

New EU rules on Non-Performing Loans

The EU Directive on Credit Servicers and Credit Purchasers (EU/2021/2167) – an EU law update relevant to sellers, purchasers and credit servicers

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Introduction

The NPL market

The amount of loans made by EU-regulated banks which are technically classified as non-performing loans (“**NPLs**”) was estimated to be EUR 345 billion in the third quarter of 2023, representing 2.27% of the EU’s total bank loans.* At the time of writing, the general expectation is that NPLs will rise in 2024, as a result of, among other things, the delayed impact of higher interest rates.

What’s new and why

The EU Directive on Credit Servicers and Credit Purchasers** (the “**Directive**”) creates certain new rules relating to NPLs which were originated by an EU bank.

The broad aim of these new rules is to reduce the number of NPLs, by improving the secondary market for NPLs.

The new rules impose various new obligations on:

- EU banks selling NPLs, whether to bank or non-bank purchasers;
- purchasers of NPLs who are not EU banks (credit purchasers); and
- entities servicing NPLs on behalf of credit purchasers (credit servicers).

The new regime will have a significant impact on trading, investment and most transactions involving NPLs.

Beware of the differences between Member States

Each EU Member State has an obligation to pass its own legislation to implement the Directive. At the time of writing, not all of the 27 Member States have implemented the Directive, despite a deadline of 29 December 2023. More on this in section 7 below.

Purpose of this note

The purpose of this note is to provide an overview of the Directive. If you would like to know more about anything in this note, please contact one of the persons named at the end of this note or your usual CMS contact.

* European Central Bank, <https://www.banksupervision.europa.eu/press/pr/date/2024/html/ssm.pr240112~7843aa75fa.en.html>

** (Directive (EU) 2021/2167



Aims of the Directive

Part of a broader EU action plan for NPLs

The Directive is part of a wider action plan on the part of the EU to:

- reduce the current stock of NPLs in the EU; and
- prevent the build-up of that stock in the future.

'The establishment of a comprehensive strategy to address the issue of non-performing loans (NPLs) is a priority for the [EU].'

See adjacent for what's driving this action plan and a reminder of what counts as a 'non-performing loan'.

Main aims of the Directive

The Directive aims to support this action plan by improving the secondary market in the EU for NPLs by, among other things:

- improving the information available to purchasers;
- creating a new category of authorised entity that can provide loan servicing support across the EU;
- protecting borrowers (particularly consumers); and
- improving supervisory oversight.

When is a loan 'non-performing'?

NPLs are bank loans that are:

- subject to late repayment (i.e. 90 days past due); or,
- unlikely to be repaid by the borrower, if, for example, the borrower faces financial difficulties.

For more detail, see Article 47a of Regulation (EU) No 575/2013.



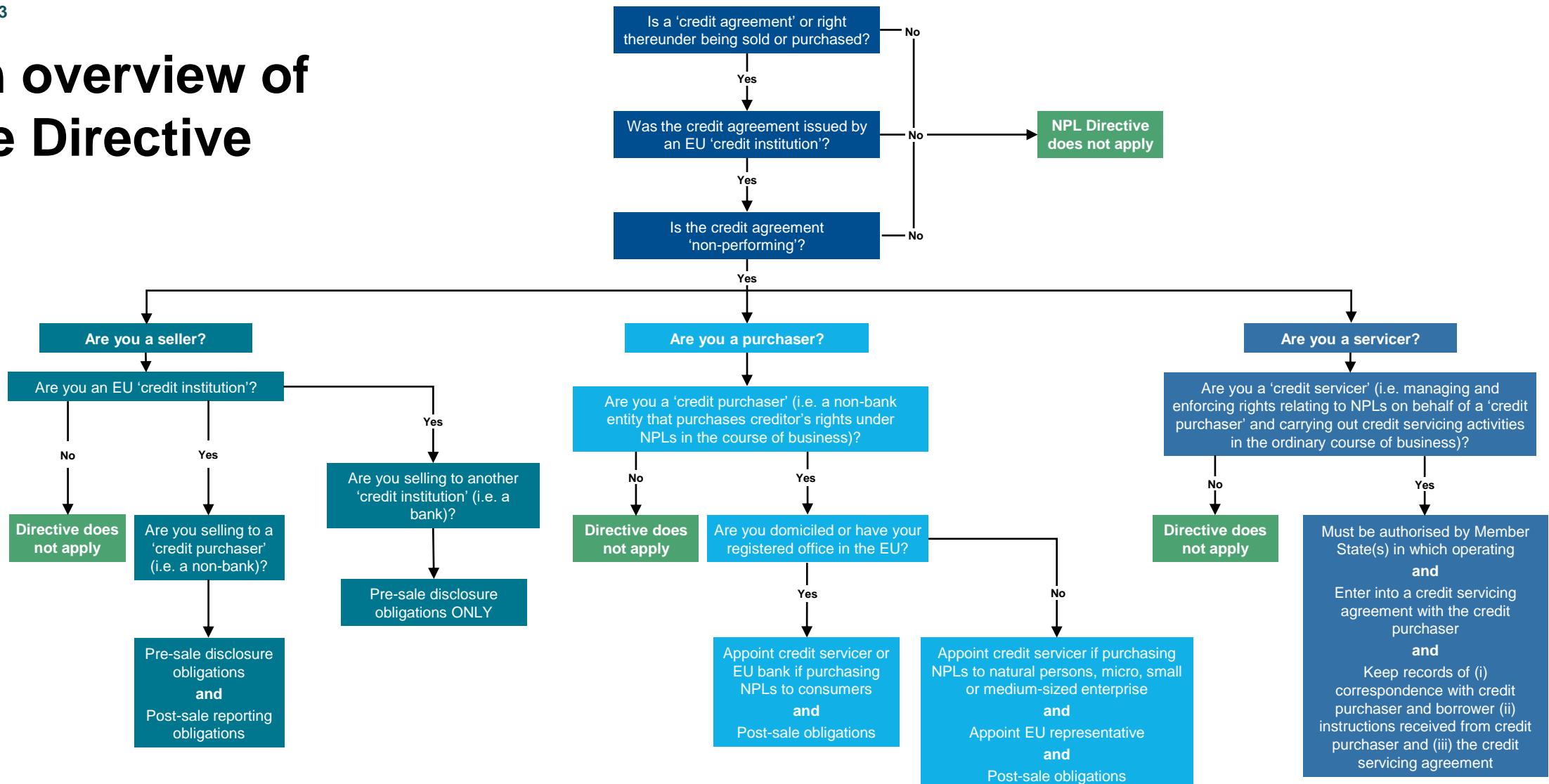
The negative effects of NPLs

A build-up of NPLs can:

- slow down bank lending;
- stymie economic growth; and
- be a threat to financial stability.



An overview of the Directive



Please note that this flowchart is, by its nature, a simplification of the provisions of the Directive and is not a substitute for reading the terms of the Directive directly.

A seller's perspective (1)

The Directive only applies to an EU 'credit institution' selling NPLs (and 'credit institution' broadly means a bank).

Pre-sale disclosure obligations to purchasers:

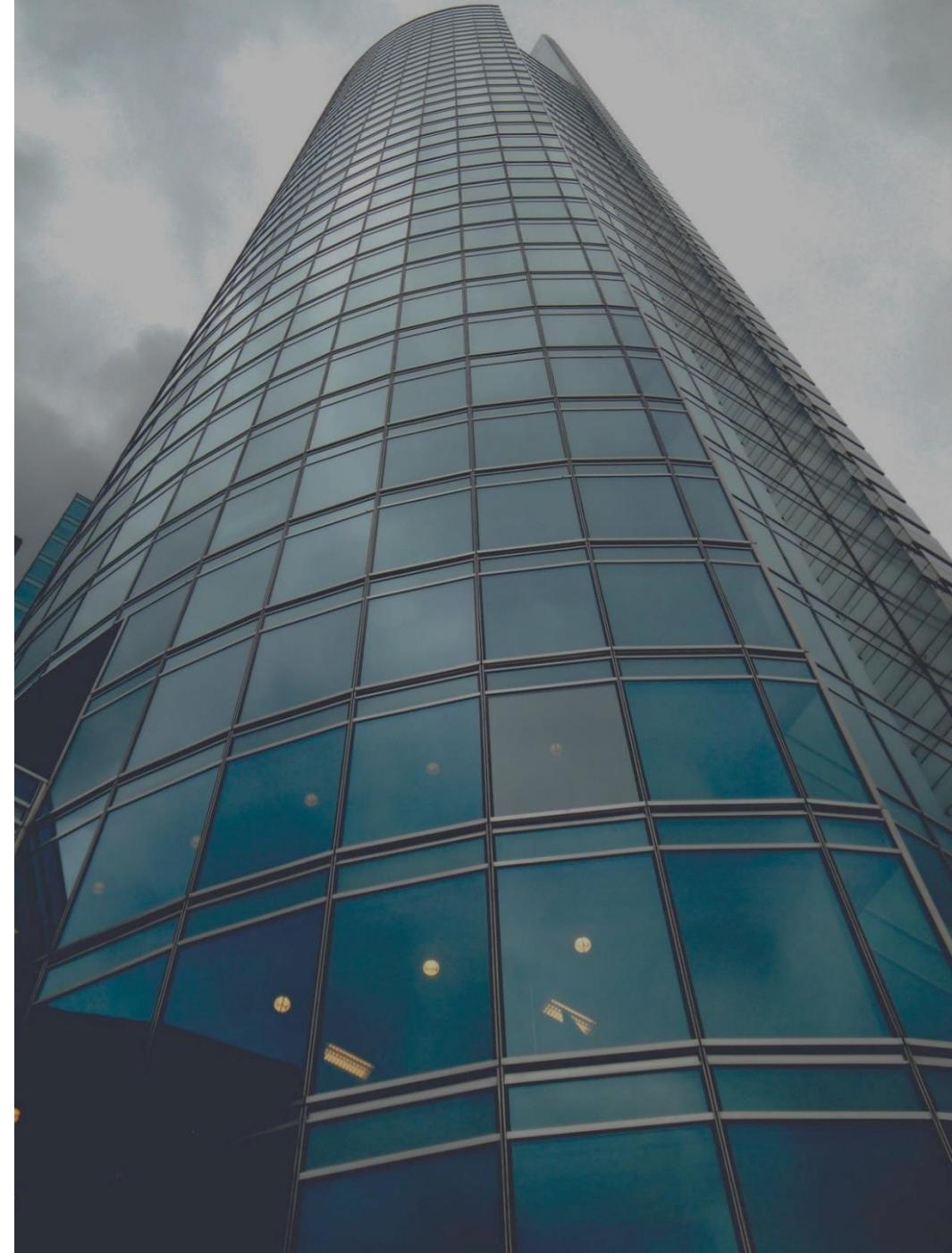
- Where an EU 'credit institution' is selling a credit originated by an EU bank to another credit institution or to a 'credit purchaser' (broadly a non-bank purchaser or more specifically a legal person that, in the course of its business, purchases a creditor's rights under a NPL), certain disclosure obligations apply.
- The seller must disclose the 'necessary information' in the form of a prescribed **data disclosure template** published by the EU in the "Implementing Technical Standards" (unless an exception set out in the Implementing Technical Standards applies, meaning the templates do not need to be completed). The aim is to enable a purchaser to assess the value of the NPLs it is considering buying.
- The templates contain 135 data fields, of which 78 are stated to be mandatory and there is also an obligation to use reasonable efforts to complete all non-mandatory fields. Mandatory fields include information on: (i) the counterparty; (ii) the credit agreement; (iii) the collateral; and (iv) the repayment history.
- Disclosure is not required in certain circumstances, including, without limitation: (i) where there is only a single NPL being sold; (ii) securitisations; and (iii) **where the borrower is not domiciled in the EU**.
- Information should be disclosed during the sales process to allow an informed analysis by a purchaser, but only at the point in the sales process where the purchaser is serious about the purchase. This will often be at the start of "phase 2", after indicative bids have been received and before a 'binding' offer is made.



A seller's perspective (2)

Post-sale reporting obligations to competent authorities:

- Where an EU 'credit institution' is selling NPLs originated by an EU 'credit institution' to a 'credit purchaser' (i.e. a non-bank purchaser only), it has an obligation to report details of the sale to both the relevant domestic authority in their own Member State and in the Member State of the borrower.
- These reports are to be submitted post-sale biannually, or quarterly if mandated by the relevant authority.
- The information to be reported includes: (i) the legal entity identifier (LEI) of the credit purchaser; (ii) the outstanding balance of the NPLs being transferred; (iii) the type of assets being used as security (if any); and (iv) whether the transfer involves NPLs concluded with consumers.
- Affected entities will need to ensure they have effective systems in place which allow them to comply with these comprehensive reporting requirements.



A credit purchaser's perspective (1)

A 'credit purchaser' (i.e a non-bank entity that purchases a creditor's rights under a NPL in the course of business) has new obligations imposed on it by the Directive. Certain obligations apply even if the credit purchaser is not domiciled in the EU.

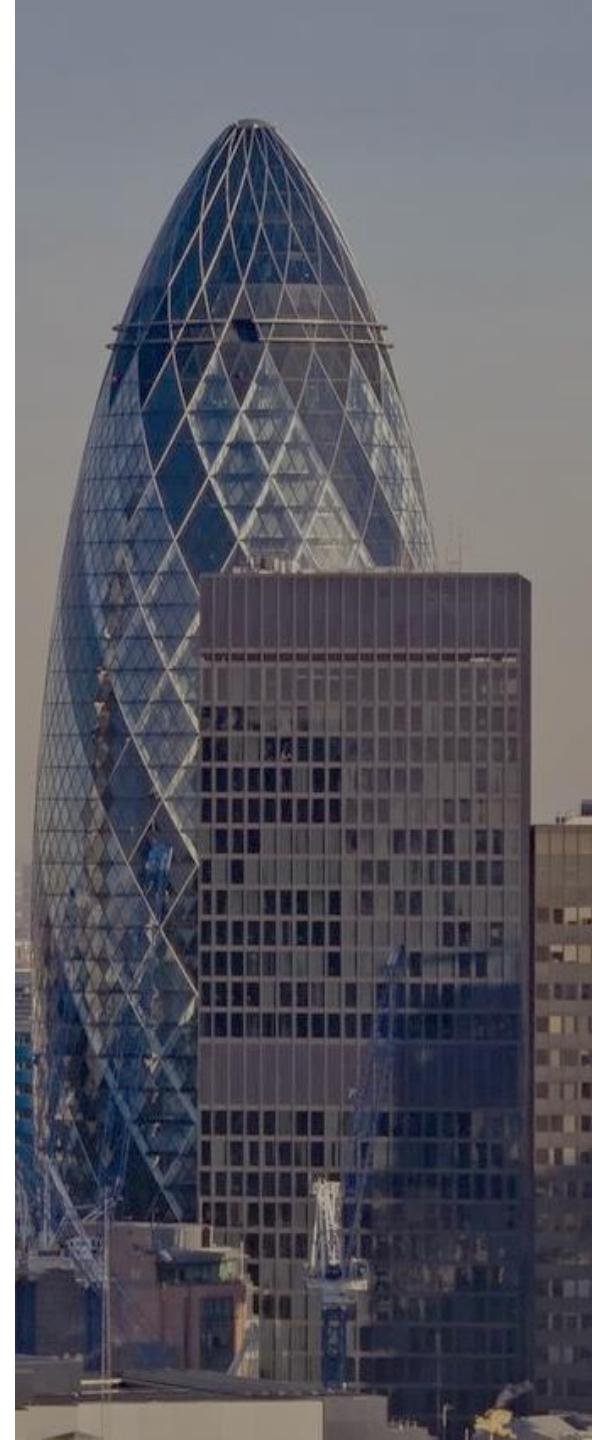
Pre-sale obligations:

Non-EU credit purchasers (i.e. a credit purchaser not domiciled in, or having a registered office in, the EU) must:

- **Appoint a representative** domiciled in the EU to ensure compliance with the new rules. The representative will be fully responsible for ensuring compliance with the obligations imposed on the credit purchaser under national provisions.
- **Appoint a credit servicer** (through its representative) to service NPLs where the borrower is a natural person or a micro, small or medium-sized enterprise.

EU domiciled credit purchasers (or those with a registered office in the EU) must:

- **Appoint a credit servicer** to service NPLs under which the borrower is a consumer.



A credit purchaser's perspective (2)

Post-sale obligations:

All credit purchasers must:

- **Act in good faith and with fair treatment** towards NPL borrowers, ensure the information provided to borrowers is not misleading, protect the personal information and privacy of borrowers, and communicate with borrowers in a manner that does not constitute harassment, coercion, or undue influence;
- **Provide certain information to the borrower** prior to debt collection, including the identity of the credit purchaser and credit servicer; and
- **Report** sales of NPLs to the competent authorities of its home Member State (biannually or quarterly if requested by the home authority).



A credit servicer's perspective (1)

The obligations outlined on the following page apply to any legal person that, during the course of its business, manages and enforces the rights and obligations related to a creditor's rights under a NPL on behalf of a credit purchaser, and carries out **one or more** of the following 'credit servicing activities':

-  Collecting and recovering payments due
-  Renegotiating the terms of the loan with the borrower
-  Administering creditors' complaints
-  Informing the borrower of changes to interest rates or any payments relating to a creditor's rights.

A credit servicer's perspective (2)

Obligations

Authorisation

- Credit servicers must be authorised by an EU national supervisory authority in its home Member State before commencing its credit servicing activities in such Member State.
- To obtain authorisation, credit servicers must meet certain standards, including as to managerial and administrative repute, knowledge, experience and robust risk, management and accounting governance.

Ongoing obligations

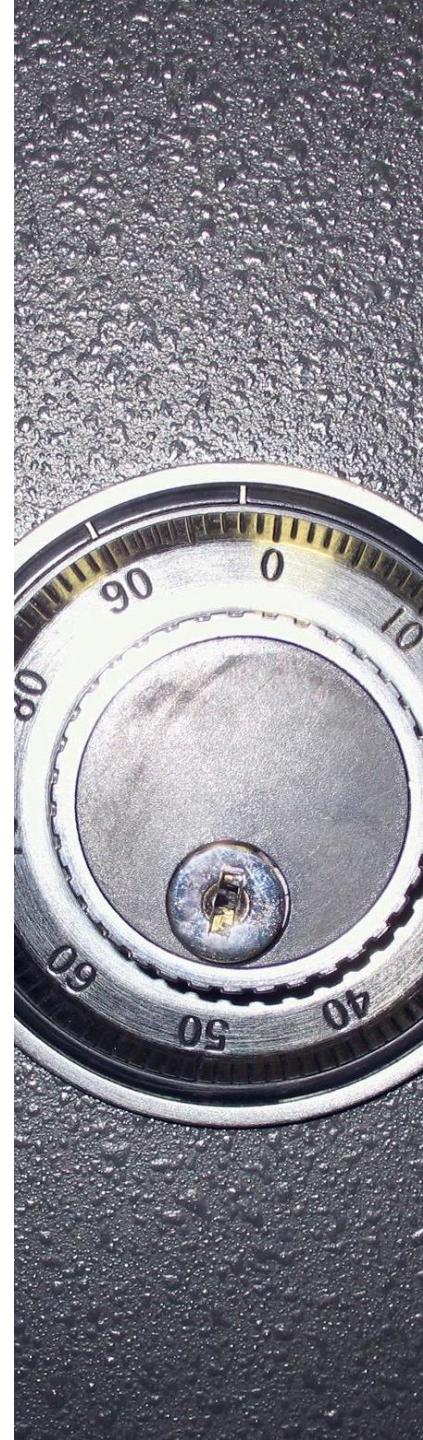
- Must enter into a credit servicing agreement with the credit purchaser to provide for, among other things, the scope of the credit servicing activities to be provided, the level of the credit servicer's remuneration and the extent to which the credit servicer can represent the credit purchaser in relation to a borrower.
- Must also keep records of all correspondence with, and all instructions received from, the credit purchaser and the borrower for a period of at least five years from the date of which the credit servicing agreement is terminated (or the relevant statutory limitation period, if different).
- Will be reviewed and evaluated for ongoing compliance by host Member State.

Outsourcing

- Outsourcing (in part) is permitted subject to the credit servicer entering into an outsourcing agreement with the credit service provider and the credit servicer remaining fully responsible for complying with all obligations under the Directive.
- The credit servicer must inform the competent authorities of its home Member State (and the Member State of the borrower) before outsourcing its credit servicing activities.

Passporting

- Akin to the "passporting" frameworks operating in the EU for banks and financial services companies, a credit servicer which has been authorised in its home Member State has the right to provide such services in other Member States. To do so, the credit servicer must notify the competent authority in the relevant Member State of various things, including:
 - evidence that the credit servicer can communicate in the language of that Member State;
 - the identity of the persons responsible for managing the credit servicing activities in that Member State; and
 - the measures to adapt internal procedures, governance arrangements and internal control mechanisms to comply with the laws of that Member State.



Implementation of the Directive

The Directive must be implemented by each EU Member State into its respective domestic legislation.

Member States were required to implement domestic legislation transposing the new rules by 29 December 2023. To date, of the 27 Member States of the EU only some have transposed the Directive into their domestic legislation including Denmark, Germany, Ireland, Greece, France, Slovenia and Romania.

Even where the Directive has not been transposed into national law by a Member State, the rights within the Directive may be enforceable in that Member State's national courts as EU Directives may, subject to certain conditions, have direct effect in national law and be relied upon within national courts.

There is no direct effect of the Directive in the UK but this will, among other things, affect purchasers in the UK where they purchase EU originated NPLs.



What's next?

Concerns:

- Will the extent of the disclosure obligations make this “too difficult” for some sellers, and have the opposite of the desired effect of opening up the market?
- Legislation to implement the Directive in each Member State will not be identical because it is open to different interpretations and there is some optionality built into the Directive. Therefore, those involved in NPLs will need to consider the legislation on a state-by-state basis.
- Will non-EU credit purchasers be put off by having to appoint an EU representative?
- There are uncertainties in the legislation, particularly in relation to when provisions apply or do not apply. This may affect market confidence and activity, at least in the short term.



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