

## Consultation response

### EBA NPL Transaction Templates

29 November 2017

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **DRAFT NPL TRANSACTION TEMPLATES**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

We summarise below our high-level response to the request for comments, which is followed by answers to the individual questions raised.

#### Overview

AFME strongly supports actions intended to remove impediments to the development and deepening of European secondary markets for NPLs and distressed debt.

Although the majority of our member firms are not currently affected by excessively high levels of NPLs, AFME supports the development of a deeper secondary market for NPLs debt and improved liquidity in this market-based alternative for credit risk management.

AFME also supports actions that improve the quality and quantity of, and access to, data on NPLs as a means to develop the secondary market for NPLs. As noted in AFME's response to the Commission's consultation on developing a secondary market for NPLs<sup>1</sup>, one of the most effective ways to attract a wider investor base is to improve the quality and quantity of data and information about the borrower and the loan (including any relevant information on underlying assets or security) that is available to investors.

Likewise, in the absence of consistent and accurate information, purchasers of non-performing loans are likely to include a discount on the prices they are prepared to pay relative to book value. This discount would reflect the higher risks resulting from the uncertainties created by the absence of such information. This in turn will result in a more negative hit to selling banks' capital ratios or discourage sales of non-performing loans.

#### Setting an attainable standard for NPL data

We welcome the objective of proposing a voluntary market standard to aggregate and share relevant information for portfolio valuation and asset disposals. This effort will speed up due diligence processes and facilitate comparison between loan portfolios from different sellers.

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<sup>1</sup> "Development of Secondary Markets for Non-Performing Loans and Distressed Assets and Protection of Secured Creditors from Borrowers' Default". AFME's response available in <https://www.afme.eu/globalassets/downloads/consultation-responses/afme-ppa-response-to-consultation-on-secondary-markets-for-non-performing-loans-and-distressed-assets.pdf>

Although standardisation (on a voluntary basis) is a commendable effort, the templates should provide the necessary incentives so that they are widely recognised by industry participants as an easier, more valuable and more efficient alternative than what is currently in use<sup>2</sup>.

We find the current draft EBA NPL templates, in particular the template for Financial Due Diligence, proposes an approach that is too granular and which may discourage market participants from voluntarily using it. In particular, we observed that 313 of the 475 template fields (or 66% of the total) are classified as “critical” for purposes of loan valuation, which we consider exceeds what is typically required in market transactions<sup>3</sup>.

Other operational practicalities should be considered. For example, ways in which the templates can be connected with credit systems of banks, so that banks can populate them automatically. Or leveraging more broadly existing reporting requirements— for example, 364 of the 475 template fields (or 77% of the total) are not harmonised with AnaCredit or FINREP reporting.

**AFME suggests evaluating the possibility of taking a simpler approach by proposing a less granular template and which reconsiders the number of fields classified as “critical” for purposes of portfolio valuation.**

### Assessing stakeholders’ views

Successful implementation requires that a critical mass of market participants voluntarily use the proposed templates in market transactions. A pre-requisite for wide adoption is building industry consensus around the minimum relevant information that is critical for asset valuation.

Although we recognise the timelines in the Council’s NPL action plan are ambitious, the industry and individual market participants would value more time to comment and analyse the cost and benefits of adopting the proposed templates. It would be helpful to consider the views of other relevant parties such as national asset management companies (AMCs), some of which may have a limited capacity to update or adapt their existing data tapes with the proposed standard.

### Other complexities behind NPL data

There are additional existing data-related challenges that the templates will not address, specifically those related to data availability and consistency of information.

One of the critical areas to address to improve the quality of data on NPLs is the existing barriers that preclude holders of NPLs from disclosing information to third parties without breaching data confidentiality rules<sup>4</sup>. Policymakers should continue to make efforts to address this market impediment. The upcoming General Data Protection Regulation (GDPR) provides good progress in that direction.

An additional complexity is related to the availability of information. Some market participants may find it challenging to populate the information requested in the templates given that the information may not be readily available in digital form (i.e. the information may only be available in paper form) or it may not be available at all.

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<sup>2</sup> As example of other existing data requirement, see Fitch’s Non-Performing Loan Securitisations Rating Criteria (“Non-Performing Loan Securitisations Rating Criteria - Cross-Sector Criteria Report”)

<sup>3</sup> AFME understands and supports that the number of critical fields will be reduced substantially in a further iteration of the template.

<sup>4</sup> Further details and specific examples are in AFME’s response to the Commission’s consultation on developing a secondary market for NPLs

## Questions

### 1) **Would you consider the two-stage approach (split into the “EBA NPL transaction templates” and the “EBA NPL portfolio screening templates”) as appropriate?**

The segmentation is appropriate.

The screening template provides high-level information that might be useful for purposes of conducting pre-due diligence processes, so that potential investors have an overview of the size, composition of underlying assets, location of collateral, and other characteristics of the loan pool.

In relation to the “EBA NPL transaction template”, as we indicate in the overview section, we consider that the template is far too granular and requires information that is not critical for purposes of loan valuations or not currently or readily available.

Some of the fields go even beyond what is relevant for portfolio valuations, such as **provision level** information and Loss Given Default (**LGD**) on the portfolio. Providing this information to the buyer may even put the seller at risk of receiving reduced prices from investors and could also could mislead the bidder as it undertakes its required independent analysis.

Likewise, some sellers select portfolios to sell based on operational criteria which might differ from the accounting/basel segmentation. Therefore, the information regarding provision or LGD may not be aligned on the portfolio selection and would give non-relevant information on the portfolio.

### 2) ***Investor specific question: Will the templates help facilitate the access to the NPL market in the EU, in case you, as an investor, have less experience in this market? If not – what should be amended?***

Our members’ perception is that the template contains significantly more information than the current market standard (even for the existing active market). More information and more transparency are certainly a welcome feature for investors, but the burden on the sellers needs to be balanced so that costs and timing are not severely impacted.

It is also worth considering whether such comprehensive templates actually make it more time consuming for investors, particularly those which are new to the market, to conduct the valuation process and whether this might have a detrimental rather than stimulating impact on the NPL market.

### 3) ***Investor specific question: Do the two templates meet your information needs for NPL transactions from an investor perspective? If not – what is missing? Is information included, which you would consider as not needed / not relevant?***

We are not able to directly comment on the views of investors. However, in conversations with loan servicers and asset management firms, one of the most frequently mentioned impediments to a successful asset disposal relates to the availability and consistency of loan information. For example,

according to a survey conducted by PwC<sup>5</sup>, investors consider that poor quality data is typically “the most frustrating aspect” of sale processes. Therefore, the templates are only as good as the quality of information with which they are populated with.

Poor data quality involves elements of availability and consistency of information, but may not imply specific concerns on the form in which the information is shared with investors. As mentioned in the overview section, the templates may be useful in setting a standard on how information should be disclosed, but may not address the overarching problem of data quality behind portfolio sales. This problem includes factors such as existing data confidentiality rules, availability of information in digital form, and availability of certain information (as creditors may have issued a loan for purposes of loan origination but not envisaging loan disposals).

**4) Do you consider the current set of asset classes as sufficient? Please provide any feedback on merging any of the asset classes or adding additional asset classes.**

We consider the existing classification is appropriate.

The asset classes categories should be consistent with existing definitions and categories as defined in other reporting requirements.

**5) Do you consider the suggested consideration of country specifics as appropriate? Are there any material country specific fields missing which you think are necessary? If you suggest to add other country specific information, please provide exact respective specific aspects including definition and background explanation.**

It is valuable that the templates take into consideration national differences in legal and insolvency frameworks. As analysed in the AFME report on “Potential economic gains from reforming insolvency law in Europe<sup>6</sup>”, country-specific features of national insolvency frameworks are relevant for purposes of assigning expected recovery rates, foreclosure times, or times for recovery, among others. These national differences have significant impact on loan valuations and interest rate spreads against benchmark rates.

In some instances, certain features of national insolvency regimes may not be summarised in binary fields. Likewise, foreclosure-related fields such as “legal status” are often not standardised due to the complexity of the different proceedings. As such, a separate text field is welcomed as it allows for further information to be provided to describe the specificities of the respective legal frameworks.

A relevant consideration is how frequently the EBA envisages updating the country-specific fields to reflect future changes to country and EU-level insolvency frameworks, particularly since the EC’s proposed Insolvency Directive has not been finalised and is still being negotiated amongst EU Member States. As noted in the overview section, a crucial aspect in order for the proposed template to become a widely used standard is that it should be reliable and contain the most up-to-date information for purposes of portfolio valuation.

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<sup>5</sup> PwC’s 2015 Portfolio Advisory Group Market Survey

<sup>6</sup> <https://www.afme.eu/globalassets/downloads/publications/afme-insolvency-reform-report-2016-english.pdf>

### Additional comments and questions

- Country-specific data miss topics regarding private individuals (for example: surendettement in France, Financial difficulties in UK)
- What category should be used for assets and debtors located in Northern Ireland?
- We could not find in the template the Centre of Main Interests (COMI) field for the respective debtor, which would indicate the relevant jurisdiction for any insolvency or pre-insolvency proceedings and might also be useful for purposes of valuation.
- For the specific case of Italian legal practices, we propose that definition 14.4. is defined as:

#### **14.4 Where ‘Private Individual Counterparty Insolvency Procedures’ is selected for ‘Legal Procedure Type’.**

(a) “**Composizione della crisi da sovraindebitamento**” is the composition for over-indebtedness of the debtor. It is applicable to both consumers and all parties that are not subject to bankruptcy procedures (professionals, small entrepreneurs, farmers, start-ups).

- (1) “**Piano del Consumatore**” (Consumer settlement): an out-of-court procedure reserved for a debtor which is a consumer and which submits to the court a proposal to creditors for the restructuring of debts, and which is approved by the judge after a detailed valuation. If the settlement agreement is successfully met, the debtor is discharged from debts.
  - a. OCC (Organismo di composizione della crisi) appointed
  - b. settlement proposal submitted and approved by judge
  - c. agreed amount liquidated
  - d. agreed amount distributed to creditors
- (2) “**Accordo di composizione della crisi**” (Crisis composition agreement): an out-of-court procedure for both consumers and other parties that are not subject to bankruptcy; the court receives a proposal to creditors for the restructuring of debts and approves it if all criteria are met, without judging its merits (but with consent of majority of credits). If the crisis composition agreement is successfully met, the debtor is discharged from debts.
  - a. OCC (Organismo di composizione della crisi) appointed
  - b. settlement proposal submitted and approved by judge
  - c. agreed amount liquidated / distributed
  - d. agreed amount distributed to creditors
- (3) “**Liquidazione del patrimonio**”, is the liquidation of the debtor obtained only by the sale of his/her properties, which leads, if successful, to discharge of debts.
  - a. OCC (Organismo di composizione della crisi) appointed
  - b. settlement proposal submitted and approved by judge
  - c. liquidator appointed and liquidation started
  - d. agreed amount liquidated
  - e. agreed amount distributed to creditors

(b) **'Foreclosure'** (Procedura esecutiva individuale) is the forced liquidation of the debtor's assets through public auction, requested by the creditor, assigned to a civil court/judge and managed by a designated professional.

- 1) preparation of sale (asset due diligence, appraisal, janitor, etc.)
- 2) auction sale procedure
- 3) auction awarded
- 4) sale's proceeds distributed to creditors

**6) *Bank specific question: Do the NPL transaction templates offer sufficient levels of harmonisation with and references to current practices of data management and administration as well as e.g. reporting (incl. references to e.g. Finrep, AnaCredit, ESMA ABS templates), in order for you to fill the templates? Would you see the need for any other / further such definitions or clarifications?***

We welcome the EBA's and KPMG's effort to harmonise some of the fields and make the definitions consistent with existing reporting requirements. Harmonisation is necessary to avoid confusion and duplication of reporting efforts.

However, EBA/KPMG should further analyse how they might leverage more broadly existing reporting requirements. We noted, for example, that 364 of the 475 template fields (or 77% of the total) are not harmonised with AnaCredit or with FINREP reporting.

- An additional standard that the EBA and KPMG may also take into consideration is the Global Credit Data (GCD) reporting standards. The Global Credit Risk Data is a not for profit initiative to help banks measure their credit risk, owned by its 50+ member banks across Europe, Africa, North America, Asia and Australia. GCD runs the world's largest wholesale bank loan databases, covering large corporates, banks, SMEs and specialised lending.
- An additional standard that can be compared for reference are the templates currently in use by rating agencies<sup>7</sup>. There have been several publicly rated NPL transactions (e.g. Hefesto/Evora in Portugal, ERLS in Ireland or GACS deals in Italy). It would be useful for sellers/issuers to have similar requirements rather than another different reporting project.

Our understanding is that the proposed templates will be integrated with the ESMA ABS templates, which will become a regulatory standard in coming years, where further engagement with the industry is welcomed.

**7) *Investor specific question: Do you consider the measures to harmonise the NPL transaction templates with existing definitions (as e.g. included in the CRR) as well with other reporting templates (e.g. Finrep, AnaCredit, ESMA ABS templates) as beneficial for their usability? Or would you suggest further improvements?***

No comment.

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<sup>7</sup> As example of other existing data requirement, see Fitch's Non-Performing Loan Securitisations Rating Criteria ("Non-Performing Loan Securitisations Rating Criteria - Cross-Sector Criteria Report")

**8) Do you consider the indicated relevance of data fields for FDD (Financial Due Diligence) and valuation purposes (“critical”, “important” and “moderate” importance) as helpful and appropriate?**

As stated in our initial overview section, we find that the number of fields deemed “critical” for purposes of asset valuation may far exceed what is reasonably required to assess the price of a loan transaction. We have noticed that of the 475 requested fields, 313 fields are deemed critical (or 66% of the total) for purposes of conducting financial due diligence and portfolio valuation.

We consider that the indication of being “critical” should be assigned only to those fields that are absolutely necessary for purposes of pricing a loan with satisfactory statistical significance in standard valuation models. Of course, being conscious of the respective differences between due diligence processes of market participants, the high level of statistical complexity, and the data experience behind their models, market participants can request additional data if they deem it necessary.

In practice, and due to the challenges previously expressed on data disclosure rules and availability of information, it is possible that many of the fields currently deemed “critical” will not be populated by the respective NPL holder.

**9) Do you consider the indicated level of data confidentiality for data fields as appropriate?**

The “confidentiality” flag well recognises some of the challenges in data disclosure and sharing information with third parties. The challenge is to strike a balance between the full transparency required by investors and any negative implications or proprietary concerns related to the release of sensitive information about credit institutions’ lending books.

As with the country-specific fields that describe the specificities of national legal frameworks, a relevant aspect for consideration is how and how frequently the EBA envisages updating the template to reflect changes in national or EU legal frameworks relating to data confidentiality rules. A crucial pre-requisite for the proposed template to become a widely used standard is that it should be reliable with the most up-to-date information for purposes of portfolio valuation.

**10) Do you consider the indication of a data field being dynamic or static as appropriate?**

No comment.

However, as the purpose of the templates is to share information on a one-off basis, it might be relevant to explore how to facilitate any future data updates or revisions post submission of the information to NPL buyers. In that case, the indication of “dynamic” or “static” may become more relevant.

**11) Please provide any other feedback that might increase the usability of the templates for you as an investor or bank.**

In order to encourage templates use as a standard for asset disposals, its design should follow principles of simplicity, ease of use, and reliability, so that they are widely recognised by industry participants as a more valuable, easier and efficient alternative than current market practices.

**Simplicity:** The template designated for Financial Due Diligence purposes may be far too granular and may constitute a baseline standard that market participants may not use for asset disposals due to its high complexity.

EBA and KPMG should evaluate how a simpler loan disposals template (that can be used for both NPLs and PLs), that is less granular and includes only the fields that market participants consider critical for purposes of portfolio valuation.

**Ease of use:** The templates should be connected to the credit systems of banks, so that banks can populate them automatically. A manual process to populate fields in this context is not feasible due to the mass/ scope of the underlying data.

**Reliability:** The templates, at least in its current form, may have to be updated on an ad-hoc basis to reflect future changes to country and EU-level insolvency frameworks and changes in consumer privacy laws.

Additional specific comments:

**Treatment of loan portfolios that pool performing and non-performing:** In practice, the templates would not be applicable for portfolios that pool non-performing loans with re-performing, subprime and performing loans. This limits usability in c25% of total European portfolio loan sales which pool both performing and non-performing assets or only performing assets.

An additional standard that can be compared for reference are the templates currently in use by rating agencies<sup>8</sup>. Consistency with these existing standards would facilitate market use. There have been several publicly rated NPL transactions (e.g. Hefesto/Evora in Portugal, ERLS in Ireland or GACS deals in Italy). It would be useful for sellers/issuers to have similar requirements rather than another different reporting project.

We could not find the default date in the “CRE” template, would assume it should be in the “loan” tab

We do not think the enforcement tab covers bankruptcy. It refers only to receiver which is a foreclosure officer in UK and Ireland. Therefore, a bankruptcy tab would be necessary. A list of minimum info might be necessary, but this really will be jurisdiction-specific.

**12) Question related to the EBA NPL portfolio screening template: Are the references to the NPL transaction templates of help when filling in data into the NPL portfolio screening templates or when analysing them? If not – what other aspects would need to be considered?**

No comment

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<sup>8</sup> As example of other existing data requirement, see Fitch’s Non-Performing Loan Securitisations Rating Criteria (“Non-Performing Loan Securitisations Rating Criteria - Cross-Sector Criteria Report”)



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