Consultation response

Development of Secondary Markets for Non-Performing Loans and Distressed Assets and Protection of Secured Creditors from Borrowers' Default

October 2017

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the consultation related to "**DEVELOPMENT OF SECONDARY MARKETS FOR NON-PERFORMING LOANS AND DISTRESSED ASSETS AND PROTECTION OF SECURED CREDITORS FROM BORROWERS' DEFAULT**".

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.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

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Executive Summary

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 members are not currently affected by excessively high levels of NPLs, AFME agrees that building a deeper secondary market for NPLs can contribute to the acceleration of the NPL adjustment process as banks continue their internal processes related to restructuring their NPL portfolios.

In our response, we have identified a number of market impediments, some of which have also been identified by extant research publications[1] and many market participants. These include:

(i) the quality of insolvency frameworks and national judiciary systems;

(ii) unharmonized licensing and regulatory regimes related to the ability of non-banks to buy or manage NPLs;

(iii) the quality and access to data on NPLs;

(iv) tax disincentives relating to the transfer of loans and loan loss deductibility;

(v) costs of recovery/servicing (including transaction costs such as registry);

(vi) subdued securitisation market; and

[1] See FSC, IMF, ESRB, ECB (1) and ECB (2) and EBA.

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(vii) lack of economies of scale for small banks to dispose of distressed assets.

To tackle these impediments, AFME supports the development of an EU Regulation that seeks to standardise sale process, approach and organisational need for sellers and buyers. We suggest such EU Regulation can cover:

- Harmonisation of requirements for the participation of non-banks, which would allow a wider number of participants to own or manage NPLs;
- Evaluation of the requirement for non-domestic investors to have a local partner to buy a portfolio and operate in a particular jurisdiction;
- Restrictions or prohibitions on aggressive, unfair or oppressive collection or debt enforcement practices;
- Streamlining registration and transfer requirements of loan transactions.

Additionally, there are other measures that can contribute to address the existing impediments.

In this regard, we encourage EU lawmakers to:

- continue their efforts towards harmonisation of minimum standards of insolvency proceedings, as proposed by the Commission's Directive on insolvency reform[2].
- Harmonise data protection laws to facilitate the transfer of loan information from sellers to potential buyers, safeguarding consumers' protection and privacy. The upcoming General Data Protection Regulation (GDPR) provides good progress in that direction;
- leverage information already provided by banks through existing channels to improve the availability and comparability of data on NPLs;
- Simplify withholding tax procedures;
- recognise the practical circumstances of purchasers of NPL portfolios especially when needing to undertake due diligence when purchasing with a view to securitisation under the new securitisation framework;
- evaluate measures that support harmonised transfer tax regimes, particularly with respect to double taxation (i.e., taxation on both the purchase and sale of loans), and stamp duty on loan transactions. Measures can be taken in the form of guidance;
- instruct supervisors to conduct data compilation of EU portfolio transactions and loan outcomes to track market development, benchmark national loan enforcement regimes and help market participants to make a more informed judgement when choosing a third-party loan servicer provider to partner with. Public disclosure, however, should consider the appropriate form of data aggregation so that information deemed price sensitive or confidential is not widely disseminated; and
- continue progress with the implementation of IFRS9[3] (expected for 1 January 2018) to enable the recognition of credit losses and sale of NPLs by banks with consideration of any cliff edge effects that its implementation may generate[4].

With respect to the proposed EU accelerated loan security, we believe that this instrument would be helpful to better protect creditors from borrower default, as it will provide more certainty on loan recovery proceedings and improve times associated with such recoveries. However, lawmakers should consider in its design and implementation, consistency with existing insolvency regimes and any legal guarantees or other credit support that might already be in place.

We believe that these measures, in addition to some of the initiatives of the Council's action plan on NPLs, will contribute to developing and deepening the European secondary market for NPLs.

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[2] Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU

[3] Standard for accounting periods will be implemented beginning on or after 1 January 2018

[4] According to the EBA's impact assessment on the implementation of IFRS9, the estimated increase of loan loss provisions for banks stands at a median of 20 % (and up to 30 % for 86 % of the respondents) compared to their current levels under IAS 39. Implementation should consider possible cliff edge effects and implications that the accounting migration may generate.

AFME and its member firms continue to stand ready to work with the Commission on well-defined solutions aimed to develop the secondary market for NPLs.

SECTION I: SECONDARY MARKET FOR LOANS

TRANSFER OF LOANS

1) 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?

Yes, certain aspects of the existing European secondary markets for NPLs can definitely have an impact on the management and resolution on NPLs and prices. The current size, liquidity and structure of the NPL markets, however, are a result of relevant structural impediments that we describe below.

Fragmentation and uncertainty caused by the current structure of European NPL secondary markets help to create an environment which engenders various impediments to strengthening and deepening such markets.

Such impediments include:

i) quality of and access to data on NPLs and their underlying assets;
ii) quality of judicial, legal and insolvency frameworks;
iii) subdued securitisation market;
iv) lack of licensing and regulatory regimes to enable non-banks to own and manage NPLs and enlarge the market of potential investors or servicer providers;
v) transfer costs and tax disincentives relating to the transfer of NPL portfolios and loan loss deductibility;
vi) lack of economies of scale for small banks, heterogeneity of loans and possible role of national AMCs in that context;
vii) costs of recovery/servicing (including, in some cases, lack of loan service providers);

We believe that the obstacles to deeper secondary markets for NPLs related to the size and structure of the European NPL market are very significant and support the attempt to address these obstacles.

<u>Size and Depth: growing volumes but heterogeneous market depth by countries</u>

The volume of European secondary market in NPLs totalled[5] €80bn in 2016 (or c€120bn including loan sales that include performing and non-performing portfolios), accumulating a total of €153bn between 2015 and the first half of 2017. This volume of NPL sales is relatively low compared to the total stock of NPLs of €1tr. According to the EBA[6], since 2013, NPL transactions (including securitisation) were recorded in only 13 (CZ, DE, GB, HR, IE, IT, LV, NO, PL, PT, RO, SI, ES) out of 27 European countries surveyed.

For Central and Eastern European (CEE) countries, the EBRD[7] estimates a total of c4.5bn EUR in NPL portfolio loan sales in 2015, with Romania being the most active market in the region. More recently, NPL sales in CEE totalled €4.1bn in 2016, which accounted for 7.7% of the NPL stock as at June 2016 (€52.6 Bn). In CEE markets, which in some cases are still at early stages, are characterized by small

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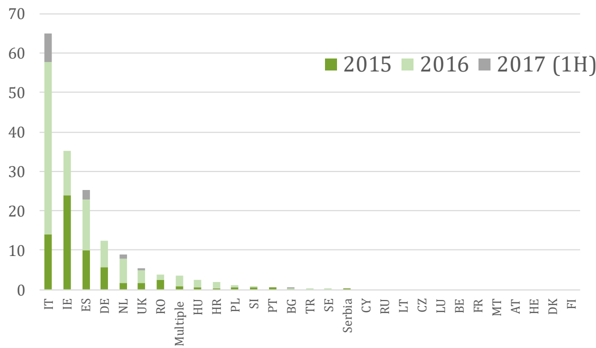
[5] PwC estimates that in 2016, European loan sales accumulated €120bn of which around €80bn were NPL volumes. In 2013, total loan sales accumulated €64bn of which around €47bn were NPLs.
[6] EBA report on the Dynamics and drivers of Non-Performing Exposure in the EU Banking sector. https://www.eba.europa.eu/documents/10180/1360107/EBA+Report+on+NPLs.pdf
[7] NPL Resolution: Prerequisites for Loan Portfolios Sales in the CESEE region.

size[8]; there is a relatively lower appetite from international investors, also due to regulatory constraints (for example having to establish a local company).

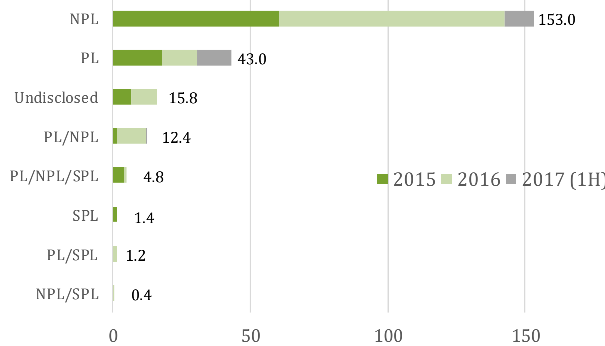
KPMG data suggests that 74% of the total loans sales completed between 2015 and 1H 2017 in Europe represented either non-performing or a mixture of non-performing loans with other risk exposures (i.e. with performing, subprime, or re-performing loans), as investor appetite for NPLs, search for yield, and willingness to diversify loan pools by risk performance remains high (see chart 1.2)[9].

1.1 EU NPL portfolio transactions by countries (EURbn)



__Source:__ KPMG. Includes completed NPL portfolio transactions that are pooled with performing loans in the same loan deal.

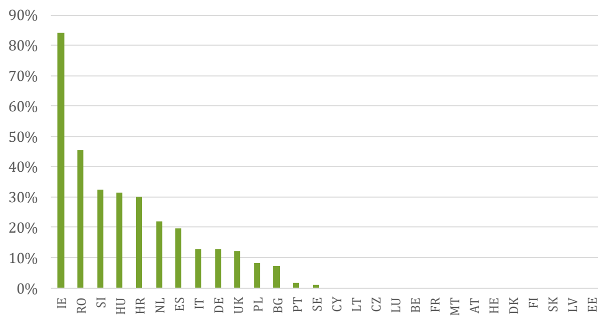
1.2 European portfolio loan transactions by risk performance (EURbn)



__Source:__ KPMG. Completed deals. Performing (PL), Non-performing (NPL), Subprime (SPL)

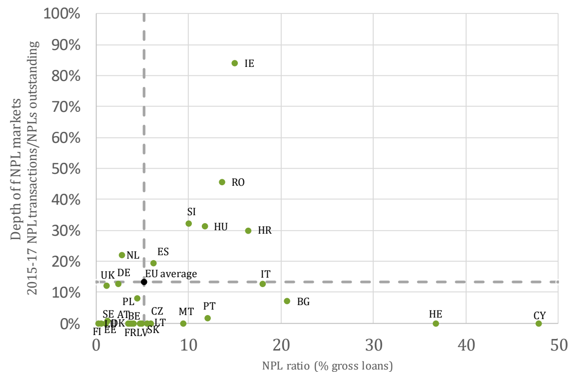
The depth of the secondary market of NPLs varies by countries. According to KPMG data, Ireland and Romania have the deepest NPL markets, in each case estimated as the value of NPL transactions relative to the stock of NPLs (using World Bank definition of NPLs). The country differences in market depth can be explained by several factors, including the availability of a large pool of existing NPLs; use of economies of scale with participation of AMCs pooling a wide range of loans; recent changes in the quality of insolvency regimes; country-specific efforts from regulators and other authorities to facilitate the disposal of assets in the secondary market; and the asset quality of banks. See charts 1.3 and 1.4.

1.3 Depth of portfolio loan transactions: 2015-2017(1H) total NPL transactions relative to outstanding NPLs



__Source:__ KPMG and World Bank. Includes completed NPL portfolio transactions that are pooled with performing loans in the same loan deal.

1.4 Depth of NPL market (NPL sales/NPLs outstanding) and NPL ratio by countries



__Source:__ KPMG and World Bank. Includes completed NPL portfolio transactions that are pooled with performing loans in the same loan deal. Depth calculated as 2015-2017 (1H) total NPL transactions relative to outstanding NPLs.

[8] Average transaction sizes in CEE stood at €288.5mm per deal in 2015 (vs. €480mm on average per deal in Europe) and €316.1mm in 2016 (€640mm in Europe).

[9] CBRE European Commercial Real Estate Finance 2016 Update.

Securitisation

Securitisation is also an alternative market-based form of asset transfer, where banks can pool various types of loans into a single tradeable liquid instrument. Securitisation transforms illiquid individual loans into a single liquid product that can be traded in markets at prices that reflect the underlying risk of the assets. In the case of distressed debt assets, banks can pool together individual NPLs into a single instrument, facilitating credit risk transfer by banks.

Securitisation is not the most frequently used product for distressed asset transfers[10]. According to AFME data, in 2016 a total of EUR 155m in NPL securitisations were issued, with IT as the leading market for this product[11]. Market analysts and extant information of deals on the pipeline indicate that the volume is expected to increase in 2017. For Italy, for example, market expectations indicate a total of c€71bn of announced NPL securitisations resulting from recent bank risk reductions and reorganisations[12].

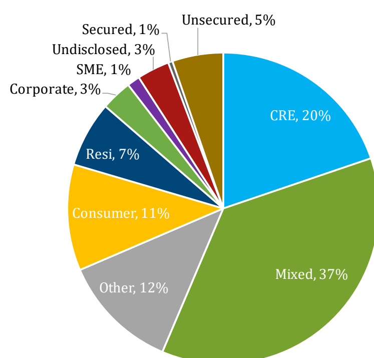
The securitisation market could play an active role in facilitating the transfer of NPL assets to the secondary market. Anecdotal evidence indicates, for example, that "the very first transaction after the Italian securitisation law was passed in 1999 was an NPL trade" (Risk Control, 2015).

Structure/Participants: few SME sales and large participation of non-European investors

Most of the NPL transactions involve loans where a form of collateral is available to secure the loan. For example, of the NPL deals closed in 2015-17 (1H), 20% had Commercial Real Estate (CRE) loans as underlying assets and 7% corresponded to residential loans. 37% of the transactions pooled different types of loans in a single deal, diversifying risks by asset classes. See chart 1.5.

Of the total volume of NPL transactions, only 1% involved SME loans. This contrasts with the fact that SME loans have the highest NPL ratio in the EU at 16.7%, compared with 7.6% of large corporate and 4.9% of households.

1.5 NPL transactions by type of loan (2015-17 1H)



***Source:** KPMG. Includes completed NPL portfolio transactions that are pooled with performing loans in the same loan deal.*

1.6 Average price on face value of NPL portfolio transactions

***Source:** PwC*

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[10] In Italy, due to restrictions under the Italian law around the entities that can purchase receivables, most investors would purchase an NPL portfolio through an Italian securitisation SPV. This, notwithstanding that the transaction can be characterised as a loan transaction.

[11] This figure does not take into account re-performing loan pools which may include also NPL pools. All the securitisations identified as NPL were retained.

[12] Italian expected deals include, for example, UniCredit's disposal of €17.7 bn in NPLs (known as project FINO), MPS €26.1 bn which results as a condition for precautionary state recapitalisation, €18bn from the transfer of two Veneto banks to the government-owned vehicle Società per la Gestione di Attività - SGA S.p.A, and €9.1bn in other recently completed or announced NPL securitisations by other banks. For further detail, see DBRS "Improving Prospects for Non-Performing Loan Securitisations"

Average prices of collateralised loans are higher than those of uncollateralised loans. According to PwC data, secured retail loans (including mortgages) normally have the lowest discount on face value among NPL transactions with average prices of c60% of face value, while CRE had an average price of c45% on face value. SME/ corporate loans and unsecured loans had the highest discounts at 35% and 10% of book value respectively. See chart 1.6.

Buyers of NPLs are typically private equity firms, distressed debt funds, or investment banks for whom the seller provides information about the underlying risk of the loans and the collateral assets (for secured loans). According to Coldwell Banker Richard Ellis (CBRE), Private Equity funds were involved in about 81% of all loan trades in 2015.

Portfolio transactions are typically large, with an average size of €640mm in 2016 and €480m in 2015, where typically only large and specialised investors may have the capacity to participate in such capital-demanding asset disposals.

Most distressed debt buyers are headquartered in the US. Out of the top 10 Investors in 2015 portfolio sales (including performing and non-performing loans), 6 were headquartered in the US (7 including the joint venture of a US and EU portfolio sale). US-headquartered "Cerberus" and "Lone Star" are consistently the most active participants in the market.

As pointed out by the AFME report on the Shortage of Risk Capital, Europe has a real shortage of domestic risk capital and the secondary market of NPLs is an additional example where foreign pools of capital can support the functioning of local capital markets.

The size and structure of the European NPL market described above results in a somewhat fragmented and uncertain environment which we believe would benefit greatly from some level of harmonisation and reform. A single regulatory framework, as suggested in our response to question 29, in addition to other supplementary elements described in the executive summary can support the development of the market. For example, the large disparity between NPL trades and the overall level of European NPLs would benefit greatly from increased (but non-duplicative) data and reporting on NPLs and increased use of third party loan servicers to improve the quality of information available to investors and decrease the gap in bid-offer spreads on NPL sales.

2) 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.)

A key consideration for banks involves a "cost of carry" analysis. Banks typically conduct a cost of carry analysis to assess the relative convenience of reducing the NPL exposures through internal recovery processes (conducted also with the support of external servicers), as opposed to a disposal strategy (taking into account expected market price for the disposal and therefore the recovery rate achieved via market disposals). The cost of carry analysis also entails an evaluation of expected recovery values, the likelihood of further levels of provisioning, future servicing costs, management and recovery costs, as well as other associated costs.

- external factors (i.e. any factors outside of the bank that are important considerations in this context.

The typical external factors that banks consider include the availability of relevant data/information, the applicable regulatory environment, the market perception of bank asset

quality and NPL ratio, the servicing infrastructure, and the relative appetite from secondary market participants on different NPL asset classes.

Aspects such as the tax cost and the reputational risk of losing the relationship with consumers are also considered, in particular in the case of performing loans or early non-performing loans.

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

Data

One way to attract a wider investor base would be to optimise the sales process by improving 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. Market surveys and anecdotal evidence indicate that data quality is the foremost important factor for a successful portfolio loan transfer.

According to PwC, investors consider that poor quality data is typically "the most frustrating aspect" of sale processes. However, sellers also indicated that one of the most frustrating aspects in portfolio sales are buyers' unrealistic data requests.

Information is relevant for purposes of identifying the credit quality of the original borrower and establishing the residual value of the collateral. In the absence of consistent and accurate information, investors can add further discounts to the book value of loan sales.

In determining the correct level and substance of data to be provided, it is important to consider related issues, such as where the exchange of information would take place and who would have access to such information. It is also important to determine how such information would be collected and used for the benefit of the industry.

Existing regulation may, in some cases, make it more difficult for parties to share information. Regulations may limit the possibility of banks sharing data with third parties without breaching data confidentiality rules, which precludes banks from disclosing personal data without previous borrower consent.

In any case, detailed and transparent information about the assets to be sold is needed. In that sense, using a standard and comprehensive set of data tapes on the assets that leverage existing reporting standards (such as those introduced by AnaCredit for example) could be useful to avoid duplication in data reporting or the introduction of impractical reporting requirements.

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 book.

Removal of barriers to entry to attract wider participation of investors

The legal framework in some jurisdictions impedes the participation of a wider variety of potential investors. Some jurisdictions, like Germany,[13] prohibit non-banks from investing in NPLs. Removing these kinds of impediments, with proper controls and oversight, would likely increase the number of NPL investors, improve competition in asset disposals and tighten bid-ask spreads.

Reducing transaction costs

In some jurisdictions the transaction costs associated with asset disposals can limit market activity. Examples of these costs include registration duties and taxes associated with asset disposal, as well as procedural non-monetary costs[14]. Removing these transaction costs can help to attract a wider

[13] For further details, see response to question 10.

[14] For example, in Spain, notice to the underlying debtors informing them about the transfer and the agreed price.

investor base. For further detail and country-specific examples please see our response to question 11.

4) In order to widen the investor base, please specify

- which incentive(s) should be given?

- whether certain obstacles to widening the investor base should be removed?

Incentives

In response to this question, we have summarised a number of proposals recently put forward by the ECB and the IMF. In absence of a cost-benefit analysis, however, we are unable to make a judgement on the efficacy, or the net benefits, associated with the introduction of market incentives. We suggest that regulators perform the relevant analysis, and that in doing so they take into account factors such as the effects that these policies may have on: volume of asset disposals, credit supply, asset disposal prices, price distortions of the underlying assets, and wider financial stability, and level playing field

General

The ECB has suggested that Member States might incentivise investors by providing guarantees of junior NPL securitisation tranches**.** For example, the state would guarantee up to 50% of the losses on the junior tranche, in return for any upside due to actual recoveries above initial estimations". As such, the Junior Guarantee Scheme (JGS) is essentially a synthetic investment in the junior tranches of a securitisation, exposing the guarantor – the state – to the same risk/return profile as a private investor.

To kick-start and support the securitisation market, the IMF[15] also proposed more direct participation of the EIB or the EIF as guarantor of Mezzanine NPL tranches or as investor of senior tranches of NPL securitisations. The IMF considers that this involvement may also foster transparency and homogeneity of NPL securitisations, setting the stage for a pan-European market.

Another ECB proposal encompasses a forward purchase scheme whereby the state finances part of the purchase price to be paid by the investor to the seller. This corresponds to the difference (i.e. the forward premium) between a future price that the buyer is willing to pay at the maturity of the scheme (for example, in five to seven years) and the bid price the buyer is willing to pay at the transaction date.

The forward purchase scheme (FPS) is effectively a loan provided by the state to NPL buyers, to finance part of the NPL purchase price. The NPL seller receives at time of purchase the full NPL forward purchase price. The private investor pays the bid price component and the government entity pays the forward premium component.

The repayment to the state of the forward premium at the maturity of the scheme must be secured by the payment obligation of the private investor (which cannot be a special purpose entity set up for the purpose of this transaction or similar transactions) as well as by a guarantee issued by a highly rated investment-grade entity, which must be a supervised institution with no links to the investor."

Of course, any such scheme or other form of aid must be consistent with any rules or regulations related to "state aid".

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[15] IMF Staff Discussion Note (2015) "A Strategy for Resolving Europe's Problem Loans"

Obstacles

Securitisation

The EC Action Plan on NPLs should take into account any impact of the securitisation rules (both current and existing) in the context of NPLs. There are several problems which arise from the Securitisation Regulation in the context of NPLs, on which AFME has already commented in separate materials[16].

However, for the purpose of this NPL consultation it is important to note that the sale and purchase of the NPL portfolio could itself fall within the CRR definition of a "securitisation" transaction due to the structuring of the transaction. Consequently, certain regulatory requirements – such as risk retention – will apply in this context to NPL transfer, making the NPL transfer more complex, burdensome and thus less attractive to investors.

We have summarised below some of the key issues. We focus on the Italian market for illustration, but similar difficulties also arise in other EU markets.

Due to a restriction under Italian law around the entities who can purchase the receivables (which is considered a financial reserved activity), most investors in the Italian market would purchase an NPL portfolio through an Italian securitisation SPV (i.e. an SPV set up under the Italian securitisation law). The ultimate investor will then fund the SPV's purchase of NPL assets by the subscription of notes. Due to the fact that the SPV would only exist to hold the NPL assets, limb (a) of the CRR "securitisation" definition may be satisfied (payments dependent on exposures). Where the investor does not need to obtain external financing to assist with the purchase of the NPL portfolio, the transaction can be carried out with a single tranche of credit so that limb (b) of the "securitisation" definition will not be satisfied and the transaction would not qualify as a securitisation under the CRR.

However, leverage is becoming more important for investors, with larger portfolios and more competition in the market. Therefore, investors are seeking external finance for the acquisition of NPL portfolios. This finance will often be provided on the basis that repayment of this financing will rank senior to repayment to the ultimate investor. The introduction of such finance could, depending on the specific facts, turn the sale and purchase into a transaction which satisfies the CRR definition of "securitisation".

The party providing this financing will therefore make certain demands, including, for example, that any risk retention requirements are satisfied before they will agree to provide the financing. In many cases, sellers of a portfolio of NPLs would not want/ be able to retain a 5% economic interest in the pool they are looking to sell. This can result in a complex analysis to find an alternative sponsor or originator to act as retainer within the spirit of the rules. This will become more complex when a direct risk retention requirement is placed on banks.

Any increase in costs associated with difficulties in obtaining financing would ultimately decrease the price that an investor is willing to pay a bank for an NPL portfolio, and hinders the ability for European banks to divest themselves of NPL loans.

It seems unlikely that the securitisation rules were intended to catch these sorts of transactions – these are legacy issues, not caused by an originate to distribute model – however, no guidance has been provided in relation to such transactions.

Therefore, we believe that a carve out or at least more helpful guidance for NPL transfer transactions would be appropriate here to make compliance with the securitisation rules less burdensome for those transactions.

[16] See for example AFME Briefing Paper on "Article 17 Securitisation Regulation – an adjusted, forward-looking standard for legacy transactions and non-performing loans" available here.

Removing entry barriers for market participants, legal limitations to the transfer of NPLs and high taxes should also be considered

In any secondary NPL market transaction, it is important to ensure that an “effective transfer of risks” from the seller to the buyer occurs. Otherwise, the upcoming IFRS 9 accounting regulation could impose additional loan loss provisioning by a bank that has already transferred the relevant loan(s).

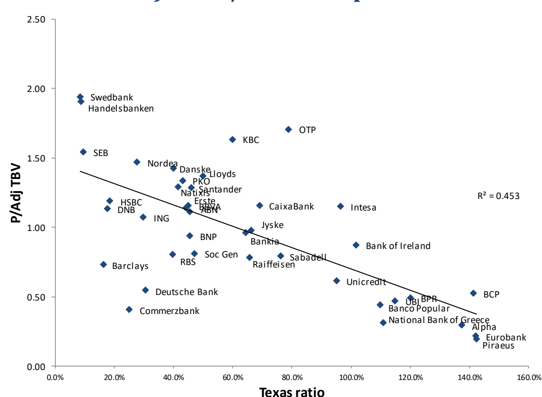
Additionally, elevated transaction costs are currently hindering the development of a liquid secondary market. These include tax (such as stamp duty or *Actos Jurídicos Documentados* in Spain), registry costs, etc. In the short term, the reduction of these costs would likely constitute an incentive for banks to participate in secondary markets. In the long term, it is essential that there is some level of homogenization of related regulations among Member States (or even across regions in one country).

5) 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?

Further development and strengthening of a European secondary market for NPLs will positively affect the capital of the banks by improving the efficiency of their NPL management, with corresponding positive effects on asset quality or equity valuations. As observed in charts 1.7 and 1.8 below for European banks, higher NPLs are strongly correlated with lower price multiples and higher Pillar 2R requirements.

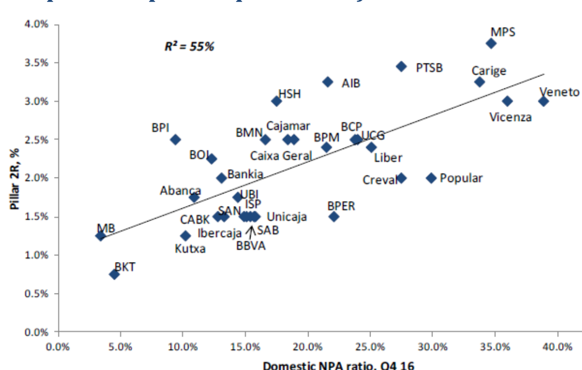
Efforts towards facilitating distressed debt disposals should contribute to improve banks’ market valuations, unlock loan supply and reduce regulatory capital burden.

1.7 **Texas ratios (NPLs as a % of T1 capital and reserves) and P/TBV multiples**



Source: *Autonomous Research*

1.8 **Linkage between NPAs and Pillar 2Rs (bank-specific capital requirements)**



Source: *Autonomous Research*

- helping banks overcome legacy assets;

Usually, no significant differences can be observed between banks, funds and other investors.

6) What are the main concerns linked to each of these investor types?

For bank investors, given their lower expected returns (relative to an investment fund, for instance), cost of equity and longer recovery horizons, advantages may include greater competition in terms of purchase price. On the other hand, banks may have less recovery options compared to investment funds. Additional concerns would be due diligence costs and availability of servicing capacity.

In certain Member States banks are subject to the voluntary Code of Good Practices, which might not apply to non-bank investors (see our response to question 25).

We see great competition amongst investment funds that are driving up prices for NPL portfolios. An investor that is an investment fund will generally have more flexibility in terms of servicing platforms but will also require very high investment returns. However, not all of them have deep and consolidated knowledge of the local legal and regulatory framework and, in some cases, they cannot participate in the transfers due to problems arising from the relevant local jurisdiction.

Additionally, a major concern with investment funds might be that, once they purchase a portfolio, they might apply aggressive recovery strategies, posing a reputational risk for the selling banks.

7) What are 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

With respect to the four specific dimensions mentioned above, we believe that they should be ranked as follows:

(1) promoting increased market size and depth and equal treatment of investors
(2) debtor protection
(3) data secrecy
(4) privacy.

We rank these items in this manner because:

- There is almost always a trade-off between these factors but we believe that the first two factors would be most helpful in reducing the level of European NPLs , as well as strengthening European secondary markets for NPLs.
- With respect to privacy and data secrecy, if these factors were too onerous it would likely have a negative effect on the ability of investors to secure sufficient information to adequately price the NPLs.
- Debtor protection should be the same no matter who is the holder of the relevant debt, but should be measured against other relevant considerations so that any such provisions do not result in increased costs and longer time frames for resolution/enforcement, which could have a negative effect on the price at which banks can sell their NPLs.

We also note, however, that some of these dimensions are interrelated.

Market depth and data secrecy: Deeper secondary markets for NPLs can provide benefits by contributing to an acceleration of the NPL adjustment process as banks continue their internal processes towards restructuring their NPL portfolios. Deeper secondary markets, with their increased liquidity and, presumably, increases in available data and information, would likely reduce the overall number of NPLs, release credit for use in other transactions and provide for

a better match between the expectations and understanding of stakeholders regarding the NPLs and any underlying assets or collateral.

Risks of onerous data requests or additional supervisory tools to NPL management and market size

The relevant risks are not necessarily related to deeper secondary markets for NPLs per se, but from a legal and regulatory point of view, we strongly suggest that any additional EU measures that are designed to encourage or grow secondary markets for NPLs are appropriately targeted and do not encompass for-reaching measures which could be duplicative and costly for firms that are currently successfully managing their NPLs internally or through the secondary markets. For example, SSM supervised banks are currently in the process of implementing the recently finalised SSM guidance to banks on NPLs. Before any additional measures are taken at EU level, it is necessary for this process to bed down, and for the SSM to have sufficient time to carry out its reviews of banks' approaches in the framework of these new guidelines, reflect these in its assessments of banks' risk profiles (through the Supervisory Review and Evaluation Process) and in their resulting capital requirement decisions (Pillar 2).

In particular, we note that supervisors already have wide-ranging powers to address perceived deficiencies in the banks they supervise. At this stage no case has been made for a need to introduce any additional supervisory tools that go beyond existing powers in the CRD/CRR. We believe that the proper approach would be to use existing reporting and data on NPLs as a foundation for any data and reporting under the NPL Action Plan, and to supplement that existing, if necessary, rather than generally imposing entirely new, perhaps duplicative, requirements. Moreover, while it may well be appropriate to introduce similar supervisory guidelines on NPLs to institutions throughout the EU, we caution against the high risk of duplication and possible conflicts between any future work that may be carried out by EBA with respect to the EU as a whole and the existing SSM guidelines.

In spite of these concerns, we believe that among the solutions that can contribute to addressing the issue of new NPLs are deeper secondary markets of NPLs, which can contribute to better management of banks' NPL portfolios.

8) How can one best strike the balance between such dimensions?

A balance can best be struck between these dimensions by keeping in mind the overall goals of the NPL Action Plan. Achieving these goals (which include, among other things, deeper secondary markets for NPLs, greater access to data and information, increased use of third party loan servicers, etc.) may, in some cases, require the rules to have an effect on some of the other dimensions, such as privacy for instance. In each case a cost-benefit analysis should be undertaken to determine whether the benefits in relation to the overall goals of the Action Plan outweigh the costs or effects on certain parties' rights or expectations. If so, the balance should be struck accordingly.

A single and comprehensive legal framework in the EU (in the form of an EU Regulation), taking these considerations into account, would be of utmost importance:

- Regulations should be set up so that investors have access to enough information to form a view on pricing, which can include hiring advisors and being able to perform adequate due diligence

- If a regulation unduly increases costs and timing for resolution/enforcement, the selling bank will see lower prices for its NPLs
- Regulations/licensing of third-party servicers would be welcomed as an impartial mitigant to reputational concerns (although this should also not be so onerous that it limits the investor base)

9) 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?

While differences in national legal, cultural and business environments are an important factor in assessing how and whether any proposal designed to improve the European NPL market might work, we do not believe that national differences in these benefits and risks would justify significantly different frameworks for secondary markets for loans. We rather anticipate that the different levels of maturity of the European national NPL markets are a driver of the perceived differences. While these matters should be considered as part of the analysis, the overall goals of the NPL Action plan (i.e., deeper secondary markets for NPLs, greater access to data and information, increased use of third party loan servicers, etc.) are possible to achieve without too much damage to existing national frameworks. These items are also important enough that they should be permitted to have an effect on any national policies or procedures if necessary.

Even when a firm has the capacity to analyse and navigate national differences (or to hire someone to do that for them) there are implicit costs and procedures that could add unnecessary complexity to a European NPL transaction. Greater harmonisation of NPL frameworks would go a long way to decreasing this confusion and complexity.

In the context of any single regulatory framework, we believe that an EU Regulation would be preferable to a Directive to minimise gold plating at the national level.

10) 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?

Current rules pertaining to secondary markets for NPLs can, in some cases, be a significant obstacle to further development of these markets. Secondary markets for NPLs in Europe are fairly opaque and there is little evidence about their operation and policy impact in Europe. However, we are aware of certain national rules that constitute obstacles to further development of secondary markets for NPLs. Any rule that prohibits or restricts non-banks from holding NPLs is a serious impediment. Another potential impediment would be any rule prohibiting or restricting the use of third-party loan servicers to service and otherwise coordinate and maintain actions and information related to NPLs. More specific examples include any rule requiring an international investor to have a local partner in order to buy a portfolio and operate in a particular jurisdiction, as well as any fiscal obstacles that may be in place.

More specifically, we have set out below certain national rules that might act as impediments in this respect:

Germany:

Due Diligence:

- Banking secrecy and data protection laws may hinder the ability of a purchaser to perform proper due diligence. This, in turn, may lead to bigger bid/ask spreads as key items (e.g. credit worthiness of debtors, guarantors and other providers of third party collateral) cannot be adequately examined; and

- Under German law, creditors and providers of third party collateral can waive their rights under banking secrecy and data protection laws (this can be done at origination of the loan). Yet, rights of other third parties (such as lessees) which are not party to such financing documentation (but which are nonetheless very relevant for due diligence purposes) are not affected by such a waiver and thus information about those parties cannot be disclosed without their prior consent. Examples might include which airline is acting as the lessee of a financed aircraft or which corporation is the long-term tenant of a financed office building.

Restrictions on transferability:

Credit facility contracts may hinder secondary trading of the underlying loans:

- Lenders will typically want to dispose of the entire contractual relationship around a credit facility, which requires the consent of the counterparty. This consent can be given in advance (i.e. in the credit facility contracts). However, it is not entirely clear whether such consent is valid (in particular if such consent is given under a standard clause due to restrictions in the German law applicable to general terms and conditions). Also, such consent is rarely introduced in older contracts. Thus, most credit facilities require the consent of the counterparties for an outright transfer of the entire relationship which is a considerable impediment to the secondary market;

- Even if lenders are prepared to remain party to the contracts with all disbursement and secondary obligations and just assign their outstanding claims against the borrower to an investor, such an assignment may be prohibited under the credit facility contracts; and

- Even if a lender and an investor agree to only transfer the contractual relationship or the claims on a synthetic basis (i.e. the original lender remains fronting bank but acts on instructions of the investor and forwards all payments to the investor) the credit facility contracts might contain restrictions on such an arrangement (e.g. that a synthetic transfer is only allowed if the investor cannot instruct on voting behaviour).

Restrictions for purchasers:

- German law requires a banking license for granting (revolving) credit lines (with particular practical relevance for working capital lines of credit). Therefore hedge funds and private equity investors cannot directly acquire such loans and execute their restructuring plans. In some instances, such investors work together with a "fronting bank" which acquires the respective loans/credit lines and acts in alignment with the investor. This of course increases complexity and costs for the investor; and

- Provisions regarding the change of creditor parties in insolvency law and enforcement law make the acquisition of loans with insolvent parties unattractive.

Transaction certainty:

- Auto-Transfer of employees can be an issue; and

- Merger clearance requirements: German rules require NPL transactions to be notified where interest income generated from the target loans exceeds €5m in Germany (booking country). As this threshold is very low, it imposes an additional burden on purchasers in NPL transactions involving low-value portfolios. In asset deals, the German competition authority

has often rejected such filings in the past on the basis that the transaction is too small and hence not notifiable. However, the additional burden of having to make the filing (for purposes of legal certainty) still exists.

Spain:

The general rule under Spanish Law in respect of the transfer of credits is that a credit may be freely transferred without the need to obtain the debtor's consent. However certain perfection requirements and legal consequences may limit the freedom of the transfer. The main restrictions on transferability are:

- Notice to the underlying debtors informing them about the transfer: although notice is not required for effectiveness of the transfer, it is necessary to oblige the debtor to make payments to the new lender. Otherwise payment by the debtor to the existing lender releases the debtor from its obligations;
- Restrictions for purchasers;
  - ➢ Certain types of security (i.e. Spanish floating mortgages and Spanish financial collateral) limit the eligible creditors to financial institutions, and
  - ➢ Possible contractual transfer restrictions.
- Spanish formalities;
  - ➢ Spanish notarial document: necessary to evidence ownership vis-à-vis third parties and to obtain certainty of date and content,
  - ➢ Registration of security: certain types of security (such as mortgages and pledges without displacement) require registration in a Spanish public registry to perfect the transfer of the security. When registration is required the new lender must be registered with the relevant public registry as beneficiary of the relevant security, and
  - ➢ Spanish tax ID number: is required to execute any Spanish notarial document as a secured party.
- Transfer costs and taxes:
  - ➢ Notary fees are calculated by applying approximately 0.0285% to the secured amount. Where the secured amount exceeds €6 million the notary fees may be subject to negotiation;
  - ➢ Stamp Duty is triggered in mortgage loan transfers – the rate applicable is the one established by the Autonomous Region where the relevant land registry is located 0.75% -1.5% over the outstanding amount; and
  - ➢ Registry fees are calculated at an approximately rate of 0.02% of the secured amount and are capped at approximately €2,080 per registered unit.
- Timing issues: registration with a Spanish public registry can take several weeks (and sometimes months) due to the Spanish Registrar's discretion power to qualify the terms of the security agreements.
- Litigious credit risk: under Spanish common law (and note regional differences in our comments on question 13) the underlying borrower may be released of its repayment obligation by paying the discounted amount if the credit has the consideration of a litigious credit. The debtor may use its right within nine days after the date that the assignee claims the payment.

Italy:

In Italy, the NPL market is well developed, partly due to the pressure by regulators on Italian banks.

Major obstacles include:

- difficulties / timing around enforcement and foreclosure;
- debtors can be litigious and judges can be very debtor friendly;
- difficulties around the ability of a creditor to take control of a company in an insolvency scenario;
- difficulties connected with restrictions around purchase of receivables (financial reserved activity);
- bid/ask spreads and evaluations on Italian banks books; and
- risks connected with need for additional capital to be held by the Italian banks as a result of losses made upon sale.

Other risks are connected with transfer of "Unlikely To Pay" debts, which are more difficult to transfer due to the fact that they are not terminated and require management of the relevant position, which usually can be carried out only by banks (i.e., not by an SPV or a fund investor). The market is also asking for further clarification on the use of [ReoCos] in connection with NPLs transactions.

France

Limitations related to purchasers of NPLs

Legal requirements / licensing: In accordance with French regulation, loan servicers are required to hold a licence in order to acquire and service French loans, which remains a hurdle for further development of the NPL market. Moreover, to acquire large NPL portfolios, purchasers must acquire, and potentially develop, existing dedicated platforms that have sufficiently trained and knowledgeable staff, as well as the technical capacity, to service large numbers of loans.

Judicial inefficiency: Judiciary and loan recovery process can be quite slow in France, which can have a significant impact on the economics even when the recovery rates are ultimately quite high.

Limitations related to NPL sellers

Legal/contractual: Banks are required to remove any loan that includes a clause rendering the loan non-transferable from any loan portfolio that is up for sale. has been inserted, at the borrower's request, into the underlying contract, as such a clause continues to be in force after a loan becomes non-performing.

11) 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 should not change after any transfer. The new owner of the debt should be bound by the same rights and responsibilities as the selling financial institution.

The transfer of a loan and/or collateral to a third party should be neutral to the debtor with respect to its legal obligations.

Likewise, aggressive or unethical collection and recovery procedures by a third-party loan servicer should be strictly forbidden.

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

Specialisation across jurisdictions, or asset classes, can provide potential advantages by helping to improve efficiency in pricing and certainty of execution and can also yield gains from economies of scale. This, in turn, should increase transaction volumes, reduce bid-ask spreads, and increase recovery values. In addition, specialised asset managers across jurisdictions can help smaller banks dispose their NPLs.

The disposal of NPLs through markets can be challenging for small banks due to their limited ability to pool together a large volume of distressed assets with similar risk profiles that is commercially viable (due to the high fixed costs behind marketability), or that are financially attractive to asset managers from a size perspective. This can be even more challenging for banks that have multiple business lines with heterogeneous risk profiles.

In smaller countries like Malta or Cyprus the development of internal economies of scale can be challenging due to the size of their internal markets, where attracting interest from cross-border investors is crucial for a successful secondary market.

Specialisation, however, is not a pre-requisite to developing and fostering a cross-national market. Ideally, in an integrated PanEuropean market of NPLs with little restrictions on who can participate and with more harmonised tax and legal structures, would permit banks to more easily and frequently structure asset disposals with greater geographical dispersion and better opportunities to assess cross-national risk exposures.

13) 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?

A major obstacle is the increased complexity of relevant laws and rules across national jurisdictions and the effect that such disparate and complex frameworks might have on the desire and ability of market participants to invest in, and support, deeper secondary markets for NPLs.

Taxation

Tax policies can also be an obstacle to further development of secondary markets for NPLs. Given that the transfer of loans is expected to generate interest income, the volume of potential withholding tax on interest income can be a determinative factor for foreign investors acquiring NPLs[17].

Transfer taxes can also affect the value of the transaction, specifically for the transfer of real estate assets. Depending on how the portfolio is acquired (i.e. whether it is via a share acquisition or an asset purchase) various transfer taxes may come into consideration.

EU countries have unharmonized treatment for transfer taxes on real estate or stamp duty, which can affect the viability of a portfolio acquisition depending on the specific treatment in each jurisdiction. In the Spanish case, for example, buyers of assets from the Asset Management Company (SAREB) are exempted from stamp duty (Actos Jurídicos Documentados).

Low provisioning by banks may deter asset disposals because this would force banks to reflect losses in their financial statements. Improvements in bank provisioning can narrow the wedge between bid prices and the book value of the assets (net of the bank's incurred loss provisioning against these impaired assets) and facilitate the disposal of distressed loans[18]. . The common practice in most EU

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[17] KPMG (2016) "Tax impediments to the sale of non-performing loans ('NPLs') in Central and South Eastern Europe ('CESEE')

[18] According to Deloitte (2015), the uplift in provisions by banks has increased coverage ratios for NPLs and narrowed bid-ask spreads. The 2012-13 Deloitte survey to banks on Italian NPLs indicated that low provisioning was the main factor for deals not completing or not coming into the market.

jurisdictions is to allow tax deductions for provisions or write-offs on loans by banks. In practice, however, KPMG argues that these conditions can introduce complexities. According to the ECB's VP Vítor Constâncio, the current IAS39 accounting standard and the absence of guidance on write-off requirements tend to lengthen NPL write-offs. Note, however, that this will be replaced by the IFRS 9 standard for accounting periods beginning on or after 1 January 2018, which contains significant changes to the way in which Expected Credit Losses are calculated for financial instruments.

The use of tax losses and the extent to which banks can offset losses against current or future taxable income (i.e. for provisions, write-offs or asset disposal below book values) can also create difficulties for banks. Restrictions can include time limits (number of years that tax losses must be forfeited) or restrictions on the use of tax losses upon change of ownership of the assets. These limitations can also make banks delay asset disposals through markets to avoid having to report immediate losses after selling loans[19].

There is also the possibility of double taxation (i.e. imposition of taxes both when a Fund buys an asset and when it sells it).

Insolvency and judiciary

Differences in national insolvency regimes can also be a significant impediment. More efficient restructuring and insolvency frameworks can contribute in a significant way to the efficient management of defaulting loans, including through secondary market solutions (e.g. reducing time to recovery) and help to avoid the accumulation of such loans on banks' balance sheets.

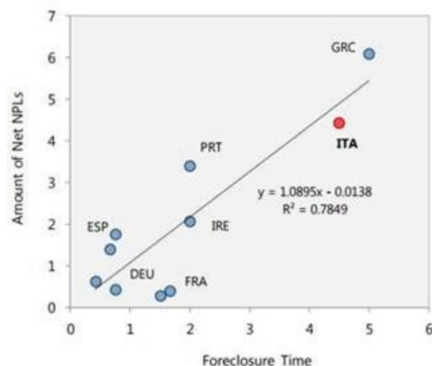
We believe that further harmonisation of minimum insolvency standards across Europe, as set out in the proposed Directive on preventive restructuring frameworks and second chance, would help to facilitate more predictable and orderly outcomes for corporate restructurings. We fully support the proposed Directive, which is a key step in developing a single market, as well as an important component of the Capital Markets Union.

Poor and lengthy pre-insolvency proceedings not only contribute to the accumulation of NPLs on banks' balance sheets (as it discourages early restructuring or out-of-court proceedings), but can also discourage investor appetite for a particular jurisdiction, adding a risk premium to loan transaction prices. According to a recent Credit Suisse Research report, "foreclosure times is indeed the most important factor, in our view, to narrow the bid-ask spread and avoid further charges for banks in terms of bad loan impairments. (…) A reduction of up to four years [in foreclosure proceedings] implies a reduction of the bid-ask price by 8-9pp."

https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-cb-deloitte-italian-npl-outlook.pdf

[19] In the EU, the European Commission has proposed, in October 2016, a Directive on a Common Consolidated Corporate Tax Base which aims to standardise some of the practices regarding the use of losses for in-scope institutions (currently defined as entities or members of a group with consolidated revenue of over 750million EUR).

1.9 **Euro area: Net NPLs and Foreclosure time (% total assets / years), 2015**



Source: *IMF*

1.10 **Recovery time reduction and price gap narrowing**

Recovery time reduction (years)	Bid-ask price narrowing (Pp)
1	1pp
2	3pp
3	**5pp**
4	**8-9pp**
5	11-14pp
6	15-21pp
7	20-30pp

Source: *Credit Suisse Research estimates*

We believe that more harmonised and efficient insolvency and pre-insolvency regimes across Europe would also help to both prevent some loans from becoming non-performing in the first place, as well as helping to foster faster and more efficient resolution of existing NPLs.

National considerations

We set out below selected national (or regional) rules that might be considered obstacles in operating secondary markets across national jurisdictions:

Spain:

Spanish regional regulation contains certain particularities which increase the obstacles to operating in secondary markets on a national basis and influence the geographical scope of business operations for certain market participants.

The most important differences between regional regulations and Spanish common law are:

- Notice to the underlying debtors informing them about the transfer: one of the recent modifications of the Catalonian Civil Code, which shall be in force as from January 2018, requires that in case of transfer of Catalonian mortgage loans, the agreed price shall be disclosed to the underlying borrowers;

- Litigious credit risk: certain specific territories (such as Navarra) allow the underlying borrower to be released of its repayment obligation by paying the discounted amount in any case, without requiring the litigious credit declaration. Cataluña has a similar regulation (in residential properties only) but its application has been suspended by the Spanish Constitutional Court; and

- Enforcement and relevance of the location of the asset. Certain Spanish autonomous regions in Spain (mainly Cataluña, País Vasco, Navarra, Aragón and Andalucía) contain specific regulations in connection with enforcement of assets located there.

Belgium:

Two obstacles which are often encountered in transactions relating to Belgian loan portfolios are the following:

Taxes / registration duties

The transfer of loans as such does not give rise to any transfer taxes or duties. For transfers of individual loans secured by a mortgage, however, the transfer of the mortgage has to be registered at the relevant

mortgage registry. This update of the registration gives rise to a registration duty of 1% on the secured amount.

In practice, we find that this often has a material impact on the economics of loan transfer transactions. In many cases, parties seek to structure the transfer as a general transfer / transfer of "universality" (e.g., demerger, partial demerger, contribution of branch of activities, etc.) as a means to avoid the tax (see item 2 below).

The Belgian legislator has introduced certain exemptions to the registration requirement in the event of transfers to securitisation SPVs , certain financial institutions and Belgian credit institutions. In such cases, the 1% registration duty does not apply. This exemption does not extend to credit institutions licensed in other EU Member States or third countries. This limitation to the scope of the exemption is seen as a significant obstacle to the development of a cross-border secondary market in loans secured by a mortgage and most Belgian legal authors and practitioners consider it to be contrary to the free movement of services and capital. The Belgian legislator has recently broadened the scope of the exemption to EU credit institutions in general and branches of third country credit institutions. This legislative amendment has yet to enter into force (and is expected to enter into force on 1 January 2018).

<u>Recognition of foreign general transfers</u>

Multinational transactions are sometimes structured as a general transfer (e.g., demerger, partial demerger, contribution of "universality", etc.) rather than a set of individual transfers of loan agreements (transfers "ut singuli"). Advantages of such structure include: (i) debtor consent to the transfer is generally not required (such consent may be required for individual loan transfers depending on the loan documentation) and (ii) registration duties may be avoided (see above).

It has to be assessed on a case-by-case basis whether such general transfer would be recognised under Belgian law. Based on conflict of laws principles and rules, the view is often held in practice that this will be the case if the features and legal consequences of the foreign general transfer are similar to those of a "transfer of universality" under Belgian law (e.g., the Dutch partial demerger). Even in such cases, however, legal uncertainty remains and in relation to certain aspects (e.g., impact of the transfer on Belgian security interests) it is not always clear whether certain Belgian requirements should still be observed. It is often advisable, for instance, to arrange for publication of the foreign general transfer in the Belgian Official Gazette, but this may not be possible in practice if none of the parties involved is incorporated in Belgium or has a Belgian branch office.

14) 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?

An EU regulatory framework regulating certain aspects of transfer of loans would be useful as it would help to harmonise minimum standards for the transfer of loans, increase certainty (particularly with respect to cross border transactions) and would likely help to strike the correct balance between the rights of the various market participants. Such regulation might also help to restrict or prohibit some of the more negative aspects and practices (such as aggressive, unfair or oppressive collection or enforcement practices).

A EU regulatory framework would also be useful as it would, among other things, allow a standardization of the sale process, as well as approaches and organisational needs of sellers and buyers. An EU Regulation would be preferable to a Directive as we believe that a more proscriptive approach, with relatively little room for interpretation or modification in applying the framework, would be more effective in addressing the problems caused by the high level of

NPLs in Europe and in applying any measures designed to strengthen European secondary markets for NPLs.

Specifically, we believe that such EU regulatory framework in the form of an EU Regulation should include:

- Harmonisation of requirements for the participation of non-banks, which would allow a wider number of participants to own or manage NPLs.
- Evaluation of the requirement for non-domestic investors to have a local partner to buy a portfolio and operate in a particular jurisdiction;
- Restrictions or prohibitions on aggressive, unfair or oppressive collection or debt enforcement practices;
- Streamlining registration and transfer requirements of loan transactions.

Additionally, we encourage EU lawmakers to:

- continue their efforts towards harmonisation of minimum standards of insolvency proceedings, as proposed by the Commission's Directive on insolvency reform[20].
- evaluate measures that support harmonised transfer taxes, including addressing double taxation (i.e., taxes on both the purchase and sale of loans), and stamp duty on loan transactions and other transaction costs (e.g. registry). Measures can be taken in the form of guidance.
- Simplify withholding tax procedures;
- Harmonise data protection laws to facilitate the transfer of loan information from sellers to potential buyers, safeguarding consumers' protection and privacy. The upcoming General Data Protection Regulation (GDPR) provides good progress in that direction;
- continue progress with the implementation of IFRS9 (expected for January 2018) to enable the recognition of credit losses and sale of NPLs by banks taking due care on any cliff edge effects at implementation[21].

In conjunction with the views raised above, we must keep in mind that the European NPL market is not necessarily a cross-country market, but is rather composed of national markets in which both national and international investors compete. However, national legislation related to secondary loan transfers is often opaque or unclear (particularly with respect to tax implications).

With this in mind, there are still some areas that would benefit from EU-wide treatment. A specific example of a barrier that should be removed at EU level would be any requirement that the purchase of a loan should be subject to a license (such as the example provided in our answer to question 10 for Germany relating to Restrictions for purchasers). Any EU-wide framework, in order to be effective, should be calibrated to take these national frameworks into account.

15) Please provide any other comments that you find useful in relation to this section.

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[20] Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU

[21] According to the EBA's impact assessment on the implementation of IFRS9, the estimated increase of loan loss provisions for banks stands at a median of 20 % (and up to 30 % for 86 % of the respondents) compared to their current levels under IAS 39. Implementation should consider possible cliff edge effects and implications that the accounting migration may generate.

16) What are the advantages of having access to third-party loan servicers in terms of secondary loan market efficiency?

Access to third-party loan servicers is crucial to the development and growth of secondary markets for NPLS. In many cases, a potential (or existing) investor will not have sufficient access to information about the creditor or the loan. This may be because the originator of the loan (or other relevant party) may be unable or unwilling to provide the information, the relevant information may be voluminous (i.e., much of this information is still in paper form) and therefore the investor may not have the time or resources to gather and review the relevant information, or for other reasons.

Third-party operators usually work for multiple banks; furthermore, they often hold loans directly and manage portfolios as principal investors, and are familiar with the NPL secondary market transactions. Because of this, their operational and informational standards – meaning on one hand their IT platforms and on the other hand the data-sets, documentation and data quality with which they manage NPL positions – are likely higher than that of the average originating bank.

The degree of participation of the loan servicers industry in the management of NPLs varies by country. In Italy, for example, PwC identified that specialised NPL servicers have gained importance due to the increasing volumes of portfolio disposals from banks to investors, together with growing outsourcing of loan servicing and recovery activities by banks. PwC[22] estimates that in Italy around 40% of NPLs owned by banks, and 100% of NPLs owned by other financial institutions (that have limited direct servicing capabilities), are outsourced and managed by the NPL servicers market. In other countries, however, the loan servicing and recovery industry has not followed the same level of growth or specialisation.

In particular, do you see specific advantages for
- helping banks overcome legacy assets;
- creating investment opportunities for specialised investors?

Some advantages to the use of third-party loan servicers include:

- third party loans servicers can, in some instances, improve efficiency of banks' loan recovery strategies;
- third-party servicers usually have more flexibility as some banks' legacy units might not have their IT systems configured to treat legacy NPLs any differently than their own loan pools; and
- third-party servicers usually also help to underwrite portfolio purchases.

It is also sometimes the case that a party, particularly a smaller company, may not have the time, personnel or administrative capability to adequately service the loan and comply with any notice, record keeping and administrative requirements related to servicing and administering a loan.

[22] https://www.pwc.com/it/it/publications/assets/docs/the-italian-nlp-market-july-2017.pdf

In order to cooperate effectively with an established and experienced NPL servicer (as well as to comply with ever more sophisticated reporting requirements), the average originating bank will have to raise its operational and informational/DQ standards and improve its internal processes, which is also beneficial when it comes to offering NPL portfolios to market investors.

However, servicing companies, due to the fact that they are usually small, sometimes do not have the execution capability, nor the capital strength to compete with other financial institutions.

17) 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

In general, there are few obstacles or legal restraints on the services that are provided to banks by third party loan servicers. For non-bank investors, however, there are regulatory restraints in some countries.

Any requirement that, in order to invest in NPLs in a particular jurisdiction, an NPL investor must have a local bank partner or loan servicer would likely be an obstacle for access to third party loan servicers. If it has the necessary information and financial sophistication, a European investor should be able to invest in NPLs in any European jurisdiction without a requirement for a local partner. Such requirements only act to reinforce and magnify any problems caused by the various different legal and regulatory regimes across Europe.

It is worth noting, however, that there is a “chicken and egg” problem for third-party loan servicers in that they are generally only created when there are already loan pools available for purchase. For this reason, development of third-party servicers always begin with unsecured consumer pools before moving on to more complex and secured banking products.

In any case, it is important to consider measures to help grow and expand the loan servicing industry which is currently fragmented and made up of only a few sizeable players

18) 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 to be beneficial or not.

In our experience, the activities that are most often outsourced to third-party loan servicers include:

- Portfolio valuation;
- Data evaluation;
- Debt collection and asset repossession strategies;
- Legal and real estate advisory;
- Loan flow management and other administrative tasks related to loan management;
- Advisory services in portfolio acquisitions or securitisation processes.

Outsourcing these activities can generally be beneficial because it can free up the time of the bank or investor in a general sense, or more specifically with respect to higher priority, sensitive

or complex matters. A third party provider might also provide expertise and information that a smaller stakeholder may not have access to, or that it may not have the specific knowledge or framework to collect and synthesise.

However, there are potential disadvantages to outsourcing some of this work. These may include, among other things:

- choosing the wrong partner (whose skills and expertise do not match the characteristics of the assigned portfolios) and /or consequent reputational risk; or
- overpaying for the service, i.e. non-alignment with the servicer's interests (via incentives, bonuses, etc.) with those of the principal.
- Losing the relationship with the client may entail a reputational risk, in particular in the case of performing credits or early non-performing.

In conclusion, we believe that almost all servicing activities could be outsourced. The question is where the decision-making lies, what is delegated and what decision-making remains in-house. If activities are outsourced, but the ultimate decision making remains in-house, then the bank must make decisions swiftly to prevent a bottle-neck. More complex products with certain high risk/value decisions should probably be kept in-house as the benefits of outsourcing related to those kinds of activities might not be apparent.

19) 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?

A major risk for debtor protection in this context might be unscrupulous or unfair collection or enforcement practices by unlicensed or unsupervised third-party loan servicers. Unsupervised loan servicing activities can result in unintended consequences on the proper functioning of the market. Recent anecdotal evidence[23] suggest that some distressed debt specialists have engaged in controversial recovery practices with unfair treatment of debtors and tenants, with the aim of avoiding a solution for existing NPLs and rather seeking fast repossession of the assets.

In Ireland, for example, the government is facing calls to regulate their activities more closely.

It is desirable to guarantee financial expertise from servicing providers, to prevent unfair or oppressive asset recovery practices.

20) 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.

Third party servicers in the NPL area may be used for the following, among other things:

- early-stage deteriorated positions (i.e. past-due phase) only pertaining to individual customer; the advantage is the cost-saving benefit; and
- revoked positions (i.e. workout phase) in all the asset classes (i.e. individuals, corporates, etc.); the advantage is in the added flexibility and efficiency, as explained in our response to question 18.

With regard to performing loans, there are third-party servicers who provide call-center and back-office/administrative services. There is no "credit management" content in the above activities, so

[23] See FT note "'Aggressive' vulture funds swoop in on Irish property" in: https://www.ft.com/content/8d559d8c-f3a3-11e6-8758-6876151821a6

we believe they cannot be compared with the activities provided by third-party servicers for non-performing loans, in which the "credit management" element is key.

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

Different skill sets are required to manage different kinds of non-performing loans. Larger CRE positions, leasing, secured SMEs, secured retail, unsecured SMEs and unsecured consumer credit are a few of the relevant classes. Specialisation in certain of these areas would allow the servicer to drive economies of scale on one hand, and also to become more effective it eh recovery of specific sub- asset classes.

Small and medium-sized operators, not surprisingly, tend to specialise in a few types (or even only one type) of loans. The advantages of specialization may be off-set by the necessity, if a bank has a diverse portfolio, to use multiple servicers, and the related set-up costs, which can be significant.

Larger operators are generally used for the workout phase on the bulk of mid and small positions, but parties can also work with a smaller specialized operators for benchmarking purposes or during the early recovery phase (soft collection).]

22) What specific services are offered by third-party loan servicers, in the markets and jurisdictions that are relevant to you? Which services do you consider to be most instrumental in terms of market efficiency? Please be as concrete as possible.

The following services are considered most relevant and helpful:

- high-volume services: call center management, mailing management, investigations; and
- high-skill services: legal expertise (capability to choose among judicial and extrajudicial procedures; capability to perform cost-benefit judgements).

23) 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?

The existence of third party servicers is of utmost importance to ensure the development of a secondary market for NPLs.

In order to eliminate regulatory uncertainty, it would be useful to have an EU regulatory framework. It would be preferable to use a European Regulation rather a Directive, in order to ensure a homogeneous framework in the different jurisdictions and regions.

The introduction of licensing requirements or a registry of servicers could bring additional clarity, but it is not necessary for the sector to develop, as it will naturally emerge once the number of transactions increases. It might also be helpful to provide benchmarking of third-party loan servicers to banks to enable them to make more informed decisions when requesting their services.

The IMF[24] recently proposed to facilitate the licensing of nonbanks that service NPLs. This would lower the cost of entry into this market and allow for greater specialisation. In addition, the use of specialist NPL servicing and legal workout agencies, and more efficient collateral auctions would help raise recovery values.

An effective regulatory framework that provides some level of supervision can serve, among other things, as a reputational safeguard for the mandating banks against possible unfair or onerous practices or reputational accidents caused by the servicers.

Although we agree that from a seller's perspective having a common European framework would be advantageous, especially where national frameworks may be more recent / weaker (see Eastern Europe), we also note that from the perspective of creating a market, and from a buyer perspective, a European framework for servicers could potentially mean more rules and higher costs that might result in lower prices /more barriers. These effects need to be considered and balanced when thinking about a EU regulatory framework for third party loan servicers.

24) Are there any other elements that should be covered by such a legal framework? Please provide any other comments that you find useful in relation to this section.

Closer supervision of the loan servicing industry would be advisable to assess the adequacy of its IT infrastructures, resources and past performances and to prevent any aggressive or unfair collection or enforcement practices.

REMOVING POSSIBLE CONSTRAINTS TO THE DEVELOPMENT OF SECONDARY MARKETS FOR LOANS

25) 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?

In Spain there is a voluntary Code of Best Practices on protection of low-income mortgage borrowers since 2012 that only affects banks. Although it cannot be considered a limitation, it is a distinction of the market. The Code establishes a moratorium on mortgage foreclosures until 2020 and sets out a plan for restructuring mortgages of families suffering extreme economic hardship and unable to pay the mortgage on their primary residence.

The German market is stricter with regards to the sale process than other jurisdictions (for example Italy, where there appears to be more flexibility in negotiating an agreement on loan sales, but we don't see this an obstacle, but rather as a requirement for different processes and handling of loan sales in Germany.

In CEE countries, there are normally more rounds of negotiation on price, since processes in emerging markets are generally less efficient and less standardised than those in developed markets.

26) As a market participant, are you actively partaking in several national markets?

[24] IMF Staff Discussion Note (2015) "A Strategy for Resolving Europe's Problem Loans"

If so, do you encounter obstacles to operate internationally in an efficient manner? Please specify.

Some of our members take part in several national markets, and they have not indicated that they have encountered significant obstacles, but we believe that any processes imposed should take into account and, if necessary, be tailored to the peculiarities of each relevant jurisdiction.

27) 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.

Some countries allow a transfer of a loan only to financial services entities (for example, HU), where a potential purchaser of a loan would have to apply for such a licence before the transaction. According to Cmock (2016), obtaining such a licence can take several months (in HU, up to 180 days). Likewise, according to the IMF, in some countries like HE, loan transfers are limited to other banks operating domestically[25].

As another example, Spain imposes restrictions on the sale of loan portfolios to non-bank entities, including that for certain types of security (i.e. Spanish floating mortgages and Spanish financial collateral) eligible creditors are limited to financial institutions.

Certain countries (for example Italy and some of the CE countries) require an investor to partner with a local management company in order to comply with national regulation.

In addition, some countries include data secrecy restrictions and/or impose constraints on this market through fiscal regulation.

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.

In a recent report, the IMF[26] found that some European countries lack licensing or regulatory regimes allowing non-banks (or nonfinancial institutions) to own or manage NPLs.

28) 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?

Generally, we believe that further standardization of regulatory and other processes and a common EU legal approach would be very helpful.

We also believe that the following items would help to facilitate existing cross-border activities:

- **Review taxation rules relating the transfer of NPL portfolios:** particularly with respect to withholding taxes and transfer taxes.

[25] See IMF (2015) Discussion Note. Recent legislative initiatives in HE have seek to address this barrier.
[26] IMF Staff Discussion Note (2015) "A Strategy for Resolving Europe's Problem Loans"

According to KPMG[27], local tax rules in some CEE countries can be "ambiguous and lead to uncertainty for banks wishing to dispose of their NPLs", while in some jurisdictions, the rules do not provide a comprehensive framework for the regulation of the sale of NPLs.

- **Full loan loss deductibility should provide incentives for banks to accumulate loan losses reserves.** Although tax deductions for loan provisions are allowed in most cases, they are often subject to a cap, creating disincentives to provisioning. Likewise, according to IMF[28] surveys in European countries, tax deductions for loan write-offs or for loan principal reductions are not allowed in about 60 percent of surveyed countries. The IMF proposes to review tax rules that discourage creditors from provisioning or from writing-off loans.

- **Harmonised insolvency regimes:** Sound insolvency regimes provide clarity to creditors about the likelihood that viable companies restructure and serve their financial commitments; the time it takes to complete an insolvency; or the share of assets that could be recovered upon an insolvency. These factors are widely considered by investors when deciding on whether to purchase NPL loans in a given jurisdiction.

  According to PwC's 2015 Portfolio Advisory Group Market Survey, NPL investors consider that the Geography/jurisdiction where the NPL assets are located is the second most important factor when considering an investment (second to data quality)— where country-specific factors such as insolvency regimes, the judicial capacity of the legal system, or more broadly, the quality of the legal framework, are key to determining the appetite to purchase assets in a given country.

  Harmonised minimum standards of insolvency frameworks can contribute to development of the market. On November 22nd 2016, the European Commission published its "Directive on preventive restructuring frameworks and second chance for entrepreneurs". The Directive seeks to harmonise insolvency proceedings with minimum standards for companies to restructures at an early stage; use of out-of-court proceedings; protections for new and interim financing; provisions related to specialisation of courts as well as qualifications of insolvency practitioners; and valuation procedures, among other provisions.

- **Improve legal framework of collateral enforcement and resolution:** In some countries, market participants have also found it difficult to undertake a rapid enforcement of their collateral, which can often involve lengthy in-court proceedings. According to the EBA[29], in some countries there are several procedural rules that offer "relatively easy possibilities for the borrower to dispute creditor actions with the aim of prolonging a creditor's foreclosure processes". Weak debt enforcement procedures raise the legal cost of debt restructuring, reducing in turn the expected recovery rate on distressed loans.

[27] KPMG (2016) "Tax impediments to the sale of non-performing loans ('NPLs') in Central and South Eastern Europe ('CESEE')

[28] IMF Staff Discussion Note (2015) "A Strategy for Resolving Europe's Problem Loans"

[29] EBA Report on the Dynamics and Drivers of Nonperforming Exposures in the EU Banking Sector (2016).

The IMF[30] and the EBA have proposed to strengthen debt enforcement and foreclosure processes, seeking to simplify and streamline them. The IMF recommends that out-of-court enforcement and foreclosure procedures should be considered where appropriate.

- **Harmonizing the regulatory framework for the transfer of NPLs:** removing existing obstacles such as the requirement for a debtor's consent and notary interventions, as well as, importantly, addressing the lack of an electronic register of real estate on foreclosure and bankruptcy proceeding data is of the utmost importance

29) 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?

As stated above, we believe that further standardisation of regulatory and other processes would be helpful in increasing certainty for investors and other market participants. It would also help to streamline procedures and result in quicker and more efficient resolution of NPL transactions, which would help to free up financing while improving the balance sheet of banks and other relevant entities.

b. loan servicing by third parties?

It would be helpful to eliminate some of the constraints on participation and activities of third parties that are imposed by the particular laws and rules in certain jurisdictions. It would also be helpful to institute some level of standardisation with regard to licensing and supervision of third-party loan servicers in order to instil and develop confidence in their industry and work, taking due care on the implications this may create to the entrance of new participants to the market (i.e. taking due care of not creating significant or unwarranted barriers to entry to potential new participants).

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.

Among other things, we believe that it would be helpful to harmonise contract processes, transfer agreement frameworks, market access rules, licensing requirements, relevant tax policies, and rules relating to data protection and trade secrets.

In particular, licensing requirements for third-party servicers would be helpful both as a control over their activities to make sure that they are lawful and consistent with the goals and expectations of the NPL Action Plan, and also a means to instil confidence in their actions and the market in general. Harmonising the other aspects mentioned above would help to increase certainty, and therefore confidence, in secondary markets for NPLs.

However, any form of standardisation or access rules should consider potential unintended consequences this may create to the entrance of new market participants.

[30] IMF Staff Discussion Note (2015) "A Strategy for Resolving Europe's Problem Loans"

30) 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.)?

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

We have identified that data on NPL market activity is fairly opaque. Notwithstanding that some of the largest management consulting companies compile and make publicly available EU loan sales transaction volumes, the information is not usually consistent across providers. Likewise, prices paid in the different loan transactions are usually not available, and loan outcomes (i.e., whether the loan was resolved/foreclosed, restructured) of past transactions, would be very helpful in evaluating the performance of loan management or loan recovery strategies.

To contribute to the analysis and supervision of the market, we would advise supervisors to conduct data compilations of EU portfolio transactions and to ideally make some of the information publicly available for analysis by market participants.

Public disclosure, however, should consider the appropriate form of aggregation so that information deemed price sensitive or confidential is not widely disseminated. Disclosure should of course take into account implications on financial stability or disclosing market-sensitive information.

Such information can also help banks and investors to make a more informed decision when choosing suitable loan servicers to partner with[31].

Data compilation efforts can also contribute to the Commission's effort of conducting benchmarking exercise of national loan enforcement regimes, in the context of the Council's action plan on NPLs.

SECTION II: POTENTIAL MECHANISM TO BETTER PROTECT SECURED CREDITORS FROM BORROWER DEFAULT

THE RATIONALE FOR A POSSIBLE EU ACCELERATED LOAN SECURITY

31) 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?

<u>Belgium:</u>

In Belgium, out-of-court enforcement is currently not possible for pledges (including receivables pledges, business pledges and inventory pledges), unless these qualify as financial collateral arrangements.

[31] See for example US FHFA report on loan sales https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Dec2016_NPL_Sales_Report.pdf

The Belgian legislator has adopted a new framework for movable asset security, pursuant to which such out-of-court enforcement will be generally possible for all security over movable assets. The entry into force of such framework has been postponed a number of times and is currently foreseen for 1 January 2018.

This new feature is generally welcomed by market participants in Belgium. It is expected that this reform will reduce unnecessary transaction/enforcement costs. In general, lenders will be able to act more swiftly in an enforcement scenario. It should be noted, however, that any action taken by a secured lender in these circumstances will be subject to ex post judicial scrutiny. It is expected that enforcement provisions in security documents will become more detailed to provide the lender with clear guidelines for enforcement. Faster enforcement and resolution procedures will have a positive effect on resolving NPLs and helping banks to more efficiently remove them from their balance sheets.

Italy

In Italy, the so-called "patto Marciano" was introduced by D.L. 59/2016 converted in Law n.119/2016. The lender and the borrower can agree, also after having signed a loan contract, that the collateral be transferred from the borrower to the lender after the borrower's default. If the value of the property, determined by a third party, is higher than the outstanding debt, the lender returns the difference to the borrower, after deducting extra costs for interests, appraisals, lawyer, etc.

The benefits are potentially huge: no foreclosure costs, no auction value depreciation (higher sale price), shorter liquidation timing, improvement in debtors' discipline, possibility (upon negotiation) of full debt discharge for the borrower in case of sale at price lower than debt, etc. In practice, however, no bank has ever made use of this possibility due to the high risks of consequent claims and potential economic loss if the repossessed assets are not sold in a timely manner or at the desired price. The main risk for litigation is the relationship with insolvency and bankruptcy when many creditors claim rights on the asset.

Spain

There is an extra judicial sale process, which is an auction carried out by a notary. This process can be included in pledges, mortgages, etc., and can be applied to any kind of asset, including real estate. After an event of default (or after acceleration, depending on the threshold set in the contract) the creditor can initiate the procedure, where appropriation is not possible. The process is usually fast, but if the debtor opposes to the execution, the judicial process would likely take longer. It can be applied both for firms and households.

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

Indeed, there are benefits arising both from the use of the out-of-court instrument for avoiding foreclosures itself and from the standardization and certainty provided by this instrument. This should result in fewer disadvantages based on the different insolvency and enforcement regimes in EU countries. In any case, a full and clear regulatory framework should be provided and it should be very clear how this instrument will work within existing European enforcement and insolvency frameworks.

33) Do you see the accelerated loan security as a valuable instrument to avoid future accumulation of NPLs in banks' balance sheets?

It is a valid and valuable instrument for avoiding certain standard (costly, long and not homogeneous) foreclosure proceedings and will increase certainty around timing, while also increasing the rate of recovery and discouraging delinquency and fraud.

However, this potential new instrument must be consistent with insolvency and other regulations in order to make sure that it is not abused or used in a manner that results in unfair prejudice to the rights of certain market participants. Permitting the holder of an accelerated debt instrument to enforce its security at a time when the company may be in trouble while exposing all other creditors to clawbacks or other asset transfer restrictions at that time may not result in the best result for the company or the creditors.

Having said that, a properly structured accelerated debt instrument might be very helpful in allowing banks to resolve NPLs and remove them from their balance sheets.

FUNCTIONING OF A POSSIBLE ACCELERATED LOAN SECURITY INSTRUMENT

34) 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?

See the response to question 33 above. Otherwise, yes, we agree in principle.

However, we believe that further consideration should be given to the impact of price fluctuations in the price of the collateral. The full discharge of the debtor may discourage banks, as the risk of a reduction in the price of the collateral is born by the bank, while an increase only benefits the debtor.

35) 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?

A bank that repossesses an asset should be permitted to re-sell the asset without passing any liabilities, transcriptions or pledges to the purchaser, as is the case in foreclosures after the auction is awarded and title to the property is transferred.

In some countries, an EU accelerated loan security would have to be recorded in the public registry in order to be effective. However, and generally speaking, private documents may not currently have access to the applicable public registry. In our opinion, the best option would be to introduce an exception so that these accelerated loan securities can have access to the public registry directly, without requiring the intervention of a notary (but, of course, complying with other formal requirements).

In addition, lenders should be allowed (and granted free of charge) access to all public and private data registers (Chambers of Commerce, cadastral offices, mortgage registries, credit registries, real estate transactions, length of foreclosures from PST Justice database, etc.), so

that banks can perform proper due diligence before deciding to activate the “private” foreclosure process.

36) 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.

There should be no exclusion for corporate loans with respect to a primary residence, unless the debtor is a small entrepreneur or agricultural sector worker. If the relevant house ceases to be the primary residence of the borrower, but the bank is still prohibited for seizing it, the borrower should be required to have all its goods “frozen” for a certain amount of time so that they are not available for disposition. On the contrary, if the primary residence has been transformed into collateral after the signature of the loan contract, such transfer of the residence should be considered null.

In any case, if the borrower has declared that the asset is not a primary residence, he should not be able to appeal that decision in the future. Self-employed workers should also be excluded in order to avoid conflicts.

37) 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 the assets becomes less than the debt)?

Debtors would be incentivized to use this security if it is cheaper compared to other securities in terms of tax, registration requirements, etc. While this security should generally be used if it is contractually agreed between the bank and the debtor, it might be useful under certain circumstances.

In any case, it should be up to the lender to decide, from time to time, whether to use the accelerated loan security or the standard foreclosure procedure. The borrower should not have any option to choose which of the possible remedies the lender will use.

RELATIONSHIP WITH RESTRUCTURING AND INSOLVENCY FRAMEWORKS

38) How should an accelerated 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?

European regulation on the subject should be as detailed as possible, in order to limit uncertainty. It should include details such as the entity that would carry out the execution of the security if it is decided to auction the asset, the types of collateral that can be affected, the

functioning of this accelerated loan security in a restructuring or insolvency situation, and its hierarchy and relation with other guarantees.

As stated above, it should also be very clear how any such instrument is treated upon insolvency (or, if applicable, during any pre-insolvency agreements amongst the parties). The effect of such insolvency-related measures as stay provisions, cramdowns, relationship to new or interim financing, etc. must be clearly enumerated and understood in order to avoid uncertainty or misunderstandings.

39) 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?

One of the main obstacles are the current privileges granted to the debtor, as the party that is often seen as being in a weaker position. This can, in some cases, have a negative effect on negotiations relating to potential opposition or revocation. The effects of bankruptcy laws and excessive judicial discretion could also undermine the instrument. The ranking of privileges should be clarified by law, since it is not entirely clear nor definitive, and many times has been defined by court decisions rather than by legislation. Please note that the relationship between an accelerated loan security and other guarantees or credit support should also be determined (if an asset could be charged with this accelerated loan security and any other security).

Self-employed workers should be excluded from the scope of this security, in order to avoid conflicts. Also, in order to foster the expansion of accelerated loan securities, incentives for demand could take the form of tax exemptions (like stamp duty). This measure could be more effective than the discharge from further repayment obligations.

40) How should an accelerated loan security instrument be designed in order to be consistent with the existing national collateral legal framework?

The Italian example could be a good one but we believe that it needs further consideration to correct its many weaknesses and uncertainties. The crucial issue that should be amended in order for the instrument to work in a proper manner are the provisions related to the transfer of property. We advocate that instead of the transferring the property, the borrower should be obliged to grant the bank (or any other broker, estate agent, real estate company, etc.) power of attorney for the sale of the asset on the market at a price estimated by an independent third-party expert. Only when and if the bank succeeds in selling the asset, the bank should be obliged to return the excess of the sale proceeds or reduce the outstanding debt if sale price was lower than debt. In this way all taxes and liabilities will be based on a real sale price (and not on an estimated value). The direct ownership transfer should be considered only after an unsuccessful proper sale period.

Furthermore, it should be clearly stated that the bank has the possibility to rely on its own real estate companies or licensed brokers for selling the asset with power of attorney (without the risk of being blamed for conflict of interest). The power-of-attorney contract must be irrevocable. In addition, the provision should clearly state what happens in case the debtor is not reachable and house is left empty.

When both parties agree to sell the asset even at the cost of lowering the price, the independent third-party estimated value should be "amended" by mutual written agreement. In such case the bank could be requested to discharge the debtor from all its obligations even if the sale price was lower than the outstanding debt.

We would also recommend introducing a prohibition on the repurchase of the asset by relatives of the debtors (in order to avoid manipulation of the "patto marciano" at values lower than the full outstanding debt) as well as discharging the bank of any extra-costs in the event of authorised eviction of any occupant.

As to additional features/services that could enhance the effectiveness of the accelerated loan security we deem that the bank should be granted free and unlimited access to public registries for better evaluate the operation (i.e. chamber of commerce data bank, cadastral registry, real estate mortgage registry, Centrale Rischi of Bank of Italy and private credit bureaus).

Taking all of this into account, however, there are potential concerns with the Italian model that might be relevant to an accelerated loan facility generally. For example, if only a power of attorney is granted, the rank of this security could be negatively affected (i.e. if a subsequent security -a pledge, or a mortgage-, or a charge/ lien is created, it might have superior rights to the assets than any rights held by the holder of a power of attorney). Consideration of the framework under the Directive 2002/47/CE on financial collateral agreements might be helpful in analysing how this instrument should be put into place. Similar to the Financial Collateral Directive regime, this instrument could consist of a new typology of security that has its own specific regulation, which would be considered a "special law" (so it could be applied even in insolvency situations, provided that it does not conflict with the "general laws").

Please note the following aspects that should also be considered:

- relationship with other securities that might be charging (with prior or posterior rank) the asset;

- how could this security be opposed to third parties (i.e. how can have access to the land registry, for example); and

- how would this security be executed (i.e. valuations, costs, procedure, etc.)

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