EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 16 August 2019

on the sale and purchase of credit facilities

(CON/2019/30)

Introduction and legal basis

On 6 June 2019 the European Central Bank (ECB) received a request from the Ministry of Finance of Cyprus for an opinion on a draft law amending the Law on the sale and purchase of credit facilities of 2015[1] (hereinafter the 'draft law'). On 9 July 2019 the Ministry of Finance submitted a new request for an opinion on a revised version of the draft law.

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC[2], as the draft law relates to the Central Bank of Cyprus (CBC) and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets, and the tasks conferred on the ECB pursuant to Article 127(6) of the Treaty concerning policies relating to the prudential supervision of credit institutions. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The aim of the draft law is to improve certain aspects of the Law on the sale and purchase of credit facilities of 2015 (hereinafter the 'Law'). In brief, the Law governs the sale and purchase of credit facilities in Cyprus and grants the CBC the power to authorise, regulate and supervise entities that wish to engage in transactions for the acquisition and sale of credit facilities.

1.2 The Law currently applies to credit facilities afforded to an individual or to a small or micro enterprise or group of affiliated enterprises the total balance of which does not exceed EUR 1 million, above which threshold the Law is not applicable. The draft law abolishes this threshold and provides for exemptions from the Law's scope of application in respect of transactions that are subject to foreign law, the Law on securitisation of 2018[3] or the Law on transfer of banking activities of 1997[4]. The draft law also removes existing exemptions from the Law's scope of application with respect to credit facilities that (a) have been granted by a credit institution or a branch of a credit institution to a natural person not permanently domiciled in Cyprus or to a legal

1 Ο περί Αγοραπωλησίας Πιστωτικών Διευκολύνσεων και για Συναφή Θέματα Νόμος του 2015 (N. 169(I)/2015).

2 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

3 Ο περί Τιτλοποιήσεων Νόμος του 2018 (N. 88(I)/2018).

4 Ο περί της Μεταβίβασης Τραπεζικών Εργασιών και Εξασφαλίσεων Νόμος του 1997 (N. 64(I)/1997).

entity not registered in Cyprus; or (b) concern activities or investments outside Cyprus; or (c) are secured by a mortgage on an immovable property or an encumbrance located outside Cyprus.

1.3 The draft law also expands the list of legal persons entitled to purchase credit facilities under the Law, by adding institutions that engage in immovable property transactions in accordance with the Law on credit agreements for consumers relating to residential immovable property of 2017[5] and legal entities that have secured the prior written consent of the CBC following a substantiated and duly justified application that explains why they are not required to apply for authorisation as a credit acquiring company. The Law currently provides that a seller of credit facilities needs to be one of the entities eligible to purchase credit facilities or any other legal entity that has secured the CBC's prior written consent for this purpose. The draft law removes this requirement and simply allows eligible purchasers to acquire credit facilities from any non-authorised entity in possession of such credit facilities.

1.4 Furthermore, the draft law establishes a framework for the licensing of credit servicers by the CBC and brings credit services under the CBC's supervisory scope. The draft law sets out the application procedure for the licensing of servicers and the procedures for the suspension and termination of these licences. It provides that any material changes that affect the information or documents submitted to the CBC as part of that procedure, the appointment of any member of the management of an authorised servicer and any increase or decrease in any special participation rights in the ownership structure of authorised servicers must be notified to and, where appropriate, approved by the CBC. The draft law also sets out the rules as regards the appointment of servicers by entities authorised to carry out credit activities in accordance with the Law, which include the requirement to enter into a written agreement with these entities governing the servicing of the credit facilities portfolio. The CBC may determine the minimum terms and requirements of such agreements by way of issuing directives.

1.5 The draft law also allows credit servicers that engage in the collection and recovery of debt collection and the renegotiation with borrowers of the terms of credit facilities to obtain access to data related to serviced credit facilities. In particular, credit servicers may submit requests to the CBC for access to the CBC's credit registry as regards the credit facilities they are to manage, and the CBC may accept or reject such requests. A request may only be granted for the purpose of servicing the credit facilities in accordance with the relevant outsourcing agreement and on the basis of the criteria and terms and conditions laid down by the CBC by way of issuing directives or in any other manner. If the CBC approves a request, the servicer will also be entitled to have access to the database of the Department of Lands and Surveys. The explanatory memorandum notes that such access to data will enable credit servicers to assess the borrowers' creditworthiness, resulting in a more effective evaluation of their repayment ability and in improvement of the proposed restructuring solutions, and that this is in compliance with Regulation (EU) 2016/679 of the European Parliament and of the Council[6].

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5 Ο περί Συμβάσεων Πίστωσης για Καταναλωτές σε σχέση με Ακίνητα που προορίζονται για Κατοικία Νόμος του 2017 (N. 41(I)/2017).

6 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (OJ L 119, 4.5.2016, p. 1).

1.6 In addition, the draft law provides that entities that intend to sell credit facilities must notify their security providers, as well as the underlying borrowers and their guarantors, and provide them with the opportunity to submit within 45 days from the date of notification a proposal for the purchase of the relevant credit facilities. It also introduces an exemption from this ex ante notification requirement in respect of credit facilities sold within the same group of companies. The transferor, at the time of the transfer and/or on the date of publication of the notice to the relevant governmental departments, must notify, free of charge, the registrar of the competent court and the Department of Lands and Surveys in relation to any proceedings which are pending before them, and such notification will constitute a final notification with regard to the transfer of the underlying credit facilities and their finality. The draft law requires the Registrar of Companies, the Department of Lands and Surveys, the Cyprus Stock Exchange and any other relevant governmental department to update their records to show the name of the new holder of the credit facilities. The transfer of credit facilities and collateral pursuant to the Law should not be subject to any charges or tax[7].

1.7 Finally, the draft law expands the ex post notification requirement to cover not only underlying borrowers, but also security providers and guarantors, the Registrar of Companies, the Department of Lands and Surveys, the Cyprus Stock Exchange and other relevant governmental departments. Accordingly, the seller and the purchaser are required (a) within 15 days from the transfer of the credit facilities to jointly and by post notify the underlying borrowers, the security providers and the guarantors of the transfer of the credit facilities and related collateral of the contact details of the persons that will be handling these facilities and the updated account details, and (b) on the date of the transfer or no later than the next business day to jointly and by means of personal service notify the abovementioned governmental departments of the sale and transfer of the credit facilities and provide them with the necessary information for the purposes of updating their records.

2. General observations

2.1 The ECB recalls that it was consulted on the draft version of the Law and issued its observations in Opinion CON/2015/45[8].

2.2 *Tasks of the CBC*

2.2.1 The draft law complements the CBC's existing tasks, particularly in respect of the supervision of regulated financial service providers and regulated businesses. However, it does not confer genuinely *new* tasks on the CBC in this area. For example, in respect of credit acquiring companies, the CBC already has powers to authorise and supervise such entities, to make them subject to the CBC's directives, and to take enforcement measures against them[9]. Consequently, the issue of assessing the conferral of new tasks on a national central bank (NCB) from the perspective of the prohibition of monetary financing does not arise[10]. The ECB notes, in any event, that the principle of financial independence requires that the Member States may not put their

7 See Article 17 of the draft law, which amends Article 18 of the Law, for the provisions referred to in this paragraph.

8 All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

9 See Articles 17, 20 and 21 of the Law.

10 See paragraph 3.1 of Opinion CON/2018/27 and paragraph 2.1 of Opinion CON/2018/31.

NCBs in a position where they have insufficient financial resources to carry out their European System of Central Banks (ESCB) or Eurosystem-related tasks[11]. Therefore, when allocating specific non-ESCB related tasks to the NCBs, additional personnel and financial resources must also be allocated so that these tasks may be carried out in a manner that will not affect the NCBs' operational or financial capacity to perform their ESCB or Eurosystem-related tasks[12].

2.2.2 Furthermore, the ECB notes that, according to the Law, credit acquiring companies must pay an annual fee of EUR 3 000 in order to cover the costs incurred by the CBC in carrying out its supervisory functions[13]. The ECB wishes to reiterate that a more flexible mechanism for determining the fee level would be more appropriate, with a view to safeguarding the CBC's financial independence. For example, it may be useful to include a provision in the Law that will allow the fees to be increased, if needed[14]. In addition, the ECB suggests that the legislator considers whether, for the sake of consistency, the Law should also cater for the reimbursement of the CBC for costs incurred in the context of the licensing and supervision of credit servicers.

2.3 *Impact on secondary markets for credit institution assets*

2.3.1 The ECB has been a strong proponent of the development of secondary markets for bank assets, particularly non-performing loans (NPLs), as reflected in the Council's action plan to tackle NPLs in Europe[15]. In the context of the large stocks of NPLs that remain on the balance sheet of some European credit institutions, and as part of a comprehensive solution to NPL resolution[16], the development of secondary markets may contribute to reducing NPLs. Looking ahead, well-functioning secondary markets may also prevent stocks of NPLs building up in the future[17].

2.3.2 Moreover, a well-functioning secondary market may have a positive effect on financial stability to the extent that it could facilitate the transfer of the risks of NPLs off credit institutions' balance sheets. The presence of significant volumes of NPLs on credit institutions' balance sheets reduces their ability to fulfil their function as providers of credit to the real economy and hampers the operational flexibility and overall profitability that are essential to a well-functioning banking sector. It is essential that the legal framework applicable to secondary markets enables the efficient transfer of NPLs off the balance sheet of credit institutions[18].

2.3.3 While risk transfer through asset sales, securitisation and other measures may be effective in reducing NPLs, risk reduction measures remain, nevertheless, an important channel, particularly in a context where NPL stocks are high. In that regard, and in the context of a comprehensive solution to NPL resolution, the originating credit institutions' internal procedures for handling the work-out of NPLs themselves will always remain important[19].

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11 See paragraph 2.4.1 of Opinion CON/2015/45.

12 See paragraph 2.2.5 of Opinion CON/2017/32 and paragraph 3.2.3.5 of Opinion CON/2018/16.

13 See Article 16 of the Law.

14 See paragraph 3.1.1, 3.1.6 and 3.1.8 of Opinion CON/2015/45.

15 See the Council's press release of 11 July 2017 on the 'Council conclusions on Action plan to tackle non-performing loans in Europe', available on the Council's website at www.consilium.europa.eu

16 See, for example, Section B of the ECB's November 2016 Financial Stability Review, available at www.ecb.europa.eu.

17 See paragraph 2.2.1 of Opinion CON/2018/31 and paragraph 1.1 of Opinion CON/2018/54.

18 See paragraph 2.2.2 of Opinion CON/2018/31 and paragraph 1.2 of Opinion CON/2018/54.

19 See paragraph 2.2.4 of Opinion CON/2018/31.

2.4 *Impact on securitisation*

2.4.1 The ECB has a strong interest in the sustainable revival of the European securitisation market. As a form of asset-based financing with the capacity both to channel flows of credit to the real economy and to transfer risk, securitisation has particular significance for the transmission of monetary policy. A healthy European securitisation market is important to ensure well-functioning capital markets in the Union. Particularly where credit institutions' capacity to lend to the real economy is constrained, securitisation can act as a fresh source of funding and free up capital for lending. Securitisation may also have a positive effect on financial stability to the extent that it can facilitate the transfer of the risks of NPLs off credit institutions' balance sheets[20]. Securitisation is one of a variety of options that banks may apply alone or in combination with other measures, such as borrower-creditor engagement, to address the issues posed by NPLs[21].

2.4.2 The ECB understands that the draft law intends to exempt securitisations from its scope. The ECB welcomes this intention, as this will ensure that the draft law does not discourage securitisation activity[22].

2.5 *Interaction with prospective Union legislative measures*

2.5.1 Finally, the ECB notes that on 3 March 2018, the Commission published its proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral[23]. This proposal seeks to set out a common Union framework and requirements for credit servicers, credit purchasers, and for the recovery of collateral in respect of credit agreements concluded with business borrowers, with a view to ensuring a high level of consumer protection and a level playing field across the Union. If this proposed Directive is adopted by the European Parliament and the Council, its provisions will be transposed into Cypriot law, potentially requiring further amendment of the rules applicable to credit ownership and credit servicing[24].

3. Specific observations

3.1 The ECB takes note of the abolition of the current threshold of EUR 1 million, above which the Law is not applicable as regards sales of credit facilities to natural persons and micro and small enterprises. The ECB understands that, by abolishing this threshold, the Law will become applicable as regards any kind of credit transaction undertaken by the entities set out in the Law, except in respect of transactions which are subject to foreign law, securitisations and transfers of banking activities. It is understood that, as a result of this amendment, any entity wishing to engage in credit transactions in Cyprus will need to comply with the requirements of the Law and, in particular, with authorisation requirements and ex ante and ex post notification requirements.

3.2 The ECB also takes note of the expansion of the list of legal persons entitled to purchase credit facilities under the Law and, in particular, the inclusion of legal entities that have been granted prior

20 See paragraphs 3.1.1 and 3.1.2 of Opinion CON/2018/16 and paragraph 2.3.1 of Opinion CON/2018/31.
21 See paragraph 2.3.1 of Opinion CON/2018/31.
22 See paragraph 2.3.2 of Opinion CON/2018/31.
23 COM(2018) 135 final.
24 See paragraph 2.4.5 of Opinion CON/2018/31.

written consent from the CBC[25]. It is understood that these legal entities will not fall within the supervisory scope of the CBC and that, in particular, the provisions concerning changes to qualifying holdings, suspension and revocation of authorisation, supervision, minimum capital, assessment of management bodies, submission of information and the carrying out of investigations apply only in relation to credit acquiring companies and credit services[26]. The consulting authority may nonetheless consider whether these provisions should also apply to legal entities that have obtained the CBC's prior written consent. In addition, from a technical drafting perspective, the words 'or natural person' in Article 4 of the draft law may need to be removed as the rest of the provision refers only to legal persons.

3.3 As regards the revised ex post notification requirements, the ECB understands that by requiring the transferor and the transferee to notify not only the underlying borrowers as regards completed credit transactions but also their guarantors and security providers, as well as the relevant governmental departments[27], the legislator may have intended to achieve greater transparency and to ensure that the records held by these departments are kept up to date. However, the consulting authority may need to consider the potential implications that the requirement to notify the guarantors and security providers might have in practice, and in particular whether it might create a risk of judicial challenge on procedural grounds, for example in a situation where one security provider has not been properly notified or not notified at all, and whether this may potentially create an obstacle to the smooth execution of transactions for the sale and purchase of credit facilities.

3.4 The draft law requires the CBC to issue a directive governing the procedure for approving or rejecting applications for authorisation of credit servicers[28]. The ECB understands that, on the basis of this provision, the CBC will not be able to consider any applications submitted by credit servicers until it has first issued a directive setting out the applicable procedure that it would need to follow. This, however, may have the consequence of delaying the practical implementation of the Law with regard to the granting of authorisations to servicers until such time as the CBC issues the relevant directive. It is therefore proposed that the wording of the relevant article should be revised in a manner that would allow, rather than require, the CBC to issue a directive regulating its internal authorisation procedure.

3.5 The ECB also takes note of the intragroup exemption introduced with regards to the ex ante notification requirements. It is understood that the purpose of this exemption is to alleviate the notification burden in respect of credit transactions carried out within the same group of companies[29].

3.6 Finally, the ECB reiterates its understanding that the Cypriot authorities opted not to impose express limits on leverage and liquidity requirements on credit acquiring companies, in order to

25 See paragraph 1.3, and Article 4(f) of the Law (as inserted by Article 4 of the draft law).

26 See Articles 6, 8, 9, 10, 11, 12, 13 and 14 of the Law, respectively.

27 See paragraph 1.7.

28 See Article 4A(4) of the Law, as added by Article 5 of the draft law.

29 The term 'group of companies' is defined in the draft law by reference to the Companies Law, Cap 113, as a group of companies comprising the holding company and the subsidiary company or companies.

offer wider opportunities for new companies entering the market for such services, with a view to facilitating private debt restructuring[30].

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 16 August 2019.

[signed]

The President of the ECB

Mario DRAGHI

30 See paragraph 3.3 of Opinion CON/2015/45.