EU Directive

CREDIT SERVICERS, CREDIT PURCHASERS AND THE RECOVERY OF COLLATERAL

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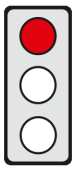
KEY ISSUES

Objective of the Directive: The Commission wants to achieve a reduction in the high stocks of non-performing loans and prevent their future rebound.

Affected parties: Creditors, credit servicers, credit purchasers, borrowers.



Pro: (1) The EU passport for credit servicers lowers existing entry barriers to the credit servicing market and contributes to the establishment of liquid, cross-border secondary markets for non-performing loans.

Contra: (1) The Commission's implementing acts envisaged by the Directive should not prescribe an excessive and costly level of information. This may ultimately prevent the transfer of NPLs.

(2) Following the CJEU line of reasoning, the AECE procedure cannot be based on Art. 114 TFEU as its aim is not to approximate the laws of the Member States.

(3) The reporting obligations for each transferred credit are disproportionate.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2018) 135 of 14 March 2018 for a **Directive** of the European Parliament and of the Council on **credit servicers, credit purchasers and the recovery of collateral**

Brief Summary

- **Definitions, context and objectives**
  - "Non-performing loans" (NPLs) are loans whose repayment is more than 90 days overdue or "unlikely" [p. 1].
  - The total volume of NPLs in the EU amounts to € 731 billion (Q2 2018). The ratio of non-performing loans to total loans in the EU ("NPL ratio") increased from 2% in 2007 to almost 8% in 2013 and fell to 3.6% in Q2 2018. The NPL ratio still exceeds 10% in Greece (44.8%), Cyprus (34.1%), and Portugal (12.4%), and is almost 10% in Italy (9.6%).
  - According to the European Commission, high stocks of NPLs [p. 1]
    - reduce the profitability of banks as they generate less income than performing loans,
    - erode the capital base of banks if NPLs cause losses, and
    - diminish the lending capability of banks as they tie up financial resources.
  - To achieve a reduction of high NPL stocks and to prevent their future rebound, the Commission proposes [p. 3]
    - an EU framework for credit servicers and credit purchasers to promote the development of secondary markets for NPLs, and
    - a common "accelerated extrajudicial collateral enforcement" (AECE) procedure to increase the efficiency of debt recovery procedures with respect to NPLs.
  - "Creditors" are banks, other credit granting undertakings or credit purchasers [Art. 3 No. 2].
  - "Borrowers" are legal or natural persons who have concluded credit agreements with creditors [Art. 3 No. 4].
  - "Credit purchasers", e.g. investment funds, buy credits issued by banks [Art. 3 No. 7].
  - "Credit servicers" perform tasks on behalf of banks or credit purchasers. For example, they monitor the performance of credit agreements or enforce rights and obligations under such agreements [Art. 3 No. 8].
  - The Directive does not apply to credit servicers or credit purchasers that are banks [Art. 1 (a) and (b), Art. 3 No. 7 and 8].
- **EU-framework for credit servicers**
  - Credit servicers must obtain an authorisation from the competent national authorities [Art. 4, Art. 20 (3)].
  - The competent authorities may grant such authorisation only if credit servicers comply with specific requirements. Inter alia, its managers and qualified shareholders must be of sufficiently good repute and have not been involved in any ongoing insolvency proceedings or declared bankrupt. [Art. 5 (1)]
  - Credit servicers may only provide their services on the basis of a written agreement with the creditor, which must include information on, inter alia, the services to be carried out, the remuneration of the services and the extent to which the credit servicer represents the creditor vis à vis the borrower [Art. 9 (1)].

Authors: Philipp Eckhardt and Dr. Martina Anzini | eckhardt@cep.eu
cep | Kaiser-Joseph-Strasse 266 | 79098 Freiburg | Germany | Telephone +49 (0)761 38693-107 | www.cep.eu

– Credit servicers have to keep records of the instructions received from the creditors and their correspondence with both creditors and borrowers for at least 10 years. They must submit them to the competent authorities upon request. [Art. 9 (2) and (3)]
– Credit servicers who have been authorised in one Member State may provide their services in the whole EU ("EU passport").
– To do so, they have to inform the competent authority in their home Member State about, inter alia, the Member State where they want to undertake their activities. [Art. 11 (1) and (2)]
– The competent authority in the home Member State is the principal responsible authority for supervising the activities of credit servicers in other Member States. However, the competent authority in the host Member State may impose "appropriate" administrative sanctions or penalties and remedial measures if [Art. 12]
  - it finds the creditor to be in breach of the requirements of the Directive and
  - the authority of the home Member State fails to take appropriate measures.

► **EU framework for credit purchasers**

– Creditors may transfer credit agreements to credit purchasers. Before doing so, creditors have to provide credit purchasers with information that allows them to assess the value of the credit agreement and the probability of the value being recovered. The European Banking Authority (EBA) must develop and the Commission must adopt implementing acts on the format for the provision of such information. [Art. 13 (1), Art. 14]
– Banks which transfer a credit agreement to credit purchasers have to inform the respective competent authorities for each agreement about the borrower, the credit purchaser, the value and type of collateral of the agreement and whether it refers to a consumer credit [Art. 13].
– Credit purchasers in non-EU countries have to designate in writing a representative within the EU. This representative – on behalf of or together with the credit purchaser – has to abide by the Directive's requirements. With regard to consumer credit agreements, credit purchasers also have to designate a bank or credit servicer established within the EU to fulfil credit services. [Art. 15 (1), Art. 17]
– Credit purchasers and, where applicable, their representatives have to inform their competent authorities about banks or credit servicers to whom they delegate credit services on transferred credit agreements. [Art. 16 (1)]
– Credit purchasers and, where applicable, their representatives have to inform their competent authorities in case they intend to enforce a credit agreement directly. They also have to inform them about the borrower and the credit purchaser, the value and type of collateral of the agreement and about whether it refers to a consumer credit. [Art. 18]

► **Accelerated extrajudicial collateral enforcement procedure (AECE procedure)**

– Member States must establish a common "accelerated extrajudicial collateral enforcement" procedure (AECE procedure) [Title V]. It is an EU-wide standardised procedure which has to co-exist with existing national enforcement measures, whether in court or out of court [Recital 40].
– The AECE procedure applies only to credit agreements between creditors and borrowers, who are not consumers ("business borrowers"). Creditors and business borrowers "may" use the procedure. They must agree upon it in writing or, if required by a Member State, in notarised form. Creditors must "clearly inform" business borrowers of the consequences of accepting an AECE. [Art. 23 (1) (a) and (b)]
– The AECE procedure applies only to credit agreements which are secured by movable or immovable assets, except residential property which is the primary residence of the borrower [Art. 23, Art. 2 (2), Art. 2 (5) (c)].
– AECE agreements have to specify the "enforcement event" and the period of time after the enforcement event within which the borrower may still repay the credit to avoid activation of the AECE. Member States may provide for a prolongation of this negotiated period of at least six months where borrowers have already repaid 85% of the credit. The agreements must include a "directly enforceable title", so that no court has to enforce the title. [Art. 23 (1)]
– In general, within four weeks after an enforcement event, the creditor must inform the borrower about his intention to realise assets by applying the AECE and whether a public auction or a private sale will take place. Upon receipt of the information, the borrower may no longer dispose of the collateral. [Art. 23 (1) and (2)]
– Member States have to determine for each type of collateral the means for their realisation: public auction, private sale or both [Art. 24 (2)]. They may also allow for an "appropriation", i.e. the creditor acquires ownership of the collateral [Art. 24 (3), Recital 47].
– The borrower may challenge the use of an AECE before a national court where the valuation of the assets, the public auction or the private sale have not taken place according to the rules established by the Directive [Art. 28].

Policy Context

In July 2017, the Council adopted an "Action Plan to Tackle Non-Performing Loans in Europe" [459/17]. In October 2017, the Commission announced a similar intention in its "Communication on completing the Banking Union" [COM(2017) 592, see cep**Input**]. The Directive is complemented by a Regulation [COM(2018) 134] that amends the Capital Requirements Regulation [(EU) No 575/2013] dealing with the insufficient provisioning for non-performing exposures.

Statement on Subsidiarity by the Commission

National rules on credit purchasing and servicing vary across Member States and in some of them there is no regulation at all. The result is fragmentation along national borders. Therefore, the objectives of the Directive cannot be reached individually by Member States. AECE procedures at national level, if they exist, have often been established only "on grounds related primarily to domestic considerations". They are, therefore, unable to support the development of a trans-border secondary market for NPLs.

Legislative Procedure

14 March 2018	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Directorates General:	Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA)
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteurs: Esther de Lange (EPP, Netherlands); Roberto Gualtieri (S&D, Italy)
Federal Germany Ministries:	Finance (leading)
Committees of the German Bundestag:	Finance (leading)
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 114 TFEU (Internal Market) Art. 53 TFEU (self-employed activities)
Type of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Persistent high levels of non-performing loans (NPLs), as recorded in particular in Greece, Cyprus and Italy, are first and foremost an issue that needs to be dealt with by creditors – principally banks –, supervisors and the Member States concerned. First of all, banks themselves should be able to decide how to deal with NPLs, e.g. whether they want to transfer them to credit purchasers and if so, when and at what price. This strategic business decision should in principle be left to the bank's management. Second, supervisory authorities should force banks to reduce their NPL portfolios only in the event of financial stability risks. In the absence of such risks, banks should be allowed to retain high stocks of NPLs on their balance sheets. Third, banks are only able to reduce their NPL stocks, if efficient national frameworks exist, e.g. on the realisation of collateral. In some Member States, this is currently not the case. Hence, the Commission's proposals rightly complement the efforts made by banks, supervisors and Member States.

In this sense, the creation of an EU framework for credit servicers and credit purchasers is a useful step. **The EU passport for credit servicers lowers** existing entry **barriers to the credit servicing market and** also enables positive economies of scale on the markets for purchasing NPLs. In doing so, the Directive **contributes to the establishment of liquid, cross-border secondary markets for non-performing loans.** However, costly information and reporting obligations could undermine the positive aspects.

Certainly, reducing information asymmetries between creditors and credit purchasers may contribute to the functioning of NPL-markets. However, **the Commission's implementing acts envisaged in the Directive should not prescribe an excessive and costly level of information**– given the professional nature of credit purchasers**. This may ultimately prevent the transfer of NPLs.**

The Directive's record keeping and reporting obligations are too detailed and give rise to unnecessary costs. Given the scale of the NPL problem – EU NPL stocks currently exceed € 700 billion –, supervisory authorities must have insight into activities on secondary NPL-markets to make sure that risks which leave the banking sector are not reconnected to the banking system again, e.g. by way of new credit relations between banks and credit purchasers. However, the extent of the reporting obligations – covering each and every transfer of both non-performing and performing loans on an individual basis – reduces the incentive for creditors to use secondary markets at all. Reporting in an aggregated manner is sufficient and individual reporting should apply only to large exposures.
The proposed AECE procedure can bypass the frequent problem of inefficiency in national insolvency and restructuring procedures. Solving this inefficiency is primarily a national policy task, given the relevance of national law to these procedures. Furthermore, the AECE procedure only addresses future credit agreements and not the existing stock of NPLs. Also, it is doubtful whether an AECE procedure will speed up collateral realisation to a sufficient extent. Potential for conflict remains, because the creditor and the borrower have to agree on a valuer for the collateral and because the borrower may challenge the evaluation.

Legal Assessment

Legislative Competence of the EU

Art. 53 and 114 TFEU provide the appropriate legal basis for establishing an EU-Framework for credit services and purchasers. However, **following the CJEU's line of reasoning** in the SCE case [C-436/03, para. 44], the establishment of **the AECE procedure cannot be based on Art. 114 TFEU as** it does not qualify as a "measure for the approximation of the provisions laid down by law, regulation or administrative action in Member States"; **its aim is not to approximate the laws of the Member States** that are applicable to the extrajudicial tools for the recovery of collaterals. In fact, a brand-new EU legal tool for the extrajudicial recovery of collaterals is established, which is added on to national tools (where existent).
This is confirmed by several recitals. First, the AECE procedure is described as a "distinct common mechanism available in all Member States", thus supporting its characterisation as a genuine EU law instrument (Recital n. 40). Secondly, it is not meant to replace existing national enforcement measures, including those that do not require the involvement of courts (Recital n. 40). Finally, the key features of the AECE procedure – i.e. the conditions for its exercise, the enforcement regime and the grounds for challenging the enforcement – are set by EU law.
The appropriate legal basis for the AECE procedure can, therefore, only be Art. 352 TFEU that calls for unanimity.

Subsidiarity

Even if the establishment and regulation of the AECE procedure were validly based on Art. 114 TFEU, they could still be in breach of the subsidiarity principle. This will be the case if the Commission's objective is to use the AECE procedure to solve a problem which affects some Member states, for the sake of establishing a level-playing field within the single market. In this case, the obstacles to a swift recovery of collaterals can be easily overcome through the establishment of national extra-judicial procedures in those Member States that need it. If, however, the overriding objective is to establish a standardised legal tool for the recovery of collaterals all over the EU, the approach envisaged by the Directive, although capable of only minimum harmonisation and therefore unfit for this purpose, would not raise any subsidiarity issue.

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other Respects

The reporting obligations set by the Directive **for each transferred credit** are liable to limit the exercise of the freedom to conduct this business activity because they constrain the target group in a manner which restricts the free use of the resources at their disposal. Indeed, they oblige banks and credit purchasers willing to undertake this activity to take measures which may cause them significant cost and have a considerable impact on the organisation of their activities [case C‑314/12 (Lidl) EU:C:2016:498, paragraph 29]. As stated in Recital 31, their aim is to facilitate supervision of credit transfers and therefore to protect financial stability, which is an objective of general interest recognised by the EU. Nevertheless, they **are disproportionate** because obliging undertakings to report in an aggregated fashion would be just as effective and, at the same time, less burdensome than imposing reporting obligations for every signed contract.

Conclusion

The EU passport for credit servicers lowers entry barriers to the credit servicing market and contributes to the establishment of liquid, cross-border secondary markets for non-performing loans. The Commission's implementing acts envisaged by the Directive should not prescribe an excessive and costly level of information. This may ultimately prevent the transfer of NPLs. Following the CJEU line of reasoning, the AECE procedure cannot be based on Art. 114 TFEU as its aim is not to approximate the laws of the Member States. The reporting obligations for each transferred credit are disproportionate.