CREFC Europe

CREFC Europe submission in response to the European Commission's proposal for a directive on credit servicers, credit purchasers and the recovery of collateral

Background

The Commercial Real Estate Finance Council (**CREFC**) Europe is a trade association promoting a diversified, sustainable and successful commercial real estate (**CRE**) debt market in Europe that can support the real economy without threatening financial stability. Our core membership includes lenders, including European and non-European banks, institutional and private equity debt funds, and intermediaries who help connect capital seeking the risk and returns of CRE debt with real estate firms seeking finance. Our membership also includes loan servicing firms, as well as law firms and various specialist advisers with an interest in the industry and markets we serve.

We strongly support the policy objectives of the Capital Markets Union, and recognise the benefits that would flow from more resilient, diversified and integrated financial markets. In 2017, we responded to the Commission's consultation on the development of secondary markets for non-performing loans and distressed assets and protection of secured creditors from borrowers' default. We are pleased that some of the points we made appear to have been acknowledged by the Commission in developing its proposals, but we are concerned that a number of important points may not have been fully taken on board. That consultation response is reproduced as an appendix to this submission for ease of reference, and because many of the points it makes remain relevant.

Comments on the proposed directive

1. In principle, we recognise the benefits that might be brought by a suitable and proportionate authorisation and passporting regime allowing loan servicers to operate across the EU. However, a number of factors indicate that the directive is unlikely to introduce such a regime. In particular:

(a) The very broad scope of the directive, covering performing loans and the syndication market, in addition to non-performing loans (**NPLs**).

(b) The very broad scope of the definition of "credit servicer", covering not only what the market would describe as loan servicers and their activities, but also the more mechanical roles of, for example, facility agents in the syndication market or security agents in the securitisation market. This risks creating unnecessary (and presumably unintended) cost and delay in the syndication and securitisation markets.

(c) The fact that such broad definitions raise the risk that the proposed new EU regulatory framework will simply add a layer of regulation to the existing patchwork of national rules that already affect some of the activities naturally carried out by loan servicers. For example, a double regulatory burden will result without the clear and consistent removal of requirements in certain Member States that an entity performing certain functions that would naturally be carried out by loan servicers must hold a banking licence.

2. In principle, we recognise the benefits that might be brought by an EU-wide accelerated extrajudicial collateral enforcement (**AECE**) regime. Those benefits will be obtained if the regime strikes a reasonable balance between existing national rules and protections for borrowers that might be affected, on the one hand, and the ability of credit providers to exercise enforcement rights in an efficient and expeditious manner. Unfortunately, the proposal does not meet that test and is therefore unlikely to deliver the desired policy outcomes. In particular:

(a) The proposal defers too much to the primacy of existing national law (which in a number of Member States would therefore continue to prevent high stocks of NPLs from being addressed).

(b) The proposal overemphasises the rights of borrowers at the expense not only of originators and credit purchasers, but also of the efficient operation of this part of the financial markets.

3. We are also troubled by the following features of the proposed directive:

(a) We do not think the institutional distinctions and territorial boundaries it draws can be justified. For example:

(i) Why are servicers owned or controlled by credit institutions excluded from scope? Such servicers may be subject to particular risks in terms of managing conflicts of interest when servicing loans originated or acquired by their parent credit institution. Equally, they may compete with independent, third party servicers to service loans in which their parent credit institution has no (or no continuing) interest.

(ii) Why are loans issued by non-credit institutions and loans issued by credit institutions treated differently?

(iii) Why are loans issued by a credit institution included even if the borrower and collateral are located outside the EU?

(iv) It is reasonable to ensure that borrower rights and protections that applied when a loan was originated are preserved following a sale of the credit agreement to a credit purchaser. However, it is not at all clear why detailed reporting obligations are imposed on a non-credit institution credit purchaser that do not apply to a credit institution (nor, for that matter, to a non-credit institution originator).

(v) Why is the AECE procedure not available to credit purchasers that are not credit institutions? That plainly contradicts the intention of encouraging diverse secondary NPL markets. At the very least, if (despite our concerns) the parties to a proposed sale and purchase of NPLs consider the AECE to be valuable, limiting its availability as proposed forces them into the cost and effort of structuring designed to ensure it can be used.

(b) In certain important respects, the regime contemplated by the directive may be so onerous and cumbersome as to reduce, rather than increase, liquidity in both NPL markets and loan markets more generally.

(i) NPL markets have functioned well in some member states, on a private basis, with strong demand from investors and acceptable pricing, where conditions are right. Our 2017 submission (in the appendix) explained what we think would help allow similar benefits to be achieved in other member states.

The disclosure obligations requiring the provision of data to a credit purchaser are likely to be both unnecessary and excessive. In many cases, credit institutions may have incomplete data or documentation relating to an NPL portfolio. Currently, that does not need to be a barrier to a sale where there are credit purchasers willing to price the resulting uncertainty into the transaction. A prescriptive legal requirement to make disclosures that (for whatever reason) cannot be made would presumably prevent at least some transactions from going ahead. Creating a recommended framework for disclosures relating to a proposed sale of NPLs could be helpful; mandating specific disclosures would not be.

(ii) The broader loan market was never understood to be the target of this legislative initiative, yet the proposals threaten to disrupt the operation of syndication markets that generally work well, and securitisation markets that are still struggling to recover.

If the requirement for an entity classified as a "credit purchaser" would apply, for example, to a non-EU pension fund to which a loan is syndicated, it is important that the requirement for an EU representative can be satisfied by the appointment of a service provider as process agent.

(c) Article 18 imposes obligations in cases where a credit purchaser "intends to directly enforce" a credit agreement. What, exactly, constitutes "direct enforcement" and, more troublingly, what constitutes an "intention"? Can "intention" be established in an objective way? On what basis are the notifications contemplated by this Article judged to be necessary and proportionate?

(d) Article 24(4) lays down a series of requirements relating to asset valuation. Is it necessary to mandate both (i) that the valuer must be independent and the valuation fair and realistic; and (ii) that the borrower must agree to the selection of the valuer and have a right to challenge the valuation? It would seem more appropriate to impose either one set of requirements or the other, rather than both. We would recommend using only the first set of requirements, as the second set (requiring agreement and allowing challenge) is inherently inconsistent with an "accelerated" process.

(e) Article 29 reasonably requires that any balance remaining after repayment of the amount owed after a disposal of collateral should be returned to the borrower – but this should explicitly recognise the lender's right first to deduct the costs of enforcement (in other words reference should be to the "net" proceeds of the sale of the asset).

We would be happy to expand on our comments and to help the Commission explore alternative approaches to achieving its policy goals. If you have any questions, please contact Peter Cosmetatos, chief executive of CREFC Europe (pcosmetatos@crefceurope.org or +44 20 3651 5696) in the first instance.

CREFC Europe

Appendix

CREFC Europe response to the European Commission's consultation on secondary markets for NPLs and the protection of secured creditors

Section I: Secondary market for loans
Transfer of loans
Q1: Would you consider the current size, liquidity and structure of secondary markets for NPL in the EU an obstacle to the management and resolution of NPLs in the EU? If yes, would you consider such obstacle to be significant?
The size, liquidity and structure of secondary markets for NPLs are a consequence of the underlying legal and banking environment in different jurisdictions, rather than a potential obstacle in their own right. While we agree that effective markets in NPLs can make a valuable contribution to the management and resolution of NPLs in the EU, they are not a prerequisite: it is perfectly possible for good management and resolution to take place on the balance sheets of originating banks or through the use of joint venture structures with third party advisers (such as loan servicers) and/or investors if suitable incentive structures are in place. The state of NPL markets and the extent to which conditions are conducive to their development is of course quite varied across EU Member States. In Member States with effective NPL markets, one typically finds: - transparent recovery / insolvency processes; - streamlined and established transfer of loans/security processes; - a willingness among banks or a strong policy drive for banks to reduce NPL exposures; - the involvement of specialist third party advisers to assist in the process; and - lower cost and faster NPL sale processes, typically involving good quality information and a degree of transparency of process, often as a result of learning through experience. By contrast, in member states where NPL markets have not developed so well, it is common to find that legal regimes and market culture do not facilitate the recovery process, leading to worse pricing and lower participation in the market by third party advisers and investors. Of fundamental importance is the extent to which banks are incentivised to reduce their NPL exposures in a meaningful way, and supported in managing the timing, impairment and capital implications of their NPL exposures (retained or sold). Other considerations are discussed in our responses to other questions.
Q2: What are the key considerations for banks in deciding whether loan sales should be a significant part of their strategy to manage its NPLs? In answering please specify: **- Bank internal factors (i.e. any factors inside the bank including the type and characteristics of the NPL portfolio, management capacity, etc.)** **- External factors (i.e. any factors outside of the bank that are important considerations in this context).**
The most significant factor by far is the need for banks to recognise loan impairments at a level which enables the loans to be priced attractively for purchasers. The ECB Asset Quality Review did not in the main provide the widely anticipated 'push factor' to encourage banks to do this. The introduction of IFRS9 with its attendant change from an incurred loss approach to an expected loss approach may have an effect via the earlier and more prudent recognition of impairments although there remains an

element of subjectivity and vulnerability regarding the realistic valuation of collateral given the stage in the property cycle.

A major challenge attached to the need for more realistic valuation of loans remains the lack of profitability of many banks. Without some form of capital injection/mergers/other measures, enforcement of higher write downs may still increase the level of bank insolvencies/instability, in particular of smaller/more specialised lenders (even in economically stronger jurisdictions) or those in economically vulnerable jurisdictions.

In addition, many banks simply do not have the level of information on loans required by purchasers, nor the capacity to collate it. This is particularly a challenge in some of the less sophisticated banking cultures. The result of a lack of comprehensive information is that purchasers will require higher levels of discount to take account of the uncertainty.

Other relevant factors include:

- National insolvency laws: If local insolvency laws are favourable towards creditors (whether original lenders or buyers of debt), that is a huge catalyst for bridging the gap between the seller's expectations and the bidder's pricing, supporting the development of an active NPL market.
- Reputational risk: Some banks remain very reluctant to dispose of NPLs due to their fear of tarnishing their corporate name and counterparty assurances in the market, with potentially long-term negative consequences for their business in the future.
- Asset management expertise and resource: If the banks have not adequately established a proper loan management platform (or have not found a third-party partner), then the volume of NPLs under management could significantly hinder the bank's focus and ability to maximise recoveries.
- Underlying market liquidity and demand: When macro-economic conditions and property fundamentals are improving (and collateral values recover), the market value of NPLs should rise, supporting better market liquidity and pricing.

Q3: What would be the best way(s) of attracting a wider investor base to secondary loan markets, especially for non-performing loans?

Encourage banks to recognise loan impairments more fully across all Member States through a combination of increased regulatory scrutiny and pressure (this could include capital relief for sellers, for example by allowing impairments to be spread over the remaining average life of assets sold); and promoting the use of structures that allow incentives to be aligned and future upside to be shared (this could include the use of securitisation, joint venture asset management companies or other shared incentive pricing arrangements). This is critical because it directly affects pricing.

Encourage better information provision, including through the involvement of third-party loan servicers. This too should support sellers, as a higher and more consistent standard of legal and commercial due diligence in the pre-marketing phase is likely to attract more competitive pricing from potential investors. Again, this might be by achieved through increased regulatory pressure, following and using the knowledge gained through the ECB Asset Quality Review. The ECB gathered a significant data base through the AQR exercise. It would be helpful if some of the wealth of information collected by the ECB in that exercise – which remains largely hidden from the market – could be made available to aid the provision of information to potential loan purchasers.

Aid the formation of larger portfolios which are more attractive to investors (who tend to operate on an international scale). This may be achieved through some form of common NPL asset management company structure where portfolios of similar loans can be aggregated on a national basis, information collated and sales proactively negotiated. Another option might be to establish an online

bidding platform that is accessible to the wider investor base, including local real estate asset managers and private individuals.

More broadly, to the extent politically and practically feasible, it would be helpful to encourage:

- Greater standardisation in the disposal process;
- A more consistent legal framework to govern the transfer of loans and security across the EU;
- Lower frictional costs that affect the cost, timing and legal certainty of a transfer for investors; and
- Greater transparency and efficiency in insolvency and enforcement regimes.

Q4: In order to widen the investor base, please specify:

- **Which incentives should be given?**
- **Whether certain obstacles to widening the investor base should be removed?**

The key focus should be to strengthen supply-side incentives by encouraging banks to value their NPL exposures realistically. This would reduce the bid/offer pricing gap and increase the amount of stock in the market, thereby improving market liquidity and efficiency.

Vendor financing of NPL sales can play a vital role in facilitating transactions, shifting risk out of the banking system and bringing in specialist third-party expertise. It should not be discouraged, such as by disqualifying a sale from being treated as a true sale for regulatory and accounting purposes.

In terms of obstacles, we would highlight national licensing requirements (for investors and/or third-party advisers such as loan servicers), which sometimes operate to restrict access and competition rather than as quality assurance.

The challenges for smaller, more isolated or less developed markets with substantial NPL exposures are especially great. These Member States, in particular, would benefit from harmonised rules and practices regarding data availability, loan transfer, licensing and insolvency and enforcement regimes. However, the political barriers to addressing these challenges appear to be considerable.

Q5: What are the specific advantages to the development of secondary markets when the acquiring investor is a bank, an investment fund or another type of entity?

In particular, would you see specific advantages for

- **Helping banks overcome legacy assets;**
- **Creating investment opportunities for specialised investors?**

Other than noting that commercial (as distinct from investment) banks are unlikely to be suitable purchasers of NPLs, we would highlight the following advantages that are generally applicable:

- The resolution of banks' legacy assets is facilitated (subject to capital constraints) by allowing the development of a transparent pipeline and process for NPL sales;
- A market in which NPLs are valued and traded provides greater market transparency, making it easier for loans still on bank balance sheets to be realistically valued;
- Bank capital is freed up, enabling them to originate new credit in the real economy;
- Collateral real estate that has been trapped by an NPL burden is released, allowing previously under-managed, under-invested real estate to be improved, supporting a better built environment and stock that is fit for purpose for the users of real estate;
- The expertise of specialised investors like funds, investment banks and family offices can be attracted by the presence of a consistent pipeline of assets that are marketed on a more consistent and comparable basis; and
- The professionalisation of advisers on both the sell and buy sides is encouraged by the existence of a bigger, more reliable market, in turn helping more sellers and buyers to enter the market with confidence.

Q6: What are the main concerns linked to each of these investor types?

Banks are unlikely to be the most appropriate purchasers of impaired secured loan portfolios as they do not generally have the resources (or arguably the cultural and operational freedoms) to carry out the intensive workouts and asset management required to access value from such portfolios.

Specialised investors are often regarded with caution and cultural lack of acceptance in many jurisdictions and there may be a reluctance on the part of a bank or national government to be seen to be encouraging their presence in a local market. This may be mitigated by (for example):

- discouraging them from buying more sensitive assets like residential mortgages or retail consumer loans;
- not being seen to allow investors to profit at the expense of tax payers (hence the effective removal of 'moral hazard' by the changed banking resolution rules since the global financial crisis – though this has only been seen to be effective in certain jurisdictions); or
- inserting a more neutral third party such as a loan servicer and/or asset management agency between the banks and the investors.

Q7: What are the potential benefits and risks from a public policy point of view when considering the appropriate legal framework for secondary markets for loans, and especially NPLs? Please rank the following dimensions (in order of importance)

- **Debtor protection,**
- **Privacy,**
- **Data secrecy,**
- **Promoting increased market size and depth and equal treatment of investors.**

The overriding principal goal should be to free up banking capacity for the making of new loans to businesses and consumers to aid real economic growth. An important secondary goal is that the release of collateral real estate from the burden of NPLs allows new investment that improves the built environment and the stock of premises that are fit for purpose for the users of real estate. Without such renewal and investment, real estate deteriorates over time, with the costs borne by businesses, communities and the economy as a whole.

In terms of potential risks, it seems clear that the political climate may make it difficult to highlight the benefits of private sector solutions to resolve legacy loans, with the focus instead on the profits that private sector market participants might be seen to make, apparently at the expense of the general public. The broad social and economic costs of failing to resolve legacy loans over the long-term need to be better communicated to strengthen public tolerance (if not demand) for resolution, including with the participation of private enterprise.

Debtor protection, privacy and data secrecy are potentially important considerations, particularly where consumer loans are involved. The sensitivity should be much lower for commercial loans, especially non-recourse SPV-based commercial real estate loans. It is acknowledged, however, that drawing a boundary between consumer (and perhaps very small business) loans and larger scale commercial loans is not necessarily straightforward, or easily harmonised across the very different economies of EU Member States.

It is often argued by market participants (including some within our membership) that data secrecy is an important commercial consideration (with perfect information availability, much profitable arbitrage would be removed). There is undoubtedly some truth in this, but we believe that, on balance, a higher baseline level of information can facilitate the smooth functioning of markets and hence pricing and liquidity. The commercial real estate market is especially opaque in many Member States, with arguably high market inefficiency and illiquidity resulting from its heterogeneous nature and the fact that real estate is not traded via a central exchange. However, it is clear from the much

more transparent and liquid commercial real estate (and commercial real estate debt) markets in the United States that these should not be insurmountable challenges. The more widespread availability of more granular and more standardised loan market information would in our view facilitate the more efficient trading of loans, hence freeing up bank liquidity and balance sheet capacity to make new loans to the real economy.

Q8: How can one best strike the balance between such dimensions?

We refer you to our response to Q7, and note in particular that it could be helpful to:

- Adopt a classification of borrowers (corporate, SME, consumer), with greater protections the more one moves towards the consumer end of the spectrum; and
- ensure that a sensible balance is struck between data security and privacy considerations (noting harmonisation under GDPR), on the one hand, and the importance of ensuring suitable access to (confidentiality protected) granular data to support property valuations, credit underwriting and effective due diligence, on the other.

Q9: Do differences in these benefits and risks across Member States justify national differences in the framework for secondary markets for loans? If yes, in which way?

Yes …but more in the sense of explanation than justification. Concern about debtor protection in particular has, in some Member States, led to inertia in addressing legacy NPL problems. This has compromised the ability of their banks to provide credit, as the European Commission and indeed other policymakers and commentators have noted. It is difficult to argue that this approach has served the citizens and the economies of those Member States well. In some cases, market participants have developed ways of working around legal restrictions (licensing requirements or restrictions on loan transfers, for example). However, national regimes that impose long, slow, expensive and uncertain court processes – coupled with a lack of incentive for banks to sell or otherwise resolve their NPLs – have made the evolution of effective NPL markets very difficult in some Member States, to the detriment of everyone involved.

We recognise the political and cultural challenges involved, but we think it is difficult to justify the approach taken by those Member States that have adopted approaches widely perceived to be "debtor friendly".

Q10: Would you consider current rules applicable in Member States pertaining to secondary markets for NPL in the EU a significant obstacle to the further development of these markets?

Yes, in many cases. However, the central issue remains the gap between seller and buyer valuation of NPLs which is more a function of impairment recognition and banks' ability to take impairments (from a capital and profitability point of view).

There is a significant cost arising from the very national nature of applicable regimes, especially for smaller Member States where the entry costs are already higher in terms of overheads relative to scale of opportunity. An example relates to licensing regimes for investors in loans or third-party loan servicers (in the worst cases, such regimes are not merely a cost of entry; they can sometimes operate to create delay and uncertainty, effectively constraining market access and competition).

Another example of how problems can arise relates to duty of care provisions in national law and the way regulatory and reputational pressure affects their use in practice. We understand that one national regulator has indicated that the sale of loans by a bank is likely to have a negative impact on its score when it comes to "serving the interests of clients". Such an approach is not consistent with policy support for efficient NPL markets as part of the solution for dealing with legacy NPLs on bank balance sheets.

The consent framework for loan transfers is another significant area where practices vary across Member States. We understand that certain Member States allow the approval of a court or regulator to suffice for the sale of an NPL portfolio to go ahead, whereas other Member States insist on the consent of every borrower to be obtained. This is more likely to present challenges with more granular consumer loan portfolios than with large commercial real estate loans.

It is not a coincidence that those Member States that have sought to highly regulate the sale process and the development of a secondary market have some of the highest levels of unresolved commercial real estate NPLs. A degree of harmonisation across the EU would clearly be helpful, particularly for smaller markets with high NPL burdens, although we appreciate that it may be very difficult to deliver politically.

At the very least, certain aspects of the sale process could be uniformly regulated across Member States, for example the form and content of offers, due diligence packages, transfer processes, and access to third-party loan servicers of a suitable standard. It would also be helpful if European policymakers could deliver a strong, clear signal to national regulators and the public that selling loans is a legitimate and sensible way for European banks to manage the health of their balance sheets.

Q11: What is the most suitable manner to protect a debtor in the case of transfer of a loan and/or collateral by the creditor to a third party?

The debtor's position is ultimately governed by the terms of the loan documentation originally entered into – and a sale of the loan should not affect those terms. Additional protection for consumers is routinely provided by the general law. For business debtors of any size, we do not see a strong case for the general law to override negotiated contractual arrangements with additional protection – but in various Member States, protections that might be entirely justifiable in the case of consumers (and perhaps micro businesses) are also available to larger business borrowers.

We have commented elsewhere in our responses on the problems that the national nature, scope and detail of such protections can create, and on the way the Member States most enthusiastic in providing broad and extensive debtor protection are often the ones still stuck with large volumes of unresolved NPLs, poor credit supply and weak economic growth.

There may be scope for a compromise, lighter-touch approach in those Member States with a culture that favours regulatory protection across the broader debt market. For example, policymakers could require the development and use of loan on-boarding best practice, and a management policy of issuing "reservation of rights" letters upon acquisition of a loan portfolio to inform debtors of the transfer and waive the creditor's rights for a specific period of time.

Q12: What are the (potential) advantages from specialisation across jurisdictions or asset classes?

Potential advantages from specialisation across jurisdictions or asset classes accrue from the ability to build larger portfolios which enhance the return/cost of trading ratio and hence are more attractive to investors. Advantages also arise from the ability of specialised investors to more expertly assess risks, undertake effective and efficient underwriting, and achieve added value. That should support broader investor appetite for NPL portfolios and better pricing for selling banks.

From the investor point of view, there are obvious benefits to a diversified portfolio – but diversification can be achieved across multiple investments and by reference to different parameters, and many of the purchasers of NPL portfolios are deploying capital representing a very small part of the overall investment portfolio of a number of large institutional investors. A focused asset management strategy at the level of the NPL portfolio buyer enables the buyer to underwrite higher values, and provide better pricing to the seller.

Q13: Are you aware of obstacles to operating in secondary markets across national jurisdictions? Would you consider these obstacles to be significant, and/or influence your geographical scope of business operations

Inefficient sales processes and challenging legal recovery systems at the back end make certain jurisdictions less popular with investors than others. The same is true for jurisdictions where the transferability of loans and security is uncertain.

For investors, access to third-party loan servicers of suitable quality and with local expertise is critically important – though of course where investor interest is strong, the business case for third-party loan servicers to build out their own capacity is also strong.

Ultimately, in addition to the critical question of whether banks are incentivised to resolve or sell their NPL exposures, important factors that determine where potential buyers of NPLs and third-party loan servicers focus their efforts are regulatory / licensing barriers to entry and the size of different national markets (where a small market is disproportionately affected by higher barriers to entry or stronger debtor protection).

Q14: Do you consider that an EU regulatory framework (Directive or Regulation) regulating certain aspects of the transfer of loans would be useful? What are in your view the key elements that should be addressed in such a framework?

It is difficult to assess what might best be achieved through EU regulation or at a national level. It may be that the best role for the EU would be to encourage a direction of travel at the national level rather than to introduce a new layer of regulation, or to tackle the daunting political challenge of aligning the very different national frameworks of Member States. Having said that, useful areas for policymakers to focus on would be:

- Encouraging and enabling banks to recognise loan impairments (particularly in relation to legacy assets) more adequately and on a more timely basis;
- Enforcing or at least encouraging the collection and availability of loan-level data (and indices) for secured commercial real estate debt (subject to protecting the confidentiality of individual market participants);
- Introducing more standardisation to the disposal process and ensuring the transferability of loans/security; and
- Promoting standardised levels of data integrity and seller due diligence, including by encouraging the use of suitable specialist third-party sale advisers.

Q15: Please provide any other comments that you find useful in relation to this section.

We agree with the Commission's analysis regarding the potential benefits of a more developed NPL market – for European banks, for businesses struggling with unsustainable debts or to access new credit, for debt investors, and for the economy as a whole. NPL sales can play an important part for various reasons.

- The buyer has neither the same economic pressure as the originating bank to get the original loan principal repaid in full (having bought at a discount), nor the reputational pressure that might encourage an originating bank to prefer inaction over conflict.
- Unlike some originating banks, the buyer will have (or will have access to) the specialist skills and resources required to service the portfolio, negotiate and implement restructurings or other consensual solutions, or (where necessary) pursue the last resort of enforcement.

We acknowledge the sensitivities in many Member States regarding appropriate protection for households and very small business borrowers. However, we would also point out that – particularly for large, SPV-based business borrowers – a more creditor-friendly approach can render the resolution

of problem loans easier and quicker, reducing the risk of making, or purchasing, a loan, and enabling the flow of credit to recover more quickly after a downturn. Certain Member States are still paying a price for applying to large business borrowers the slow, uncertain and costly court procedures that might more easily be justified in the interests of protecting of small borrowers.

Making loan transfers easier and facilitating the growth of third-party loan servicing platforms (including reducing barriers for entry to the loan servicing market) are important steps for enabling the transfer of NPLs and ultimately (and more importantly) the resolution of problematic legacy loans, whether through enforcement or otherwise. However, a number of other factors are probably more important.

- The time, cost and uncertainty that a prospective NPL buyer anticipates for getting its money back (whether through a consensual solution or enforcement) all feed into the discount it will demand. The time and cost involved in diligencing the deals due to general lack of information and inconsistency of underlying documents also lead to fewer market participants (we understand that the top five European NPL buyers in H1 2017 accounted for 70% of all European NPL deals in that period).
- Critically, the value (realistic or not) that the originating bank ascribes to the NPL and its ability to absorb a write-down will feed into the discount it is able to accept.
- Tax and regulatory factors that add frictional or ongoing costs to the transfer of NPLs from the originating bank to a (typically non-bank) buyer can further complicate the economics, as well as the practicalities, of a transaction.
- Some originating banks will want to ensure that they benefit from any upside in the ultimate recoveries from the NPLs whilst other NPL sellers will be more concerned to ensure a complete exit from the NPLs as a result of the transfer. In particular, some originating banks may shrink from being seen to have any ongoing relationship with NPL buyers perceived by the public to be more aggressive towards borrowers.

Taking a step back, it is important to remember that the central goal is the resolution of legacy NPL portfolios. NPL sales and more effective NPL markets are one useful mechanism for achieving that goal, not an end in itself. It is also important to remember that for NPL buyers, just as for originating banks, the goal is to recover as much as possible of your initial investment with the minimum of frictional delay and cost. Almost any creditor will prefer a consensual solution over formal enforcement where that is reasonably achievable.

It is essential to incentivise banks to value their NPL exposures in a realistic way so they are not blinded by a par amount that is no longer actually recoverable, and the difference between their valuation and the valuation of a potential buyer is narrowed. It would also facilitate the resolution of problem loans – whether within the originating bank or following a sale – if borrowers were incentivised to seek a consensual solution. A simpler, faster enforcement process for secured creditors might provide such an incentive, albeit we appreciate there may not be political consensus in favour of consistent EU rules to achieve this.

Finally, it should be recalled that Europe's excessive reliance on bank finance is one of the problems that Capital Markets Union seeks to address. One solution that the European Commission should explore (and encourage the EU's financial regulatory authorities to explore) is how securitisation, including CMBS, could be used to deal with NPLs.

In our view, CMBS offers a tried and tested mechanism for engaging the skills of specialist third party servicing firms, while also providing the machinery for the seller to preserve a right to part of the upside from better-than-expected recoveries. CMBS has the advantages (when compared with the wider European commercial real estate debt market of which it forms, in functional terms, a small but potentially important part) of being relatively transparent and liquid, and subject to multiple layers of oversight and governance.

Third party servicers
Q16: What are the advantages of having access to third-party loan servicers in terms of secondary loan market efficiency? In particular, do you see specific advantages for - **Helping banks overcome legacy assets;** - **Creating investment opportunities for specialised investors?**
At a high level, the advantages are in the areas of: collation and presentation of information and data, including at the due diligence stage (facilitating better pricing); ability to work out loans (provision of resources and skills, facilitating better recoveries); and providing a 'buffer' between banks and/or investors and customers (political and reputational acceptability). In a little more detail, these are key advantages third-party loan servicers can offer to banks dealing with legacy assets: - A third-party loan servicer can provide objective analysis and appraisal of the extent of the problem for bank senior management (and, where relevant, regulators). - Banks may not need to dispose of their legacy assets; however, the injection of objectivity into the management of the assets may enhance work-out recoveries and opportunities. - Banks without an independent work-out department can benefit from utilising the experience and infrastructure available from a third-party loan servicer. - Using third-party loan servicers provides an opportunity for new strategies for disposals/work-out to be considered, maximising value and minimising losses. - Internal work-out teams may be dis-incentivised from pursuing certain options which if pursued would be to the bank's overall advantage. These can be unlocked through the involvement of a third-party loan servicer. - Using third-party loan servicers to deal with legacy assets frees up resources within the bank for other activities connected with the supply of new credit. From the point of view of potential buyers of NPL portfolios, third-party loan servicers offer the following advantages: - Certain investors may not be in a position to manage the assets themselves (e.g., because they have insufficient infrastructure to manage the investments, lack of language capabilities or other expertise and/or lack of presence in the relevant jurisdiction). For such investors, a third-party loan servicer is the only option. - In other cases, the investor may have the ability to manage the investments, but there could be efficiencies to be found in outsourcing certain functions to a third-party servicer, and benefits resulting from the servicer's broader market experience. - Third-party loan servicers have experience in taking on portfolios of loans and communicating with debtors regarding changed circumstances and new ownership. - Third-party loan servicers often have experience across many jurisdictions of dealing with portfolios of assets, including experience in complying with local recovery laws, customs and regulations. - A third-party loan servicer can objectively and dispassionately review options with new owners and debtors regarding each specific loan. - Third-party loan servicers can deliver standardised and detailed reporting for investors on the assets under management in accordance with investor requirements. - Exposure to many portfolios of differing qualities and other jurisdictions allows a servicer to promote a level of professionalism in the ownership and management of the assets.
Q17: Are there any obstacles for banks and non-bank investors to have access to third-party loan servicers? If yes, please specify the nature of these obstacles, i.e.

- **Regulatory,**
- **Legal, or**
- **other**

Yes. Commonly encountered regulatory and legal barriers include the following:

- Some Member States have regulations requiring servicers to have a unique local licence in order to provide services. While this may be a simple administrative requirement or a form of genuine quality control, it can sometimes become an effective barrier to entry for international, independent, reputable servicers seeking to enter markets that are inadequately served by a limited pool of incumbent domestic servicers.
- In some Member States, there is a requirement that a loan owner must be a licensed financial institution or its servicer must be authorised by the relevant local regulatory body. Again, this requirement can effectively operate as a significant barrier to entry for third-party loan servicers, with costs in terms of competition and market efficiency.

The most significant non-regulatory/legal barrier is a 'chicken and egg' problem especially common in certain smaller Member States. The absence of a viable secondary market for commercial real estate NPLs means that there is little incentive for third-party loan servicers (like potential investors) to make the considerable investment required to enter such a market. Whereas Member States potentially affected by this problem could address it by simplifying or even incentivising access, these are all too often the same jurisdictions that present significant legal and regulatory barriers, and indeed cumbersome enforcement frameworks.

Q18: What are the advantages and risks of outsourcing specific activities to third-party loan servicers compared to internal workout of loans? Please be concrete as to the activities that have been outsourced and why this has proved beneficial or not.

Activities that are typically outsourced include sale advisory functions and acquisition due diligence and support. Beyond that, they range from simple loan administration, through agency (managing the relationship with debtors on behalf of the owner of the debt), to the development and implementation of asset and/or portfolio level work-out and recovery strategies. More specifically, they can include the following:

- Data migration / loan on-boarding;
- Oversight of collections / preparation of interest statements;
- Reporting;
- Site inspections;
- Covenant compliance testing;
- Point of contact with borrowers / borrower communication; and
- Development / implementation of portfolio/asset recovery strategies.

The advantages that outsourcing to third-party loan servicers can provide include the following:

- Higher quality, more consistent and transparent reporting than is typically achieved by the owners of loans;
- More efficient data management resulting from experience in data migration from different scenarios;
- Availability of dedicated resources to undertake the outsourced activities;
- Expertise in collation, presentation and interpretation of data relating to the loans and portfolio, and in reporting on the same;
- Dedicated, specialised teams with local expertise to implement strategies;
- The ability to benefit from economies of scale, leading to efficiency across the business, helping drive returns to the owner of the debt. The owner can avoid burdensome overheads

and infrastructure which would otherwise need to be developed and maintained in-house, while linking costs to key performance indicators;

- No conflicts of interest; a third-party loan servicer can objectively and dispassionately review options with a bank or investor owner and debtors for each specific loan;
- Opportunity for the owner to free up its own resources to concentrate on other activities which truly drive their businesses (such as new lending for a bank or sourcing new investment opportunities for a loan portfolio buyer); and
- We understand that historical data suggests third-party loan servicers can achieve quicker and better collections than is typical of internal departments.

In terms of risks, it would normally be the case that a servicing agreement locks the owner of the loan portfolio into the relationship with the third-party loan servicer for a certain period of time. However, if the owner of the exposures has used a sufficiently rigorous selection process and negotiated appropriate terms of engagement, service levels and performance criteria, we do not think this should be a problem.

Q19: What are the main risks for debtor protection, in particular for the households in financial difficulties, which are linked (directly or indirectly) with the practices of the third-party loan servicers?

It is clearly important to ensure that appropriate debtor protection exists for different types of borrower, most obviously for consumers and ordinary households. However, as a general rule, it is not obvious why the involvement of a third-party loan servicer (any more than the involvement of any particular type of lender or debt owner) should affect the debtor's position. A borrower's position will always be a function of the contractual terms and any applicable overlay imposed by the general law. Unless the general law applies debtor protection for households in financial difficulty by reference to the identity of the lender or loan servicer, rather than by reference to the identity of the borrower (something that would strike us as very odd), the risk of a change to the borrower's rights and obligations should therefore be minimal.

It seems to us that the main reason why a change may arise when an originating bank either engages a third-party adviser or sells a loan would be that for cultural or reputational (rather than strictly legal) reasons, the originating bank chose not to exercise particular informational or enforcement rights. But it would be wrong, in our view, to regard the mere exercise by or on behalf of a creditor of the rights its contract and the law provide, as presenting a risk for debtor protection.

As a general matter, it would presumably be important to ensure that regulation and commercial incentives match up so that a third-party loan servicer (or indeed a buyer of a loan from the originating bank) is not encouraged to attach a lower importance than the originating bank to compliance with debtor protection requirements. In most cases it will surely be a matter for the owner of the debt to set suitable parameters to guide the behaviour or any third-party loan servicer it may engage.

Q20: In the markets and jurisdictions that are relevant to you, is third-party loan servicing mainly focused on management of performing loans, non-performing loans, or both? Please describe the advantages and drawbacks of both situations.

Portfolios can consist of both performing and non-performing loans. For performing loans, neither the creditor nor any third-party loan servicer would be permitted to take any action, so any third-party loan servicer will provide administrative support for the management of loans, with the added benefit of high quality reporting and surveillance that can help identify possible problems early. Agency in the routine relationship with borrowers may also be included. This kind of work may be high volume, but can only justify low margins.

For non-performing loans, servicers can offer investors much more substantial advantages in respect of management, workout and collection opportunities. This may be lower volume work, but it justifies much higher margins, reflecting the high value added.

Q21: Do, in your experience, third-party loan servicers concentrate on a specific asset class or does their asset mi tend to be more diverse? Please describe the advantages and drawbacks of both.

With respect to real estate assets, third party servicers tend to be specialist in that there are residential mortgage servicers and commercial mortgage servicers. The systems, expertise and staffing levels required to service a granular portfolio of residential mortgage loans differ from what is required to service commercial real estate loans traditionally made to corporate borrowers. In addition, the two asset classes operate under different regulatory frameworks. This specialisation offers investors clear advantages in terms of being able to access genuine expertise for particular assets, but with the drawback that investors holding diverse loan books may have to outsource the servicing to more than one servicer.

Q22: What specific services are offered by third-party loan servicers, in the markets and jurisdictions that are relevant to you? [*The range of activities could include debt collection, monitoring loan performance, payment and invoicing services, gathering and developing information, one-stop-shop, full life-of-loan services that include sourcing and structuring of debt and equity, underwriting and due diligence services, etc.*] Which services do you consider to be most instrumental in terms of market efficiency? Please be as concrete as possible.

Please see our response to Q18. Using different words, one might summarise the services as follows:

- Loan advisory – underwriting and due diligence support for both sellers and buyers;
- Data – gathering and storing of information;
- Loan administration – loan calculations, debt collection, cash management, gathering borrower reports, etc.;
- Monitoring – analysis of loan / asset performance;
- Client reports – loan collections, loan performance, workout scenarios, asset updates; and
- Recoveries – developing and implementing work-out and recovery strategies at loan and portfolio level.

Q23: Do you consider that a EU regulatory framework (Directive or Regulation) regulating third-party loan servicers would be useful? If yes, should such legal framework include rules on

- **the licensing requirements for such servicers;**
- **the supervision of such servicers?**

Are there any other elements that should be covered by such a legal framework?

Yes – the licensing requirements for such servicers.

Please note that we have checked "Yes" in order to be permitted by the online form to provide further comments.

It is quite possible that an EU-wide register of approved or accredited third-party loan servicers could play a useful role by offering a simplified and harmonised form of quality assurance, provided it also removed additional regulatory oversight and licensing requirements at the national level. Such a scheme could focus on criteria such as capitalisation, EU servicing experience, infrastructure, regulatory compliance record, etc. There may be suitable precedents in the AIFM regulatory framework, for example.

More generally, following a great deal of regulatory action since the global financial crisis, there is a wariness in the industry regarding further regulatory intervention, particularly in relation to a group of

market participants that generally perform an advisory function on behalf of their clients. We would find it difficult to support any initiative that was not driven primarily by a desire to use harmonised EU rules to reduce the overall regulatory burden across Member States.

Q24: Please provide any other comments that you find useful in relation to this section.

No further comments.

Removing possible constraints to the development of secondary markets for loans

Q25: Are you aware of significant differences in business practices in different markets and jurisdictions, for example through voluntary codes of conducts, industry standards, etc. If yes, does this, and how, constitute an obstacle to your business?

Yes. Members report to us the "10 Golden Rules" in the Netherlands, which serve as a guideline for minimum standards without creating an obstacle to business. We are not aware of other examples in the largely private and opaque world of commercial real estate NPL trades.

Q26: As a market participant, are you actively partaking in several national markets? If so, do you encounter obstacles to operate internationally in an efficient manner? Please specify.

Yes. Please note that we are a European industry association, rather than a market participant, so we respond based on what our members tell us and our market knowledge in relation to commercial real estate.

We are aware of numerous market participants that operate across a number of Member States, although participation is often very low in some of the smaller markets that would appear to have a great deal to gain. Obstacles include:

- Inconsistent licensing requirements and loan transfer rules;
- Inconsistent rules relating to the ability of international servicers to participate in markets;
- Inconsistent insolvency/recovery rules;
- Inconsistent approaches taken by the holders of NPL portfolios (including in terms of the information they make available and the flexibility with which they will approach dealing with their NPL portfolio); and
- More generally, variable levels of transparency.

Q27: In the markets and jurisdictions that are relevant to you, are there unduly onerous legal restrictions in place:

a. on the sale of loan portfolios, including to non-bank entities? Please specify these restrictions and their impact.
b. On banks that want to outsource some or all loan servicing functions to third-parties, including to non-bank entities. Please specify those restrictions and their impact.

Such undue restrictions could for example concern the areas of debtor protection, privacy, data secrecy, equal treatment of investors.

If yes, could the removal of such undue requirements be considered? Please specify where such an approach could be contemplated and describe the advantages and drawbacks thereof.

In terms of restrictions on sale, some jurisdictions do place restrictions, and this can reduce the universe of potential buyers and, logically, the reduction in competition is likely to result in pricing that is less attractive to the sellers of loan portfolios. Such restrictions are likely to be driven by a desire to

protect debtors (which arguably makes a lot less sense in the context of larger commercial loans than small consumer loans).

One possible way to address underlying policy concerns about allowing acquisitions by unlicensed overseas opportunistic fund managers might be to require the appointment of a loan servicer (which may but need not necessarily be an independent third party) that is approved (perhaps at EU level) to oversee the portfolio and assume responsibility for certain regulatory functions. However, the real solution should surely involve national authorities understanding, and explaining to the public, that NPLs need to be resolved for the good of the economy and to enable the flow of new lending – and a more pragmatically regulated framework for sales that can accommodate international investors has a part to play in delivering that.

Outsourcing in some countries can be a difficult process. There is no uniform code of requirements for banks interested in outsourcing, which makes the process inconsistent and at times unnecessarily protracted. Particular problems arise when there are assignability restrictions in loans which prevent the assignment of loans to the economic buyer. We understand that in such cases market participants will often find a way to structure around such restrictions so that the seller remains the lender of record, but such solutions inevitably involve complexity and cost (and in some cases risk), reducing flexibility for recovery.

As mentioned elsewhere in this response, a fundamental underlying problem is that the originating banks that hold NPL portfolios are in many jurisdictions not incentivised to work out their NPLs, and if they are valuing them at par, the discount imposed by potential buyers may be prohibitive.

It is instructive to compare the position with the much-maligned securitised market, where the deal structure means that it is not possible to hide impairments and 'kick the can down the road' indefinitely. Despite all the alleged failings and complexity of securitisation, problems were flushed out as they arose, resolution strategies were developed and implemented, and bondholders were repaid, at least as regards more than 98% of the principal amounts they were due (around 97.7% in respect of AAA-rated bonds). The write-offs actually suffered by, or still hidden in, the balance sheets of many of Europe's commercial banks are, at an estimated 10%, far worse (and significantly worse than the level of losses suffered at the loan level in the CMBS universe, which is perhaps a fairer comparison). In recent years, research from Bank of America Merrill Lynch, for example, has provided detailed analysis of performance at loan and bond level, based on a level of information that we can only dream of in relation to the legacy exposures of many of Europe's commercial banks. Please let us know if you would like us to share available industry research in this area with you.

Q28: What specific aspects could be improved, in order to facilitate existing cross-border activities and/or entry into new markets? Going beyond mere facilitating, what would accelerate the resolution of NPLs?

As discussed elsewhere in this response, the central challenge is to encourage originating banks to value their NPLs realistically and to incentivise them to resolve them – whether internally, with the assistance of specialist third-party expertise on a consultancy or joint venture basis, or through sale. While there may be legitimate concerns to protect consumer and micro business debtors, and indeed to protect the solvency position of banks carrying substantial NPL burdens, it seems clear that the strategy of 'kicking the can down the road' is not a solution. Banks are unable to lend, borrowers are paralysed and prevented from making new investment, and collateral real estate is becoming increasingly dilapidated and less fit for purpose the longer this situation continues.

The political challenges around harmonising national insolvency regimes, or the licensing frameworks applicable to the buyers and servicers of loan portfolios are plainly considerable. The extensive regulatory response to the global financial crisis has generated considerable wariness among industry participants about whether new EU regulatory initiatives, however well-intentioned, would make the situation better or worse.

As a result, we are unsure whether it is possible to do something that would be politically acceptable while also making a material and positive difference commercially. Our responses to other questions discuss specific pieces of the jigsaw in a little more detail.

Q29: Do you consider that the development of a common EU approach would have an added value in the areas of:

a. The sale and transfer of loans?
b. Loan servicing by third parties?

If yes, which areas so far regulated under national law should be the focus of such harmonisation efforts? Potential focal points could include third party servicers' licensing regimes, capital requirements, trade secrecy and consumer protection.

Are there other actions that could be taken at EU level that would yield significant benefits for market efficiency (for example EU guidance or recommendations, the creation of a central register of loan servicers, etc.)?

Practical steps might involve policymakers, including at the national level, encouraging (perhaps through the adoption of industry best practice or guidance, rather than regulation):

- Greater standardisation in the disposal process;
- The use of specialist independent sale advisers;
- The introduction of standardised disclosure guidelines, for example in the due diligence package provided by sellers on which buyers can rely; and
- Improvements more generally in the quality of data provided as part of the disposal process.

As mentioned elsewhere in this response, the highest priority should be on incentivising banks to address their NPL exposures swiftly, including by requiring realistic valuation, and perhaps by providing capital relief for sellers (such as by allowing write-offs to be spread over the remaining average life of the exposures sold). Such measures would presumably be a matter of regulatory action at the EU level. In parallel, debtors might be encouraged to explore consensual solutions (which most creditors would prefer over enforcement action) if insolvency and enforcement regimes across the EU were more transparent and efficient and less susceptible to being used as a delaying tactic. We appreciate the political challenges that might make this difficult to achieve.

Specifically as regards third-party loan servicers, barriers to entry could be reduced so as to allow them to operate on a more pan-European basis, through harmonisation of servicing practices and/or cross-border recognition of servicing qualifications (limiting national regulation to a requirement to demonstrate facility and compliance with any requirements particular to a Member State).

Q30: Please provide any other comments that you find useful on this section.

No further comments.

Section II: Potential mechanism to better protect secured creditors from borrower default

The rationale for a possible EU accelerated loan security

Q31: Do similar forms of out-of-court enforcement allowing banks to enforce secured loans exist in your country? If yes,

- **Please describe these.**
- **What are the benefits of these provisions for banks in terms of enforcement and value recovery from NPLs?**

- **What are the main risks and challenges arising from these forms of out-of-court enforcement tool?**

Yes. We are not responding in relation to any specific country, but have checked "yes" so that the online form allows us to provide our comments. Others will be better placed than us to provide summaries of national regimes. Clearly, certain countries have well-developed frameworks for the enforcement of security without the need for a court process (i.e., on a basis that is to a greater or lesser extent creditor-friendly).

Benefits are reflected in the fact that in such countries' legacy NPL problems have generally been substantially worked out, often (though not universally) via sales or other arrangements involving third party advisers, servicers or investors. Banks have been able to return to their core business of lending.

The existence of such enforcement regimes does not necessarily mean that creditors automatically use them – they can also operate to focus the minds of debtors on the importance of resolving problem loans in a timely manner (and there is typically additional protection in place for more vulnerable categories of borrower or collateral, such as consumers or residential property).

At the other extreme, the situation is very different in countries where secured creditors need to go through a long, slow, expensive and uncertain court process to enforce. Borrowers are able to 'kick the can down the road' even if there is a creditor keen to resolve (whether through enforcement or consensually). Problem loans are left unresolved, paralyzing the banking system and preventing new investment in the upkeep and refurbishment of buildings, resulting in a more dilapidated built environment.

We would not identify particular risks or challenges.

Q32: Do you see benefits in ensuring that every Member State makes available an instrument along the lines of the 'accelerated loan security' facility?

A simpler, faster enforcement process for secured creditors would be welcomed, given that the likely recovery period on NPLs is one of the key unknowns which impacts pricing, but any new enforcement mechanism (including the proposed accelerated loan security instrument) will be limited in value to the extent that borrowers remain able to frustrate or delay the process by bringing actions in local courts.

Rightly or wrongly, there seems to be little political appetite for overriding national rules in order to protect secured creditors. Furthermore, the European Commission's preference for providing the benefit of any new enforcement right only to banks strikes us as inconsistent both with the broader goals of Capital Markets Union to reduce dependence on banks, and with the proposals in this consultation regarding the desirability of encouraging the development of secondary markets in NPLs.

On the basis that a new, effective Europe-wide enforcement mechanism is likely to be difficult to implement, a more realistic ambition may be to agree a set of best practice guidelines for dealing with borrower defaults expeditiously on a consensual basis, which could, for example, include referral to a non-judicial forum such as independent experts. In parallel, commentary on the most efficient national processes could be shared with relevant national regulators, making the case for, and hopefully prompting, future reform.

The consultation paper does not address the differences in publicly available information on the underlying collateral across jurisdictions. While in some jurisdictions (such as the UK and the Netherlands) land registry information is readily accessible and up to date, in others it is much more difficult and time-consuming to obtain accurate information on title, security and licensing. Planning information is in general particularly hard to ascertain. Addressing this would have a positive impact on liquidity and pricing, and may also positively impact the performance of loan servicers.

The benefits of greater standardisation in NPL sale and purchase agreements and related documents may be modest, as these will always be tailored to the specific assets, jurisdictions and parties' requirements. Industry guidelines and best practice may have a role to play, however.

There may be more value in continuing to encourage greater standardisation in commercial real estate loan and security documentation across jurisdictions. In the business (rather than consumer) context, this, too, is essentially a matter for the industry.

At a more detailed level, two specific problems with the proposal are:

- The fact that the proposal refers to the collateral being "transferred" to the lender. This could give rise to unwelcome liability issues for the lender in the real estate context such as responsibility for environmental issues, health & safety, insurance, tenants etc.
- The proposal suggests that the underlying debt might be extinguished. In circumstances where the value of the collateral had fallen below the amount of the debt, this could lead to a situation where debtors are incentivised to walk away and hand the keys back to the lender. This is both a moral hazard and potentially unhelpful for the creditor.

Members have suggested to us that the proposed instrument could more generally create significant problems in certain jurisdictions that already provide adequate enforcement mechanisms for secured creditors, clashing with the way security law and practice currently operates without a corresponding benefit.

Ultimately, it is important to remember that neither banks nor non-bank purchasers of NPL portfolios like to resort to enforcement proceedings. Even in jurisdictions where enforcement is relatively straightforward, most lenders will prefer a consensual, negotiated restructuring or other solution. The European Commission's priority should be to focus on creating the conditions that encourage creditors and borrowers to seek solutions. An essential element of that is to incentivise banks with large NPL exposures to value them realistically, as that will facilitate either a sale or the resolution of the loan within the originating bank. Incentivising borrowers to seek a resolution rather than to avoid or delay one would also help, but the proposed accelerated loan security seems unlikely to have that effect.

Q33: Do you see the accelerate loan security as a valuable instrument to avoid future accumulation of NPLs in banks' balance sheets?

Ultimately, no.

The central problem that continues to afflict many European banks (and their borrowers) is the wide bid/ask spread in the value ascribed to problem loans by potential sellers and buyers. Not only does this make bank sales of NPLs difficult to achieve; it is also indicative of the unrealistic approach that complicates resolution of such loans within banks. If a bank holding such loans recognised that their true value is lower than their face value, they would be easier to deal with, whether within the bank, in some kind of joint venture arrangement, or through a sale. IFRS 9 may help that happen. Dealing with problem loans would also be easier (again, whether within the originating bank, in a joint venture or following a sale) if borrowers were incentivised to seek a consensual solution. A simpler, faster enforcement process for secured creditors might provide such an incentive.

But while in principle an additional out of court enforcement mechanism would be welcomed by the NPL market, the proposed accelerated loan security seems unlikely to make a significant difference. It is too limited in scope and ambition, being available only to banks (even though the goal is to reduce reliance on banks, and to get NPLs out of the banks) and remaining subject to any national insolvency process (even if commenced after use of the security right is initiated). Unfortunately, it also seems clear that a more muscular change to insolvency rules and culture across the EU – such as might really make a difference – would be extremely difficult to deliver politically (we note that it is not even put forward for consultation by the Commission).

It should be remembered that Europe's excessive reliance on bank finance is one of the problems that Capital Markets Union seeks to address. Solutions to the NPL problem and improved protection of secured lenders should aim to promote a more diverse and flexible financial system, not to entrench the dominant position of the banks. The Commission should not create new rights that are only available to banks. No less importantly, the Commission should explore how securitisation (including CMBS) could help transfer loans out of banks while also providing a tried and tested mechanism for engaging the skills of specialist third party servicing firms.
Functioning of a possible accelerated loan security instrument
Q34: Do you agree with the possible main features of an accelerated loan security as described above? If not, what are the features that you do not agree with and why?
No, for the reasons outlined in our responses to Q33 and earlier questions.
Q35: What are the (additional) features that an accelerated loan security should have in order to enhance its effectiveness in avoiding the encumbrance of bank balance sheets with further NPLs in terms of functioning of the mechanisms?
We refer you to our responses to earlier questions.
Q36: Do you agree with the proposed restriction on the scope of a possible accelerated loan security instrument to loans to businesses and corporates, and on the exclusion of primary residence of borrower even in the case of these loans? Please explain the reasons for your answer.
While we do not support the instrument as proposed, we agree that it would be reasonable for any such instrument to be limited to loans which are not secured by the primary residence of the borrower. This would mitigate potential political risk and accusations of unfairness and undue pressure perhaps being put on retail borrowers – a particular concern in the current political climate. We also agree that such an instrument would be better suited to loans to businesses and corporates, rather than to consumers. However, we suspect it may be difficult to differentiate reliably between those loans secured on primary residence which are used to fund corporate and business interests and those which are not. In addition, examples from the global financial crisis such as in Ireland revealed further complications, for example the measures that business borrowers can take to avoid repossession of a primary residence (e.g. transfers into the names of other family members, or artificial/technical divorces). There is perhaps a separate point here for lenders to consider in cases involving personal guarantees and the personal assets of business borrowers.
Q37: In what ways could an accelerated loan security be rendered potentially advantageous to borrowers to ensure its willing take-up by debtors (e.g. possible discharge of debtors in case the value of assets becomes less than the debt)?
Differential pricing might be a suitable way of reflecting the value to the lender and the rights given up by the borrower – provided that the accelerated loan security instrument operated in such a way as to deliver those outcomes on a reliable basis. We do not consider that that proviso is satisfied.
Relationship with restructuring and insolvency frameworks
Q38: How should an accelerate loan security instrument be designed in order to be consistent with the preventive restructuring framework and the insolvency law of your country (e.g. stay on

enforcement actions, cram-down on minority creditors, avoidance actions, ranking of creditors)? In your view, what would be the main obstacles to ensure such consistency?
Members report compatibility issues with the existing framework in the Netherlands and Germany, two jurisdictions where we understand that the instrument would not provide any meaningful benefit to secured creditors in any event.
Q39: How should an accelerated loan security instrument be designed in order to be consistent with the public and private law rules and principles (including for instance property law, public and private law) of your country? In your view, what would be the main obstacles to ensure such consistency?
We refer you to our responses to earlier questions. We believe a fundamentally different approach is required if the rights of secured creditors are to be protected in a way that truly supports the operation of the market consistent with existing policy goals.
Q40: How should an accelerated loan security instrument be designed in order to be consistent with the existing national collateral legal framework?
We refer you to our responses to earlier questions. We believe a fundamentally different approach is required if the rights of secured creditors are to be protected in a way that truly supports the operation of the market consistent with existing policy goals.