the banking sector.

The Law on Debt Discharge sets out the following conditions for the full discharge of the debt: (i) the debtor is a natural person and the creditor is a credit institution, non-bank financial institution or assignee of receivables against consumers; (ii) the amount of the loan does not exceed the Ceiling; (iii) the consumer has contracted the loan for the purpose of acquiring, building, extending, modernizing, laying out or rehabilitating an immovable asset with residential purposes or, irrespective of the purpose for which the loan was contracted, one of the security interests granted in favour of the lender is a mortgage over an immovable asset which has residential purpose; and (iv) the consumer has not been convicted of a criminal offence in relation to the loan for which the debt discharge is requested.

Even since the legislative authorities were debating the draft law, the ECB advised the Romanian authorities to carefully consider the impact of the draft legislative provisions on existing credit agreements in order to ensure legal certainty and avoid undue interference with the contractual and property rights of credit institutions. In addition, ECB has invited the Romanian authorities to liaise with the European Commission as to whether the Law on Debt Discharge is compatible with the provisions of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumer relating to residential immovable property.

The European Commission mentioned in several occasions that the implementation of the law on debt discharge represents a major downward risk to macroeconomic developments, the main concerns being the retroactive and wide applicability, as well as the fact that the law applies independently of the financial status of the debtors. On 3 May 2016 the European Commission released the European Economic Forecast Spring 2016, whereby it restates the fact that the Law on Debt Discharge could have a substantial negative impact on investor confidence and credit outlook over the forecast horizon and beyond, causing uncertainty in the external environment.

It is envisaged that the new law may have negative impact on financial institutions and will change the decision making process of all financial institutions when granting loans. The down payment for these loans will be increased for all borrowers (by some indications to no less than 35% of the total purchase price) and the banks will most probably add into their risk assessment a new indicator i.e. the potential depreciation of the encumbered assets, which eventually will impact the access to credit for natural persons.

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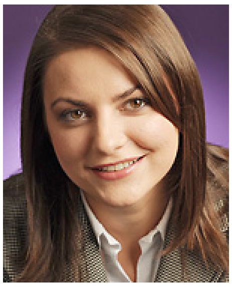

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