Clifford Chance

BRIEFING

Impact of EU Insolvency Harmonisation Proposals on Avoidance Risk for Dutch Banks

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Executive summary

The rules on avoidance actions as suggested in the General Approach of the Council for a proposal for a Directive harmonising certain aspects of insolvency law would substantially increase the avoidance risk for banks active on the Dutch market in relation to the basic and crucial banking transactions of repayments, prepayments and set-off with payment transactions in the three months prior to the submission of a request to open insolvency proceedings in respect of its debtor. The increased risk might, however, be negligible in case banks have all-encompassing security packages over their debtor's assets. Several ambiguities in the proposed rules create legal uncertainty, in particular, concerning the relevancy of security in relation to the required detrimental effect (Article 4), the definition of closely related parties (Article 2(14)), the qualification of mandatory prepayments and set-off as a satisfaction as owed (congruent coverages; Article 6(2)), the scope of the exception for legal acts against direct and fair consideration (Article 6(3)) and the extent of the bank's liability in relation to revolving credit and bank account usage by the debtor (Article 9(2)).

Key issues

1. The proposed EU insolvency harmonisation rules would materially increase avoidance risk for banks in the Netherlands, particularly for repayments, prepayments and set-off transactions carried out shortly before insolvency proceedings.

2. The increased risk may be partially mitigated where banks hold comprehensive security packages, but the Proposal does not clearly address how such security affects the assessment of creditor disadvantage.

3 The Proposal introduces greater legal uncertainty than current Dutch law, particularly due to ambiguities in how key concepts are defined and applied.

4 There is uncertainty around core legal classifications, including whether banks could be treated as closely related parties and whether certain transactions qualify as “congruent” or “incongruent” coverages.

5 The Proposal provides limited clarity on key protections and liabilities, including the scope of the fair consideration exception and the extent of bank liability in the context of revolving credit and account activity.

Introduction

1. On 7 December 2022, the Commission submitted to the Council and the European Parliament a proposal for a Directive harmonising certain aspects of insolvency law. The proposal aims to encourage cross-border investment within the single market through a targeted harmonisation of insolvency proceedings. Title II of the proposal contains rules on avoidance actions.

2. The Council adopted its position on the proposal with its general approach, as agreed on 12 June 2025 ("Proposal"). The compromised text of Title II includes technical and linguistic changes aimed at improving the clarity of the provisions and removing unnecessary details.

3. The harmonisation of avoidance actions is aimed at the protection of the value of the insolvency estate for creditors through the minimum harmonisation of the rules on the annulment of legal acts that are detrimental to creditors and have been perfected prior to the opening of insolvency proceedings.[1] However, the choice for minimum harmonisation will hardly contribute to the overarching goal of the Proposal to encourage cross-border investment within the single market, as national avoidance regimes can continue to differ. Also, the optional elements in the Proposal, such as the protection of certain transactions in Article 6(3) and the lapse of enrichment defence in Article 7(1), would contribute to differences in avoidance actions regimes throughout the Union. It is safe to say that the cross-border investment climate is served best with as few differences as possible in terms of national avoidance action regimes and clarity about the avoidance action risks.

4. Avoidance actions may also be directed at legal transactions performed with the bank of the insolvent debtor. The chance of such transactions being challenged successfully by an insolvency practitioner are an integral part of the risks connected to banking. A change in the applicable avoidance rules may lead to an increased insolvency risk that banks run on their borrowers. The Proposal is not exclusively aimed at cross-border transactions. This means that the proposed avoidance regime also impacts the voidability of purely domestic banking transactions. Legal certainty in relation to domestic banking transactions, often developed over decades in case law, may be negatively impacted by the Proposal, resulting in an increased risk attached to such transactions.

5. Against this backdrop the Dutch Association of Banks (*Nederlandse Vereniging van Banken*) has requested a high-level analysis of the avoidance action rules in Title II of the Proposal and a comparison to the status quo under current Dutch insolvency law and German insolvency law.

6. The analysis is limited to three transactions that are crucial to the Dutch banking practice: (i) repayment, (ii) prepayment by the debtor of term loans, and (iii) set-off by the bank with funds transferred by third parties to the bank account of the debtor ("payment

[1] Recital 5 of the General Approach

transactions"), all performed within three months prior to the submission of the request to open insolvency proceedings in respect of the debtor (the "hardening period").

7. Please note that Dutch banks, particularly when operating in the SME market, may have security (undisclosed rights of pledge) over all assets of the debtor, including claims and bank accounts, which gives them a right to enforce and take recourse with highest priority in insolvency proceedings, and without any contribution to the insolvency estate. This can be a relevant factor in assessing the voidability risk of banking transactions. For the purpose of this assessment, we have assumed that the creation of such an all-encompassing security package itself cannot be successfully challenged.

Current situation under Dutch insolvency law

8. The Dutch rules for insolvency avoidance actions are laid down in Articles 42 to 51 of the Dutch Bankruptcy Act ("**Fw**"). These rules do not link any legal effect to the inability of the debtor to pay its mature debts as such. Rather, the rules attach importance to the debtor's and its counterparty's knowledge of certain facts and circumstances. Application of these rules to the repayment, prepayment and set-off in relation to banks in the three months before the request to open insolvency proceedings against the debtor, results in the following assessment.

Repayment

9. Repayment refers to the regular process of the debtor paying back to its bank money borrowed under the terms of a loan agreement. This typically involves scheduled payments that cover both the principal amount of a term loan and accrued interest. Such repayment obligations are due and payable at the time the debtor performs their payment.

10. Under Dutch avoidance rules, such mandatory repayments that are to the detriment of the general body of creditors can only be annulled by the insolvency practitioner in the subsequent insolvency proceeding of the debtor if (a) the bank knew that a request to open insolvency proceedings was pending at the time payment was received, or (b) the payment was the result of collusion between the debtor and the bank, in the sense that they both have had the aim of favoring the bank over other creditors.[2] Outside these two narrow grounds for annulment, repayments made to the bank cannot be annulled if they are made within three months prior to the submission of the request to open insolvency proceedings in respect of the debtor.

11. In the context of revolving credit facilities, which allow the debtor to flexibly withdraw, repay and withdraw again up to an agreed credit limit, the extent to which the repayment obligations are due and

[2] This follows from Article 47 Fw, as interpreted (restrictively) by the Dutch Supreme Court. In particular, knowledge by the bank that a request for opening insolvency proceedings would be submitted or that the opening of insolvency proceedings was to be expected or inevitable are insufficient grounds for annulment.

enforceable will be relevant. This will depend on the contractual arrangements. To the extent the repayment obligations were not enforceable at the time of their satisfaction, the transactions will – for the application of Dutch avoidance rules – be treated as prepayments, as discussed hereafter in para. 12. However, repayment in the context of revolving credit will generally be the result of set-off with money transfers to the debtor's bank account. In that case, the set-off can be challenged in the manner discussed in para. 14 below.

Prepayment

12. Prepayment can refer to mandatory prepayment and voluntary prepayment. Mandatory prepayments concern situations where the debtor is contractually required to pay off a portion of its debt upon the occurrence of a certain event, e.g. a disposal of assets. Such mandatory prepayments are to be considered the performance of a due and payable obligation of the debtor and, for the purpose of avoidance actions, are treated similarly as mandatory repayments.[3]

13. Voluntary prepayments cover the situations in which the borrower pays off all or part of its loan to the bank before the scheduled due date. Such prepayment differs from repayment and mandatory prepayment in the sense that the debtor had no due and payable repayment obligation towards the bank at the time the payment was made. Such an incongruent prepayment can be annulled if the transaction had a detrimental effect on the general body of creditors and both the debtor and bank had (actual or constructive) knowledge of that detrimental effect at the time the transaction was performed.[4] Such knowledge is rebuttably presumed if the payment was made within one year prior to the opening of insolvency proceedings.[5] As such, prepayments made within three months prior to the submission of the request to open insolvency proceedings in respect of the debtor can generally be annulled. An exception applies to prepayments that have had no detrimental effect, in particular, because the monies or proceeds used to prepay the bank would have been exclusively available to the bank anyway in the insolvency proceedings of the debtor. This is typically the case in which all the debtor's assets have been encumbered with security rights in favour of the bank.

Set-off of payment transactions

14. Banks may (automatically) set off their claims against the debtor with funds transferred to the bank account of the debtor. This mechanism is particularly relevant in the context of revolving credit arrangements, such as overdraft facilities, which allow a borrower to withdraw, repay and withdraw again up to a specified credit limit, as often as needed, so long as the account remains open and the borrower complies with the terms of the agreement.

3 See para. 9 above.
4 Article 42 Fw.
5 Article 43(1)(2°) Fw.

15. In case law, strict rules have been accepted for set-off by banks prior to the opening of insolvency proceedings of the account holder.[6] Set-off is not allowed with a debt arising from the crediting of the payment account with an amount originating from a third party. Banks cannot rely on set-off if such non-cash payments were received at a time that the bank knew, or should have known, that the account holder was in such a financial state that the opening of insolvency proceedings in its respect was to be expected.[7] In such a situation, the bank will have to pay the funds it has received to the insolvency practitioner. It is not relevant that the bank account itself is provided as collateral to the bank.

16. Whether the bank should simply transfer to the insolvent estate all the funds it has received for the account holder in the period when it had to anticipate the opening of insolvency proceedings (gross approach), or whether the bank may deduct the amounts it made available to the account holder in that same period to dispose (net approach), is unclear. The matter is currently pending before the Dutch Supreme Court.

17. An exception to these strict rules applies to set-off with money transfers made to the account holder by third parties that are the payment of receivables that were provided as collateral to the bank for its counterclaim.[8] In this situation, the bank may always set off its debt resulting from the crediting of the debtor's bank account against any counterclaim that was secured by the collateral, regardless of the financial state of the account holder or the opening of insolvency proceedings in its respect. This safe harbor arrangement, which applies if the bank is provided with security over the account holders' receivables and payment of those receivables is made to the account administered by that same bank, can be considered a true cornerstone of Dutch banking practice since it enables banks and other financiers to continuing financing distressed companies without running the risk of claw-back claims if the company fails to overcome its problems and goes bankrupt.

Interim conclusion

18. The avoidance risk that banks run for repayment, prepayment and set-off with payment transactions in the hardening period under current Dutch law is limited. In case the bank has an all-encompassing security package, i.e. over all of the debtor's assets, the risk is virtually absent.

Impact of Title II of the General Approach

19. The proposed rules in Title II take a different approach to avoidance actions than current Dutch insolvency law. The Proposal distinguishes between a variety of specific avoidance grounds that complement the

6 These rules are not based on the rules involving avoidance, but rather a specific provision that prohibits a certain abuse of set-off. The outcome is, however, very similar to the treatment of set-off of payment transactions as a voluntary satisfaction of the bank by the debtor.

7 As follows from Article 54(1) Fw, as interpreted by the Dutch Supreme Court.

8 In the Dutch context, the collateral would typically have been provided in the form of an undisclosed pledge over the receivables.

general prerequisites for avoidance actions.[9] In general, the Proposal requires the existence of a legal act that was perfected prior to the opening of insolvency proceedings to the detriment of the general body of creditors.[10] It then provides additional requirements for transactions that benefit one or more creditors by satisfaction or collateralisation (called "preferences"),[11] for transactions against no or manifestly inadequate consideration,[12] and for transactions that were intentionally detrimental.[13]

20. Banking transactions would generally be within the scope of avoidance grounds for preferences. The avoidance grounds for transactions against no or inadequate consideration seem to cover, in principle, donations and gifts.[14] It is hard to conceive that transactions that result in the satisfaction of an existing debt are covered by this avoidance ground.

21. In the context of the avoidance grounds for preferences, the Proposal makes a further distinction between "congruent coverages" and "incongruent coverages" depending on whether the involved creditor was satisfied or secured as owed. If the performance was in accordance with the creditor's claim, the transaction can only be annulled if the creditor had certain knowledge of the financial condition of the debtor, which knowledge will be presumed if the creditor is closely related to the debtor.[15] The Proposal allows for some optional exceptions to the voidability of certain transactions, including one for legal acts performed directly against fair consideration to the benefit of debtor's assets.[16] A successful avoidance action will, among other things, oblige the relevant creditor to return the benefits obtained or the monetary equivalent thereof.[17]

Repayment

22. Repayments having a detrimental effect on the general body of creditors would be considered a "preference" as the bank would benefit from the satisfaction of its claim against the debtor.[18] Such preference is treated as a so-called congruent coverage as the repayments will be due and enforceable and the bank has been satisfied or secured in the owed manner.[19]

23. Repayments can be annulled if the repayment was made at a point in time less than three months before the submission of the request that led to the opening of the insolvency proceedings, provided that the bank at the time of the repayment either knew that the debtor was insolvent (in the sense of being generally unable to pay its debts as

9 Recital (7) Proposal.
10 Article 4 Proposal.
11 Article 6 Proposal.
12 Article 7 Proposal.
13 Article 8 Proposal.
14 Cf. Article 7(2) Proposal, which excludes donations and gifts of a symbolic value.
15 Article 6(2) Proposal.
16 Article 6(3) Proposal.
17 Article 9(2) Proposal.
18 Article 6 Proposal.
19 Recital 8 Proposal.

they fall due) or knew that the request to open insolvency proceedings had been submitted.[20]

24. Such knowledge shall be rebuttably presumed in case of closely related parties. This also involves "persons with access to non-public information on the affairs of the debtor, who have the possibility to benefit from the debtor's financial position".[21] This category includes external advisers, accountants and auditors. The background lies in the information advantage that such actors usually enjoy an information advantage with regard to the financial situation of the debtor.[22] It is unclear, but far from unthinkable, that banks may fall under the scope of this category.

25. An important element to consider is the detrimental effect of repayment. From Article 4 of the Proposal, it follows that only legal acts that have a detrimental effect on the general body of creditors can be annulled. This raises the question of whether repayments are actually detrimental in this sense if, for example, the repayment obligation of the debtor to the bank was fully covered by security rights or repayment was made with monies or the proceeds of assets of the debtor that were subject to the bank's security package. The Proposal is unclear in this respect.

26. In the context of revolving credit, the bank might be protected under the (optional) exception for legal acts that are performed against fair consideration to the benefit of the debtor's assets.[23] These are legal acts that aim to support the ordinary daily activity of the debtor's business. Such legal acts require a contractual basis, the direct exchange of mutual performances that are equivalent in value and performance of the counter-performance to the benefit of the debtor (and not a third party).[24] To the extent the bank – pursuant to a pre-existing agreement – allows, or has allowed, the debtor to again withdraw repaid amounts, one could argue that this qualifies for the application of this exception. This is, however, far from clear at the moment. Outright problematic in this respect is the remark in Recital (9) of the Proposal that "this exemption should not cover the granting of credit". It is unclear what is meant by this and how this may affect the application of the exemption in this situation. Recital (9) of the Proposal adds to the confusion with the remark that the exemption should cover, in particular, the "creation of a security right against disbursement of the loan or during the continuation of a loan, if this is necessary against the background of national rules to maintain an equivalence in value between performance and counter-performance".

27. To the extent there is no special protection for this type of transaction, the question arises whether the extent of the bank's liability would be limited to the sums of benefits received, allowing for the deduction of any amounts that were redrawn by the debtor under a revolving credit

20 Article 6(1) and (2) Proposal.
21 Article 2(14)(a)(v) Proposal.
22 Recital 12 Proposal.
23 Article 6(3)(a) Proposal.
24 Recital 9 Proposal.

arrangement or transferred by the debtor from its bank account, or whether the bank would be fully liable for the total amount of preferences received in the hardening period. The Proposal gives no guidance in this respect. If the bank would be fully liable for the total repaid amount in the hardening period, instead of the delta of repaid and withdrawn amounts, this could incentivize banks to prematurely terminate revolving credit facilities when a client is facing financial difficulties.

Prepayment

28. Also, prepayments having a detrimental effect on the general body of creditors would be considered a "preference". A mandatory prepayment, pursuant to a due and payable contractual obligation for the debtor, should – in all likelihood – be considered a congruent coverage for the application of this avoidance ground as the bank claim is satisfied in a manner provided for in the underlying loan contract. The voidability would be determined in the same way as for repayment, as discussed immediately above. It would, however, be desirable if Recital (8) explicitly names mandatory prepayments as an example of congruent coverages, if only to avoid any doubt about such payments being premature and therefore incongruent. For voluntary prepayments, it seems clear that such a preference is treated as a so-called incongruent coverage as this involves a premature payment that is not entirely in accordance with the bank's claim, as the debtor was under no obligation to make the payment at the time it was made.[25]

29. Voluntary prepayments made at a point in time later than three months before the submission of the request that led to the opening of the insolvency proceedings can simply be annulled in the subsequent insolvency proceedings.[26] There are no further requirements. In particular, it is not relevant whether the bank knew about the submitted request or the dire financial state of the debtor.

30. Here also, it should be considered whether a voluntary prepayment might not have a detrimental effect and, as such, cannot be annulled, in particular, where the credit claim of the bank was fully covered by security rights or payment was made with monies or the proceeds of assets of the debtor that were subject to the bank's security package.[27]

31. In the context of revolving credit, the bank might be protected under the (optional) exception for legal acts that are performed against fair consideration to the benefit of the debtor's assets.[28] The analysis here is, in principle, similar to the one for repayments,[29] with the exception of the following. Recital (9) of the Proposal assumes that the exemption is limited to "congruent coverages", but such limitation is not reflected in the wording of Article 6(3)(a) of the Proposal. This

25 Recital 8 Proposal.
26 Article 6(1) Proposal.
27 See para. 25 above.
28 Article 6(3)(a) Proposal.
29 See para. 26 above.

ambiguity creates legal uncertainty in relation to the application of this exception. Clarification whether the exemption can be applied to all preferences, so both congruent and incongruent coverages alike, seems necessary.

32. To the extent there is no special protection for this type of transaction, it is unclear to what extent the bank's liability would be influenced by the withdrawal of revolving funds or the transfer of amounts from the bank account of the debtor in the hardening period.[30]

Set-off

33. The proposal takes a broad approach of legal acts that can be the subject of avoidance actions. In the context of 'preferences', it includes deliberate behavior by the debtor's counterparty or third parties.[31] The recitals explicitly mention acts that create a right to set-off as an example that is covered by this avoidance ground.[32]

34. Set-off by a bank of its claims against the debtor, with funds transferred to the bank account of that debtor, will be considered a preference. What prerequisites apply to the annulment of the set-off will then depend on whether the set-off is considered a congruent or incongruent coverage. This raises the question whether the claim of the bank was due and enforceable at the time of the set-off, and whether the set-off is satisfaction of the bank's claim in the owed manner. It is currently unclear whether a satisfaction through the set-off of a due and enforceable debt is a congruent coverage. One could argue that the bank receives payment in another way than has been contractually agreed and that as such, set-off is, in principle, always an incongruent coverage. One could also argue that the satisfaction of a due and payable claim through set-off is just as good as an actual payment and therefor a congruent coverage. The matter will be decisive for the treatment of set-off under the Proposal and clarification is desirable given the practical importance of set-off in banking as it is a legal instrument applied in almost every banking product. Care should be taken to avoid substantial legal uncertainty in this regard.

35. If set-off is considered an incongruent coverage, any set-off performed at a point in time later than three months before the submission of the request that led to the opening of the insolvency proceedings can simply be annulled in the subsequent insolvency proceedings.[33] If set-off is considered a congruent coverage, annulment additionally requires that the bank knew that the debtor was insolvent (in the sense of being generally unable to pay its debts as they were due) or knew that the request to open insolvency proceedings had been submitted.[34] Here, too, there is a risk that the

30 See above under para. 27.
31 Recital 6 Proposal.
32 Recital 8 Proposal.
33 Article 6(1) Proposal.
34 Article 6(1) Proposal.

bank can be considered a closely related party and that it will be presumed that the bank had such knowledge.[35]

36. It should be considered whether a set-off might not be detrimental to the general body of creditors, in particular, in those circumstances where the bank was provided with security rights over the receivables that were paid into the account and the bank has security rights over the bank account as such. It is, however, unclear whether such set-offs would be exempted from annulment under the Proposal.

37. Also in the context of set-off, it is unclear whether the bank would be protected under the (optional) exception for legal acts that are performed against fair consideration to the benefit of the debtor's assets,[36] if and to the extent the bank allows, or has allowed, the debtor to again withdraw amounts that were credited to its bank account and offset against its bank debt.[37] To the extent there is no special protection for this type of transaction, it is unclear to what extent the bank's liability would be influenced by such withdrawals of revolving funds or the transfer of amounts from the bank account of the debtor in the hardening period.[38]

Interim conclusion

38. The avoidance risk for banks in the hardening period in relation to repayments, prepayments and set-off with payment transactions under the Proposal is substantially higher than under current Dutch insolvency law.

39. In case the bank has an all-encompassing security package, i.e. over all of the debtor's assets, the difference might be negligible, but it is unclear to what extent such a security package will give a bank a successful defence based on the argument that other creditors are not disadvantaged. Such a security package is common in the bulk of the SME market, but rare in the large enterprises market. As a result, the Proposal might have negative repercussions for the financing of large corporate debtors.

40. Furthermore, there are relevant uncertainties and ambiguities regarding the following issues:

    (a) whether banks would be considered "closely related parties". If this were to be the case, the risk that repayments in the hardening period will be successfully avoided will practically border on certainty;

    (b) the extent to which banks would be protected in relation to revolving credit arrangements and payment transaction set-off under the (optional) exception for legal acts that are performed against fair consideration to the benefit of the debtor's assets; and

35 See above under para. 6(a).
36 Article 6(3)(a) Proposal.
37 See above under para. 31.
38 See above under para. 27.

(c) in relation to revolving credit facilities and payment transaction set-off, whether banks would be liable only for the sum of repaid/received and withdrawn/transferred amounts (net approach), or instead for the total amount of repaid/received amounts in the hardening period, without any deduction for amounts withdrawn/transferred (gross approach).

Analysis according to German law

41. The rules in Title II of the Proposal are unmistakenly heavily inspired by German insolvency avoidance law. The Proposal seems to build on the Model Law put forward by an international working group led by Bork and Veder.[39] The Model Law takes into account the principles of 25 jurisdictions, but, in essence, it heavily reflects the characteristics of German avoidance law. It is useful to assess the voidability of banking transactions according to this law in order to identify possible gaps or ambiguities in the Proposal in this respect.

42. The German insolvency avoidance rules are contained in sections 129 *et seq*. of the German Insolvency Code ("**InsO**"). As a basic element, all avoidance rules require that a legal act (*Rechtshandlung*) involves a detrimental effect on the general body of other creditors (*Gläubigerbenachteiligung*). In addition, each specific avoidance rule requires such legal act taking place within certain hardening periods (3 months, 1 year, 2 years, 4 years or 10 years) and certain other specific requirements, sometimes in particular regarding the debtor's and its counterparty's knowledge of certain facts and circumstances. Application of the German insolvency claw-back regime to repayment, prepayment and set-off in relation to banks in the three months before the request to open insolvency proceedings against the debtor results in the following.

Repayment

43. Generally, any repayment has a detrimental effect on the body of creditors as it would reduce the assets – the liquidity – of the debtor when payment is made on a liability. It is not relevant that such payment also reduces the liabilities of the debtor as the effects are not netted. When such repayment is made according to the terms of the underlying facilities agreement, i.e. at the point of time and in an amount it is due and in a currency it is owed, such repayment is considered to constitute a congruent coverage as it has been made in the owed manner.[40]

44. Such congruent repayments can be annulled when repayment was made at a point in time not earlier than three months before the filing for insolvency took place, provided that at the time of the repayment, the bank (i) either knew that the debtor was illiquid (in the sense of being generally unable to pay its debts as they are due) or (ii) when the repayment was made after the filing for insolvency took place, the

39 Bork & Veder, *Harmonisation of Transaction Avoidance Laws*, Cambridge: Intersentia 2022.

40 The cash privilege exemption (*Bargeschäftsprivileg*) of section 142 InsO does not apply to the repayment of loans. This follows from German case law.

bank either knew that the request to open insolvency proceedings had been submitted or it knew that the debtor was illiquid.

45. Such knowledge shall be rebuttably presumed in case of closely related parties. This also applies to persons with access to such non-public information on the affairs of the debtor that generally is only available to senior executives and authorized signatories. This category can include external tax advisers and lawyers but regularly not lenders or suppliers.[41]

46. However, when such congruent repayment was made with amounts or the proceeds of assets of the debtor that are subject to the bank's security package (and the security itself is not subject to a successful claw-back action), such repayment generally would not have a detrimental effect on the general body of creditors, which would then exclude a successful claw-back.

47. Regarding revolving credit arrangements, it is relevant to note that, depending on the facts at hand, the bank might be protected under the cash transaction exemption (cf. § 142 InsO) insofar as the repayment and withdrawals are booked in a current account (*Kontokorrent*), i.e. a bank account that is used for the debiting and crediting of daily business transactions of the debtor.[42] This requires a legal act for which the debtor immediately receives equivalent consideration. The consideration is received immediately if it is provided in a timely manner, i.e. within one or two weeks. Therefore, to the extent the bank allows, or has allowed, the debtor to again withdraw repaid amounts and such transactions more or less happen on a daily basis, the cash transaction exemption applies. In this instance, such repayment, i.e. when the debit amount of the current account is reduced, could not be voided. However, please note that this does not apply to case fees, interest or other repayments under other credit facilities of the respective bank that are paid/made from the current account. Insofar as the cash transaction exemption does not apply, the bank is only liable for the net amount of monies repaid in the hardening period, even if the bank has no security package to rely on.

Prepayment

48. Any voluntary prepayments, i.e. repayments that are not made in a manner owed or that are made prior to the time they are owed, are subject to the German avoidance rules. The detrimental effect on the general body of creditors is the same as in the case of a repayment (see above). Such prepayment is treated as a so-called incongruent coverage as the voluntary and early prepayment is not entirely in accordance with the bank's claim.

49. Voluntary prepayments made no earlier than one month before the filing for insolvency took place or that were made after the filing can

41 This is the prevailing view in legal literature. For example, if the bank only receives the quarterly and annual reports, that does not render the bank a closely related party. However, if the bank has live access to all accounting data, that is definitely a problem in this context.

42 Please note that the exemption is discussed in German legal literature only regarding current accounts. If this applies also to an RCF, it is not discussed, although the situation seems to be comparable.

simply be annulled in the subsequent insolvency proceedings. There are no further requirements. In particular, it is not relevant whether the bank knew about the submitted request or the dire financial state of the debtor. Voluntary prepayments made no earlier than three months but not later than one month before the filing for insolvency took place can be annulled in the subsequent insolvency proceedings, if (i) the debtor was illiquid at the point of time of the prepayment or (ii) if it knew that the prepayment was to the detriment of the general body of the insolvency creditors.

50. In case a voluntary prepayment is made with amounts that are subject to the bank's security package and such security is not voidable, then such prepayment could not be avoided as it would not have any detrimental effect on the general body of other creditors.

51. Regarding any prepaid amount that has been withdrawn again by the debtor as a starting point, the same analysis applies as above under 47. In addition, regarding an incongruent transaction – and that is exactly what the prepayment is – the cash transaction exemption does not apply.[43]

52. Insofar as the cash transaction exemption does not apply (i.e. since the transactions did not take place in a timely manner because claims from the respective bank were concerned or because it is incongruent), then the bank is only liable for the net amount of monies paid into and out of the bank current account in the hardening period, even if the bank has no security package to rely on.

53. In contrast to voluntary prepayment, a mandatory prepayment, i.e. pursuant to a due and payable contractual obligation for the debtor, is considered a congruent coverage as the bank's claim is satisfied in a manner provided for in the underlying loan contract. The voidability would be determined in the same way as for repayment, as discussed above in para. 43.

Set-off of money transfers

54. If an insolvency creditor is entitled to set-off by operation of law or by agreement at the time of the opening of insolvency proceedings, this right is not affected by the proceedings (see section 94 InsO). Such a set-off situation exists at the relevant time of the opening of insolvency proceedings if reciprocity, similarity and fulfilment of the principal claim (*Hauptforderung*), as well as the due date and enforceability of the counterclaim (*Gegenforderung*) of the creditor (here: the bank), are given. The fundamental admissibility of set-off is restricted by section 96 (1) no. 3 InsO.

55. The restriction under section 96 para. 1 no. 3 InsO refers to situations in which a creditor has obtained its right to set-off through an avoidable legal act. This covers both the creation of a debtor position for an insolvency creditor and the reverse case of creating a creditor position for a debtor of the insolvency estate. The creation of the due date of the counterclaim may also be avoidable. This must be

[43] This follows from German case law. The reasoning is that transactions that deviate from the performance that was contractually agreed deserve no special protection.

examined in terms of the respective requirements for the individual grounds for avoidance, so that in the last three months prior to the filing of the insolvency application, the provisions set out above for repayments and prepayments essentially apply, depending on whether the coverage was congruent or incongruent. An insolvency creditor who has acquired the right to set-off through an avoidable legal act is not worthy of protection.

56. The creation of the set-off situation is itself a legal act that can, in turn, be challenged independently. Depending on the specific avoidance provision, this does not have to be a legal act of the insolvent debtor. The legal act here is payment by the third party into the account during the relevant period, which creates the possibility of set-off for the respective amount, and possibly also making the claim of the creditor due and payable. Since there is generally no right to set-off under loan agreements, this is incongruent,[44] so that set-off against such incoming payments is always excluded for the last month before the insolvency application was filed and is very likely to be excluded for the two months before that. There are, however, situations where a set-off can be considered a congruent coverage. Examples of those situations include set-off in a current account where transactions in the ordinary course of business are made, i.e. as long as the current account is in no way blocked; and the set-off that is specifically agreed in a loan agreement.[45]

57. However, there is no disadvantage to creditors if the claim paid into the account was (uncontestably) assigned to the bank as security. Collateral, insofar as it cannot itself be avoided, generally gives rise to a right to separate satisfaction. [46] If a bank account has been pledged as collateral, a similar issue of contestability arises, as the concrete pledge only arises upon receipt of payment into the account and the bank will then regularly be aware of the insolvency/insolvency petition filed – therefore, the protection by such pledge is limited. The secured creditor could, however, still benefit from this security and apply the set-off for lack of creditor disadvantage if both the claim that the third party transferred to the account and the account itself served as security, because the transfer to the account is then a pure exchange of the security. It therefore makes sense to rely not only on the account pledge, but also on the assignment of claims to mitigate the insolvency claw-back risk.

58. Insofar as the bank has no (sufficient) security package to rely on, the bank is only liable for the net amount of monies paid into and out of the bank account in the hardening period. This way, the prevailing view in Germany avoids incentivising banks to prematurely terminate revolving credit facilities.

44 This also means that the cash transaction exemption (section 142 InsO) does not apply.

45 Please note that this is only a simplified overview of a complicated area of German avoidance law.

46 Depending on the respective security, however, the secured creditor must pay the estate a flat fee for assessment and realisation, which together regularly amounts to 9% of the proceeds from realisation. However, this does not apply to account pledges, as the insolvency administrator does not have the right of realisation in this case, but this directly lies with the secured creditor.

Interim conclusions

59. Under German insolvency law, a bank would run avoidance risks similar to those under the regime of the Proposal. The German law analysis supports the followings ideas regarding interpretation of the Proposal:

    (a) The existence of an all-encompassing security package would give banks a successful defence against avoidance actions, based on the argument that the repayment, prepayment or set-off transactions in the hardening period did not disadvantage the general body of creditors;

    (b) banks should not be considered as "closely related parties";

    (c) banks are not likely to be protected under the exception for legal acts that are performed against fair consideration to the benefit of the debtor's assets (cash transaction exception) for incongruent coverages, such as prepayment or the set-off of payment transactions; and

    (d) the liability of banks in relation to revolving credit facilities and payment transaction set-off would be limited to the sum of repaid/received and withdrawn/transferred amounts in the hardening period (net approach).

Conclusions and suggestions

60. The implementation of the Proposal would substantially increase the avoidance risk for banks active on the Dutch market in relation to repayments, prepayments and set-off with payment transactions. The increased risk might be negligible in case banks have all-encompassing security packages over their debtor's assets. However, the Proposal is not clear in this respect.

61. The Proposal harbors several other ambiguities that could negatively impact the position of banks in relation to repayments, prepayments and payment transactions set-off. To create legal certainty for these crucial banking transactions, it would be desirable that an amended Proposal provides clarity on the following issues:

    (a) The relevance of security rights in relation to the detrimental effect of preferences, particularly in the context of banking transactions, within the meaning of Article 4 of the Proposal;

    (b) the exclusion of banks (and other lenders) from the scope of the definition of "closely related party" in the sense of Article 2(14)(a)(v) of the Proposal;

    (c) the qualification of mandatory prepayments and set-off as forms of the satisfaction of due claims as owed (congruent coverage) in the sense of Article 6(2) (and Recital (8));

    (d) the scope of the exception for "legal acts performed directly against fair consideration" in the sense of Article 6(3), and as explained in Recital (9), in particular, whether it applies to both congruent and incongruent coverages or only to congruent coverages; and

(e) the extent of liability for banks in relation to revolving credit and bank account transactions in the hardening period, in particular, whether the bank is only liable for the sum of any repaid or received amounts and any withdrawn or transferred amounts by the debtor in the period. This effectively would require clarification of the terms "benefits" in Article 9(2) of the Proposal.

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