afme/ Finance for Europe

Position Paper

Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral

8 June 2018

I. Executive Summary

AFME welcomes the European Commission's legislative proposals for further development of a secondary market for NPLs, as well as measures intended to provide more certainty on loan recovery proceedings and improve times associated with such recoveries.

AFME supports the intention to create a common set of rules for developing a true European market for NPLs, creating a common framework for conduct, and supervisory standards, of credit servicing activities, removing impediments to the purchase and management of distressed debt, and improving legal frameworks to better protect creditors from borrower's default.

As a general rule, AFME supports targeted action that can address genuine economic or supervisory problems, and the NPL issue has been identified as a key concern for European banks. At the same time, and in the spirit of less but better regulation, promoted by the current European Commission, it is important that policy makers do not attempt to fix what is not broken and instead focus their measures on the areas and market actors most in need of action.

Against this background, we would like to bring your attention to unintended negative consequences that this proposal could possibly have on a number of areas, including secondary markets for performing-loans, large corporate NPLs and syndicated loans, as well as possible disruption in the relationship between banks and their clients. We also raise issues related to undue costs resulting from the proposal that may actually hinder further development of the secondary market for non-performing loans.

In this executive summary, we provide high-level positions on some of the key aspects of the proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral (the "Proposed Directive") and provide article-specific comments in the following sections.

Scope

Certain provisions of the Proposed Directive, notably those relating to loan transfers and minimum disclosure/reporting, apply to transfers of all loans (i.e. not just non-performing loans). An overly-broad application of the Proposed Directive would likely require significant changes to existing market practice and would also be likely to have unnecessary and negative effects on disclosure, reporting and licensing with respect to performing loans and large corporate NPLs. These impacts may reduce liquidity and increase cost in segments of the secondary loan market that are currently functioning in a satisfactory manner.

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It is important that the scope of the Proposed Directive is targeted to markets where policy interventions are needed. The introduction of onerous disclosure and reporting requirements for well-functioning markets such as performing loan transactions and large corporate NPL markets risk reducing liquidity and increase transactions costs in market segments with strong transaction volumes and robust investor appetite. Or simply put, the Directive should not try to fix problems where there are none.

A thorough assessment of the potential impacts of a broad scope should be undertaken to ensure the Proposed Directive addresses its policy objectives in a manner that meets the proportionality and public interest tests, and that also avoids disruption to existing markets and practices where intervention is not necessary. We provide further detail in our comments in the "Title III (Credit Purchaser)" section below.

Additionally, we consider that the proposals relating to loan transfers should not apply to secondary trading of loans, or loans held on the trading book (e.g. securitisations). Each form of transaction has its own nuances which should be taken into consideration to minimise any potential market disruption. As well noted in paragraph 33 (page 24) of the recitals, secondary transactions don't involve the disposal of distressed credit but rather the transfer of an existing portfolio between sophisticated investors at their own risk. The recital concludes that it is "not justified to require those types of investors to apply for authorisation or to set special conditions for them". We provide further detail in our comments to the "Title I (Subject matter, scope and definitions)" sections below.

The Proposed Directive gives the impression that primary syndicated arrangements (where there are multiple original lenders) are in scope for purposes of disclosure and registration requirements (Title III, Credit Purchasers), which we find puzzling as this type of instrument is not used for portfolio disposals of distressed assets. The Proposed Directive should explicitly clarify that syndicated loan arrangements are not in scope. Complications or uncertainty in this context would have a negative and serious impact on the liquidity of the syndicated loan market, and seriously hinder loan syndications in Europe.

In recent years, the majority of the large portfolio disposals in some Member States with high levels of NPLs have been via securitisations. It is important that the Proposed Directive and the Securitisation Regulation are consistent with each other and that the provisions of the Securitisation Regulation do not result in any negative unintended challenges for NPL transactions. Securitisations generally, and the Securitisation Regulation specifically, should complement outright NPL sales, expand the universe of distressed debt investors and, where
relevant, allow governments to jump-start the NPL market. We suggest that as these two workstreams progress, regulators should keep in mind their potential effects on each other and the European NPL market as a whole.

We also encourage more clarity with respect to the general wide-reaching exterritorial effect of the Proposed Directive. For, example, it is unclear if, and if so how, the rules would apply to a non-EU credit institution that acts as a credit servicer or credit purchaser in Europe.

Credit Servicers

The provisions regarding non-bank credit servicers go in the right direction as they set high standards for the authorisation of credit servicers to operate in Europe and require credit servicers to apply the same standards (i.e., duty of care, customer protection) vis-à-vis borrowers as those of the banks whose NPLs they acquire.

The proposals seeking to facilitate the cross-border (intra-EU) provision of credit servicing activities are also encouraging. Access to third-party loan servicers is crucial to the development and growth of secondary markets for NPLs.

Credit Purchasers

The provisions regarding non-bank credit purchasers create new and onerous procedural and informational requirements for the transfer of loans, with negative timing consequences for both performing and non-performing loan disposals.

The requirements for the provision of "all necessary information" to credit purchasers is wide-ranging and goes against the purpose of the recently published EBA NPL data template[1], which is to set up a market standard for voluntary use in non-performing loan transactions. They also reverse current market practices whereby loans are traded in Europe on a "buyer beware" basis.

It must also be noted that a creditor may not possess, or have access to, the relevant information. There are also limits imposed by data protection laws and practices relating to bank secrecy, all of which may preclude the creditor from disclosing certain information to third parties.

Additionally, a substantial proportion of purchasers of loan debt in the secondary markets act on the 'public' side, meaning that they purposely restrict themselves from learning any information that is not publicly available in relation to the borrowing group. Trading 'public' side enables, among other things, market participants to trade in a borrowing group's loan debt whilst remaining clear to trade in that group's publicly listed instruments without the potential for being tainted by material non-public information. It would appear that such 'public' side trading would not be permitted under the proposed regime as the seller would be required to provide minimum levels of information (which is likely to be non-public in nature) to the buyer as a matter of law. Without the ability to trade in this capacity many participants' business models and ability to invest in the secondary loan market would be significantly compromised, which may lead to a withdrawal from the market, thereby negatively impacting liquidity.

Likewise, provisions creating new reporting obligations for the transfer of credit agreements, or for the enforcement of credit obligations, create additional complexities and burdensome requirements for the transfer of loans. It is unlikely that the potential benefits of such burdensome requirements outweigh the costs and uncertainty for market participants and competent authorities of compliance, reporting, and processing the information.

[1] The EBA's data template, also a policy initiative of the Council's NPL Action Plan, was published in December 2017. See AFME's comments to the draft EBA template on this link: https://www.afme.eu/globalassets/downloads/consultation-responses/afme-npl-eba-transaction-templates.pdf

The Directive does not cover credit originally issued by non-credit institutions, and although these may currently represent only a minor part of the market, the new Directive will create incentives for increased non-regulated credit intermediation (shadow banking) and may result in an uneven playing field.

Accelerated Extrajudicial Collateral Enforcement (AECE) Mechanism

AFME welcomes the introduction of the AECE Mechanism across the EU, especially given that some Member States do not have similar provisions in their legal frameworks.

It is important to clarify that enforcement of collateral is a process that banks do not trigger unless they are convinced that it is the last resort for recovering value from an NPL. In general, collateral enforcement disrupts the relationship between the bank and its client, undermines restructuring efforts, and can lead to destruction of value and reputational damage.

However, many Member States already have in place effective extrajudicial collateral enforcement processes, in various forms. The existence of these processes has the effect of creating a backstop to forbearance, workout and restructuring efforts of the bank, thus lenders and borrowers alike must adjust their behaviour to them.

The provisions relating to the AECE mechanism may have a material impact on banks. The proposal may require Member States to amend well established extrajudicial collateral enforcement measures under national laws to comport with the provisions of an AECE. In certain Member States, this would introduce material new enforcement conditions, such as requiring a valuation report in each case, and mandatory minimum prices (for private and public auctions), which may result in a requirement for more than one round to sell collateral. The AECE mechanism, as currently contemplated, might also force the parties to agree to enforcement notice periods before all of the issues raised above can be adequately analysed and resolved.

Such changes could undermine existing effective extrajudicial collateral enforcement processes. If the AECE is perceived as substantially more advantageous for either lenders or borrowers, this could also undermine their incentives to forbearance, workout and restructuring efforts. If perceived as substantially more advantageous for lenders, in combination with other measures facilitating the secondary market, it could attract aggressive credit purchasers who are not interested in maintaining the relationship with the client, but instead may enforce collateral too quickly or easily. If perceived as substantially more advantageous for borrowers, they could be discouraged from working with the lender to resolve the situation, thus undermining workout and restructuring efforts, which are proven to be the most effective methods of loan recovery.

Therefore, it should be made clear that the AECE mechanism does not replace or supersede national enforcement mechanisms but is an additional enforcement measure which can be used at the discretion of the creditor (with borrower consent). This would ensure that the AECE mechanism delivers its benefits in those Member States where an enforcement of collateral requires the involvement of courts and which do not already provide creditors with a directly-enforceable title to collateral without such court involvement. However, this should be contingent on the requirement that such provisions do not harm well-established and effective enforcement systems.

II. Title I (Subject matter, scope and definitions)

Subject Matter (Article 1)

The rules and requirements relating to non-bank "credit servicers" would likely apply to facility agents and security agents, or to entities such as fund managers or investment advisors (depending, of course on the services that they provide for their clients). We do not believe that these requirements should apply to these entities, nor are they necessary or appropriate considering these parties' roles in this context (i.e., these parties do not generally perform all of the duties associated with a "credit servicer" and may not be involved in non-performing loans at all). It is possible that any unnecessary or onerous obligations imposed on these parties might have a chilling effect on their desire or ability to perform their duties and provide adequate services to their clients.

Scope (Article 2)

It is unclear if, and if so how, the rules would apply to a non-EU credit institution that acts as a credit servicer or credit purchaser in Europe. More clarity is required with respect to this point, and also with respect to the general wide-reaching extraterritorial effect of the Proposed Directive.

Articles 2(1)(a) and 2(10(b) both refer to a "credit agreement issued by a credit institution established in the Union . . .". It is unclear exactly what is meant by "issued" in this context. Additionally, in certain jurisdictions, e.g. Italy, there's a distinction between "transfer of credit" and "transfer of credit agreements" that should be taken into consideration.

It is also unclear what effect these provisions have, or are intended to have, on primary distributions and syndicated loan transactions. Transactions where there are multiple original lenders (including credit institutions and other non-credit institutions) appear to be captured, but it is unclear how such transactions will be affected by the Proposed Directive.

Further clarity is also required with respect to the European syndicated loan markets. We don't believe the Proposed Directive should apply to syndicated loan arrangements, as this would likely have negative effects on structure, timing and disclosure/reporting obligations. For example, it would be quite odd for some syndicate members to be subject to the Proposed Directive while others are not so bound. In this case, only some investors would receive the information required under the minimum disclosure/reporting requirements while other investors might not receive such information. Unnecessarily complicated procedures and uncertainty might discourage or seriously hinder loan syndications in Europe. We strongly suggest that the Commission exclude syndicated loan arrangements from the Proposed Directive

An example of potential difficulty would be a situation where a credit institution buys from a non-bank lender (i.e., with no disclosure and no reporting) and then decides to sell on to a non- bank purchaser. Under these circumstances the selling credit institution would be required to provide information to the credit purchaser which it did not receive from the original lender.

As stated above, we believe that these provisions should only apply to primary distribution of the non-performing loan from the original lender and should not apply to secondary trading of the loan between third parties. Any application of the Proposed Directive to such secondary trading would have a negative effect on liquidity and trading of European NPLs (see our comments on Article 19). Such application would also undermine paragraph 33 (page 24) of the recitals, which states that since buyers on the secondary market are sophisticated and are not creating new credit (i.e. they are buying existing credit at their own risk), they do not cause prudential concerns and their potential contribution to systemic risk is negligible. The recital concludes that it is "not justified to require those types of investors to apply for authorisation or to set special conditions for them . . ." . One of the stated objectives of the proposal is to "remove impediments to transfers of NPLs from banks to other entities"[2], but application of the Proposed Directive to secondary trading of NPLs by third parties would not further that objective.

In addition, we strongly suggest that the Commission undertake an impact assessment related to the effects of the Proposed Directive on liquidity in the European NPL market, as well as on the overall market impact of a broad scope for application of the Directive. We believe that this would be very helpful and is necessary if the Commission intends to most effectively implement its stated goal of strengthening secondary markets for European NPLs.

Finally, we make the following points:

(a) As stated in the executive summary, it is important that the Proposed Directive and the Securitisation Regulation are consistent with each other and that the provisions of the Securitisation Regulation do not result in any negative unintended challenges for NPL transactions. It should be clear if, and if so how, the Proposed Directive applies to securitisations;

(b) Article 2(1)(b) states that the credit purchaser will "assume[s] the creditor's obligations". Most loan transfers under English law are assignments and there may be other methods of "assuming" a creditor's obligations. Please clarify the intended scope of this provision;

(c) Article 2(4)(b) refers to a situation where a "credit agreement is replaced . . .". It is unclear what "replaced" means in this context. Our view is that this would not relate to refinancings, as that result in the creation of an entirely new loan. Please clarify exactly what kinds of arrangements (i.e. restructuring, amendments?) this provision is intended to cover.

Definitions (Article 3)

As an initial matter it would be helpful for the Proposed Directive to define "NPL" either within the Directive or by referring to a corresponding and relevant external definition.

[2] See page 2 of the impact assessment related to the Proposed Directive: http://ec.europa.eu/finance/docs/policy/180314-non-performing-loans-directive-summary-impact-assessment_en.pdf

Secured Credit Agreement is defined as "a credit agreement concluded by a credit institution or another undertaking authorised to issue credit, which is secured by [specified collateral]". We would like further clarity on what happens if, under the laws of its relevant jurisdiction, that other credit institution does not need to be "authorised" in order to issue credit, and therefore it is not "authorised" to do so? Are credit agreements involving those kinds of entities not in scope?

III. Title II (Credit Servicers)

Art. 5

It should be specified that all obligations about consumers' protection currently applicable to banks should also be applicable to the credit servicers under the Directive.

Register of Authorised credit servicers (Article 8)

Is this requirement only for "home" Member States, or are "host" member States also required to keep track of all credit servicers in their territories (i.e., those that register in the Member State as well as credit servicers that provide services under a "passport" pursuant to Article 11)?

IV. Title III (Credit Purchasers)

General Scope

We note that Title III applies to all loan transfers made to non-banks, including transfers of performing loans and large corporate NPLs. It is important to understand and address any negative or unintended consequences from having this Title apply to performing loans or large corporate NPLs. It is also important that any application of this Title to performing loans or large corporate NPLs is necessary to further the stated goals of the Proposed Directive, is proportionate to their role, if any, in helping to reduce European NPL levels, is non-disruptive to existing market practices with respect to those instruments and does not serve to fix or affect markets or markets practices that are already functioning in a satisfactory manner.

We understand that one of the Commission's key concerns, and one of the main reasons for the proposed application of the new regime to both performing and non-performing loans, is that the additional cost of either separating performing from non-performing assets held within a single portfolio or dealing with two separate regimes when disposing of that portfolio may act as a deterrent to potential purchasers. While it is correct that certain structured products rely on bundled portfolios of loans and in those circumstances additional costs may be incurred in separating them, the separation and sale of performing and non-performing assets which had previously made up a single portfolio should often not be administratively burdensome or costly to either buyer or seller and is often desirable (for example, certain market participants will specify that they will only wish to purchase the non-performing assets in a wider portfolio whilst others will only purchase the performing assets).

To the extent that certain structured scenarios may incur additional costs, we would suggest that this would be counter-balanced by the additional administrative costs incurred by participants in the market for performing loans and large corporate NPLs who will need to adopt an entirely new regime to their existing portfolios. More

importantly, it should be viewed in relation to the deterrent effect that the new market regime is likely to have on participants in the primary and secondary markets for loan debt. This is particularly relevant in relation to the removal of the 'buyer beware' nature of loan sales, which may lead to an overall decrease in liquidity and market activity, the cost and impact of which cannot be quantified.

It is also unclear how data protection laws or practices related to banking secrecy will be affected by the obligation of the bank to provide the purchaser with information on the purchased loan portfolio. There should be more clarity on the notice and information obligations. In particular, these rules should consider, and be consistent with, European data protection and banking secrecy laws.

Right to Information regarding the credit agreement (Article 13)

In general terms the Directive introduces a series of provisions and obligations for credit sellers that may hinder the development of the NPL secondary market. The minimum disclosure requirements in Articles 13(1) and 13(2) may have a negative effect on timing, and compliance may also be difficult for creditors if they do not have possession of, or access to, all of the relevant information. These requirements could also result in such significant changes to existing market practice that they act to disincentivise loan transfers. Consideration should be given to any negative timing implications on loan transfers that might result from the notice and information requirements in Article 13, and the minimum disclosure requirements should be qualified to exclude any information that the party does not have and cannot reasonably be expected to obtain. It should also be made clear whether these provisions apply only to full loan transfers, as opposed to transfers of rights or synthetic arrangements.

We also have the following more specific questions/comments:

- Title II states that the requirement to report is on the "credit institution…that transfers…". Does that mean there is no obligation to report if the selling entity is a non- credit institution? Why should there be a distinction?

- With respect to Article 13(1), loans are traded in Europe on a buyer beware basis (see clause 21.2 of the LMA T&C's). It appears that the Proposed Directive seeks to reverse this position, and only in respect to a sale of loans (i.e., what about other assets a credit institution might intend to sell)? We would strongly recommend a detailed impact assessment on liquidity in the performing loan markets of any proposal to reverse the buyer beware principle. Reversing such a fundamental contractual principle would be highly disruptive for all market participants and would risk serious unintended consequences. If banks cannot trade loan assets without fear of future liability for non-disclosure, that may create a bias in favour of other financial assets (e.g. bonds) which continue to trade on a buyer beware basis. That outcome would restrict choice and access to capital for borrowers.

- Also, as noted above, there could be a situation where a credit institution buys a credit from a non-bank lender (i.e., with no disclosure and no reporting per Article 13(1)), and then decides to sell the credit on to a non- bank purchaser. In this case, according to Art 13(1), that credit institution would then have to provide information to the

credit purchaser which it didn't receive from the original lender (who was a non-bank lender and wasn't required to provide the information to the credit institution).

- With respect to Article 13(2), our initial question is what is the "value" of the credit agreement? The OPB or the level as to where the loan is marked?

- We don't believe that imposing additional reporting requirements when loans are transferred to a credit purchaser facilitates quicker and more efficient disposals of NPL's. The introduction of an additional regulatory burden would seem to make disposals more cumbersome rather than less. We understand that there are concerns related to shadow banking activities in this area but we do not believe that the Proposed Directive is the appropriate place to address those concerns. These provisions would be more appropriate for monitoring shadow banking rather than having anything to do with NPLs. Certain markets (e.g. the leveraged loan market) are already dominated by institutional investors and introducing additional regulatory burdens on these participants is likely to adversely impact liquidity for performing leveraged finance borrowers.

- Article 13 (2) (c) requires a creditor that transfers a loan to inform the relevant competent authority of the address of the debtor, and Article 13(3) requires the relevant competent authority to provide that information to the competent authority where the borrower is established or resident. However, in the event that the Borrower has moved or made other changes to its residence, there is no obligation for the borrower to inform the creditor of this fact. Therefore, any information held by the creditor may be incorrect or incomplete. We suggest that the requirement for the creditor to provide this information be removed from the Proposed Directive, as we do not believe that it is sufficiently relevant to the issues raised in the Proposed Directive nor to its stated purpose.

Technical Standards for NPL Data (Article 14)

We note that the EBA has developed NPL Data templates, and it is possible that these templates will be incorporated into any related technical standards. If so, there is a concern that they may too granular and also not suitable for performing loans. Implementation of such templates would mean enormous costs for financial institutions, since it may be very challenging to populate the requested information. The data related to non-performing loans may not be readily available in digital form (i.e., the information may only be available in paper form), may only be partially available or, in a worst-case scenario, may not be available at all.

Article 14(1) refers to "credit exposures in the banking book". Loans held in a banking book are held by the bank on a "hold to maturity" basis, which means that those loans are not intended to be traded or used in certain of the bank's market activities. Other loans, held in the trading book, are loans that may be used for market making, securitisations, secondary trading or other ongoing arrangements. It is unclear whether the reference to credit exposures in the banking book is intended to exclude the types of loans that are typically held in a bank's trading book, but the answer to this question would obviously have important implications for banks going forward.

Also, this Article seems to only apply to creditors that are credit institutions whereas Article 13(1) applies to all creditors. Is this distinction intentional?

If the intention is to only impose a standardised form of data tape to be populated by sellers of large, granular SME or consumer type portfolios, this should be explicitly stated.

Obligations of credit Purchasers (Article 15)

With respect to Article 15(1), presently there are many loans (e.g. fully drawn term loans) which either a non-bank lender or a non-EU bank lender is permitted to purchase. This Article appears to introduce a new additional requirement under which these entities must appoint a representative domiciled or established in the Union who will be "fully responsible for compliance with the obligations".

What is meant by that requirement with regard to the legal status of the "representative" - does the representative need to be a legally incorporated presence of the non-bank lender, or a "process agent" type entity, or something else? Again, these requirements would seem to make it more difficult and expensive for these lenders to purchase loans in the EU and would accordingly make disposals of loans more, rather than less, cumbersome. This uncertainty, coupled with the introduction of additional compliance requirements (with no obvious advantage) will likely disincentivise market participants from engaging in this activity (at least in the context of NPLs), and will likely have a negative effect on liquidity for these instruments, which would be antithetical to the goal of strengthening secondary markets for European NPLs.

With respect to Article 15(2), what effect would this provision have on Member States' existing national lender licensing laws? Will these be dis-applied or revoked in this context?

Representative of credit purchasers not established in the EU (Article 17)

Please note that the comments above relating to Article 15(1) and 15(2) should also be applied to the corresponding sections of Article 17.

Credit Purchasers directly enforcing a credit agreement (Article 18)

Is the new requirement in Article 18 to communicate with competent authorities before taking any enforcement action only applicable if that purchaser wishes to avail itself of the proposed new accelerated extra judicial enforcement procedure? We assume this must be the case, because if not there would be a negative impact on the liquidity of NPLS's as their enforcement in certain jurisdictions would be made more difficult and cumbersome.

Please refer to our comments on Articles 13(2)(c) and 13(3) relating to our views on any requirement for the creditor to provide information on the residency of the borrower. In the context of Article 18, the credit purchaser might also not have such information.

Transfer of a credit agreement by a credit purchaser (Article 19)

Article 19 seeks to impose a reporting obligation on sellers where there is a transfer of a loan between non-credit institutions. What is the purpose in this context? This article seems to impose complex reporting requirements with the intention of monitoring shadow banking activities, but would provide little value in monitoring the functioning of the European NPL market. We would expect this to also have a negative effect on liquidity and trading of European NPLs.

Again, uncertainty coupled with reporting obligations and requirements that do not appear to address the build up of NPLs on banks' balance sheets or many of the other stated purposes of the Proposed Directive may disincentivise potential purchasers of European NPLs, who night decide that it is more beneficial to place their funds elsewhere. This would be a direct impediment to increasing NPL trading and helping to reduce the stock of European NPLs. It might also have unintended consequences, such as incentivising parties to originate more loans in the shadow banking sector.

This article also gives the impression of undermining the language in paragraph 33 of the recitals which states that "buyers on secondary markets are sophisticated investors . . . it is therefore not justified to require those kinds of investors to apply an for authorisation or to set special conditions for them to engage in such activities".

V. Title IV (Supervision)

AFME believes that that it would be burdensome (both from a timing and an administrative perspective) for credit servicers to submit every outsourcing agreement to competent authorities for review and, considering the potentially large number of such agreements, it would likely be more burdensome for competent authorities to review each such agreement.

VI. Title V (Accelerated Extrajudicial Collateral Enforcement)

General Comments

As an initial matter, we note that both the Proposed Directive and other pronouncements have made it clear that national insolvency procedures will override any enforcement rights held under an AECE. It is unclear how this will work in practice and what effect it would have on the effectiveness of any AECE mechanism. We temper our comments below with the caveat that it is difficult to provide final comments before we fully understand this interaction and its impact on the overall effectiveness of the AECE. Please see our comments below on Article 32 (Restructuring and insolvency proceedings).

Since the AECE mechanism, in some respects, differs materially from existing European national collateral enforcement mechanisms, it is important to clarify that existing national enforcement mechanisms remain unaffected and that the AECE mechanism does not replace or affect such existing measures.

Member States should implement the AECE mechanism as an additional enforcement mechanism that exists alongside any other, national, enforcement mechanisms, so that creditors have a choice amongst all alternatives, Otherwise, AECE may have the unintended consequence of having a negative impact on markets in countries that already have efficient and effective enforcement mechanisms.

Conditions for voluntary use of AECE (Article 23)

Under the laws of some Member States, an enforcement of collateral is only possible when the collateralised loan is overdue. The Proposed Directive allows the parties to define enforcement event, which might result in enforcement taking place before the secured loan is due. Different starting points for enforcement may lead to two types of collateral, which might make corporate restructurings vulnerable to disturbances. In Member States with a well-developed restructuring system this might reduce recovery rates for some banks. The Directive could explicitly state that in no case will the "enforcement event" occur at an earlier point of time than an enforcement can take place under the relevant laws of the Member States (See Article 23(a)).

We note that if the creditor is obliged to notify the borrower within 4 weeks of the enforcement event, as set forth in Article 23(c), it would be possible for the borrower to immediately file for insolvency. During this time, a stay of individual enforcement would likely be initiated, which would block enforcement of the collateral under the AECE (and in complex cases could even result in a world-wide asset freeze). Under these circumstances, notice of an enforcement that is (or could be) effectively blocked may be meaningless.

More generally, we believe that the conditions set out in Article 23 may be too strict (for example, the above-mentioned 4 week notice period in Article 23(c)). Typically, enforcement events mark the start or intensification of workout efforts, which normally take months at least (and often longer). Enforcement within four weeks of the enforcement event will be a rare occurrence, even in insolvency proceedings. Such a short period will provide an incentive to initiate enforcement procedures too early or to cut corners, which may adversely affect workout prospects. It will also be difficult, at the beginning of the credit relationship (which is often when collateral is provided), to determine and negotiate an appropriate notice period after enforcement.

Moreover, an extension of the period for the execution of the payment in cases where the borrower has paid at least 85% of the loan (Article 23(1) subpara. 2) seems to be an inappropriate concession for a business borrower, particularly if the creditor already knows that the borrower has exhausted its resources in making the 85% payment, or otherwise has a reasonable basis to believe that the borrower will default on the remaining indebtedness. Another consideration would be whether there is still any collateral available that is enforceable against the remaining 15% of the debt. If so, there should be no discharge or forgiveness of the remaining 15%.

To make the AECE instrument more effective, we recommend a more generous notice period that is calculated by counting back from the intended enforcement sale and not start from the default event. The proposal already includes a requirement for 10-day advance notice (prior to a public or private sale). Different enforcement dates for different asset classes could be considered where appropriate (for example, real estate warrants a longer notice period than perishable goods).

It would also be helpful to have an objective concept of a "reasonable period of time" for execution of payment and for taking reasonable efforts to avoid the use of the AECE mechanism. Perhaps this could be accomplished by fixing a specific number of days.

Enforcement (Article 24)

Firstly, we agree with the concept of Article 24(4)(b), which requires that, if a valuation is required (which may not always be the case, see below), the valuation be conducted by an independent valuer. It is very important that in all instances the valuer is a third party with demonstrable independence from both the creditor and the borrower. We also appreciate the flexibility of being able to enforce through private or public auction, as we note that public auctions are not generally appropriate for corporate loans involving complex or non-tangible assets. In addition, public auctions can often be subject to disruption due to external factors.

Secondly, requiring a separate valuation for the purpose of each enforcement may not necessarily be proportionate in all circumstances. A valuation seems a prudent measure in case of a private sale but a properly organised public auction may, as a matter of principle, be assumed to result in the realisation of the enforcement value. Additionally, suitable valuations may already be available, or the cost of valuation may be too high compared to the value of the collateral. It should be noted that the cost of valuations will typically be borne by the business borrower.

Art. 24.4 (c) requires that the 'fair and realistic' valuation of the asset is conducted. We consider that "fair and realistic" is a subjective concept. A more objective and quantifiable definition would be useful in order to provide adequate certainty to market participants and AECE debtors and creditors.

Furthermore, making the appointment of the valuer dependent on the agreement of the borrower may unnecessarily delay enforcement proceedings. For example, if the borrower does not agree (i.e., is non-responsive), the creditor will probably only be able to proceed by involving a judicial court. This would mean that if the borrower remains passive the enforcement proceedings will likely become judicial. This may well be an unintended aspect of the proposal, given the extra-judicial purpose of the AECE mechanism. Perhaps the parties could agree a "short-list" of acceptable valuers at the signing of the contract.

We recommend removing any requirement for a valuation in the case of a public auction and providing a principle-based exception to creditors in case of a private sale. In the event that the creditor invokes the exception, the borrower should have a right to seek an injunction from the court requiring a valuation as prescribed by the proposal,

Auctions and Sales (Public Auctions (Article 25)/Private Sales (Article 26)

Articles 25 and 26 both require the creditor to notify "any third party with an interest in or right to the asset". This could lead to manipulation and open-ended litigation at a later stage, with such third parties emerging years later or with false claims, which may frustrate the process or result in excessive legal costs. Both articles in principle (subject to limited exceptions) require the purchase price is at least 80% of the valuation in the first attempted forced sale. Member states may accept a lower price at a second attempt. This is too strict for the public auction. A properly organised public auction should be assumed to result in the realisation of the enforcement value.

Art. 25(1)(b) and Art. 26(1)(a) require that the creditor make "reasonable efforts" to notify and attract potential purchasers. Acceptable "efforts" should be enumerated, or

this requirement should otherwise be made more objective, so that parties can avoid arguments or litigation over reasonableness or other aspects of any efforts in this context.

Art. 25(1)(c) and Art. 26(1)(b) should clarify that they should be limited to interests and rights known to the creditor or which are registered in publicly accessible registers.

In Article 25(1)(f) and Art 26(1)(e) there should be no minimum price because, as we've said, the price in a public auction should be set by the market and the auction itself, while in a private auction, minimum price and disposition of any debt remaining after enforcement will be subject to national laws. In addition, an excessively high minimum price may make it less likely that assets are successfully sold and therefore prevent the creditor from realising value from the secured asset. There should also be a more objective or quantifiable description of what is meant by "imminent deterioration of the asset".

Member States should ensure that business borrowers grant access to the relevant information regarding the assets (i.e., pictures, floor plans, building permits, etc.) in order to permit the creditor to advertise the asset before the auction.

If applicable, it should be specified that the asset should be delivered to the buyer free of inhabitants and goods, unless the asset is occupied under a valid and legal lease contract. In the case of an eviction, neither the creditor nor any purchaser should bear the costs.

Right to Challenge enforcement (Article 28)

The AECE mechanism might not be as beneficial for banks as anticipated. It can only be used for "business borrowers" and not for "consumers", and only plays a role in cases where an enforceable title is necessary to begin enforcement proceedings. In some Member States banks need such title for the foreclosure of land charges and, in very rare cases, for pledges on rights. For land charges in some Member States the law already provides a direct enforceable title (e.g. for Germany the Zwangsvollstreckungsunterwerfung).

While it is not clear whether this is also the situation in Member States with high NPLs, Article 28 sets out that the business borrower must have the right to challenge the enforcement before a court. As a consequence of any such challenge, involvement of the courts becomes inevitable at some stage, which would jeopardize the efficiency of AECE mechanism, particularly in Member States with lengthy judicial procedures.

Forbearance will largely take place before it comes to restructuring/insolvency. However, forbearance measures usually slow down the enforcement of a bank's claims/collateral, while the AECE mechanism is meant to speed it up. It is important that the AECE mechanism is well-integrated with the restructuring and insolvency frameworks of the individual Member States, as well as any relevant forbearance measures (link to EBA Guidelines and ECB Guidance). It might be dangerous to allow the holder of an instrument that is subject to AECE to begin enforcement proceedings while holders of traditional collateral are still precluded from taking any such action (particularly where, as would likely be the case, there are not enough assets available for all similarly situated creditors to be paid in full).

Restitution of the Exceeding Amount (Article 29)

Before any reimbursement is made to the borrower, it should be clarified that all expenses (of any type), related to the transfer of the relevant asset, are subtracted from any positive difference between the sum outstanding and the proceeds from the sale of the asset

Settlement of the Outstanding Amount (Article 30)

A debtor's full discharge from further repayment obligations, when the recovered value from the sale of assets is lower than the value of the outstanding loan, might encourage borrowers to act irresponsibly and increase speculative behaviour among borrowers, especially when asset values decrease.

Moreover, a possible discharge of debts in a case where the recovered value is lower than the debt amount would delete the efficiency of the security, as the creditor may be disincentivised from using the AECE mechanism. The creditor's claim would no longer be guaranteed and its position might even be worse than if it hadn't agreed to use the AECE mechanism. The creditor's risks might increase leading to a possible increase in interest rates and/or restrictions on credit distribution.

Restructuring and insolvency proceedings (Article 32)

It may be impossible to distinguish between restructurings in order to apply the "without prejudice" condition. Also, given the fact that insolvency and pre-insolvency proceedings would prevail over the AECE mechanism, the collateral would only be enforceable as long as the borrower is not in financial distress.

It is important that the Proposed Directive consider, and is consistent with, any related provisions of the proposed Insolvency Directive. In particular, stay provisions, creditor rights and enforcement mechanisms, among other areas, must work together in a way that decreases confusion or uncertainty. As noted in our comments to Article 23 above, once a debtor receives notice of impending enforcement from the creditor, it might be incentivised to institute pre-insolvency or insolvency procedures in order to take effect of stay of enforcement or other provisions of insolvency laws that could frustrate the creditor's ability to enforce under the AECE.

Notice and information requirements, creditor hierarchy and other imbedded aspects of national insolvency regimes could also frustrate the effectiveness of the AECE mechanism. In this environment, it would be difficult for creditors to properly gauge the utility and effectiveness of entering into an AECE, particularly when coupled with the right to challenge enforcement under Article 28. It is easy to imagine creditors holding AECEs being held up in litigation, and being subject to stays of enforcement, in relation to an instrument that is meant to provide certainty and speed up enforcement of collateral.

The provisions relating to AECE should also be consistent with any other potentially applicable areas of law (e.g., contract law, data protection, collateral, property law, etc.)

Data Collection (Article 33)

Member States should be required to provide credit institutions (free of charge) with access to all public and private data registers so that they can perform proper due diligence.

VII. Title VI (Safeguards and duty to cooperate)

Modification of the credit agreement (Article 34)

This Article would likely require a creditor to notify the customer about every modification of the relevant credit agreement, including those that are small, insignificant or otherwise immaterial.

We note, however, that customer notifications in the loan context are already sufficiently regulated within other specific legislation.

In particular, we refer to the following legislation:

- Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property
- Directive 208/48/EC on credit agreements for consumers
- Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

Moreover, it is not clear where the article give the consumer the possibility to lodge complaint in case of modifications by consent of the consumer or by operation of law.

We consider that any benefit of including additional prescriptive notification provisions is outweighed by the costs associated for creditors and competent authorities. To avoid overlap and duplication of this article with existing legislation and considering the excessive and unnecessary burdens on the creditor, we suggest deletion of Article 34 altogether.

VIII. Title VII (Amendment)

Amendment to Directive 2014/17/EU (Article 38)

This Article inserts the following language into *Directive 2014/17/EU (Article 38) (as new* Article 28a):

> *If a creditor assigns to a third party its rights under a credit agreement (or assigns the agreement itself) the consumer shall be entitled to plead against the assignee any defence which was available to him against the original creditor. (including set-off if applicable)*

If, in this context, there are any national "soft-law" regulations (i.e. regulations that are only applicable to borrowers when the creditor undertakes them), such national soft-law regulation should bind the credit purchasers only if they agree to be so bound.

After you have had a chance to review and consider our comments and questions, the AFME NPL group would greatly appreciate an opportunity to meet with you to discuss the Proposed Directive and our views.

Please feel free to contact Gary Simmons at +44 203 828 2723 (gary.simmons@afme.eu) or Julio Suarez at +44 203 828 2726 (julio.suarez@afme.eu) if you have any questions or need any additional information.