OPINION OF THE EUROPEAN CENTRAL BANK

of 12 November 2015

on the regulation of companies acquiring credit

(CON/2015/45)

Introduction and legal basis

On 5 November 2015 the European Central Bank (ECB) received a request from the Cypriot Minister for Finance for an opinion on a draft law regulating the activities of companies acquiring credit (hereinafter 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 (the 'Treaty') and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC[1], as the draft law relates to the Central Bank of Cyprus (CBC) and to the rules applicable to financial institutions insofar as they materially influence the financial stability of financial institutions and markets. 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 purpose of the draft law is to give the CBC the power to authorise, regulate and supervise the business activity of acquiring credit facilities that have been granted by a credit institution either: (1) incorporated in Cyprus and authorised under Cypriot law; or (2) operating through a branch in Cyprus[2]. These powers will allow the CBC to ensure that the activity of acquiring and managing credit facilities is carried out properly, and will also safeguard financial stability in Cyprus[3]. For this purpose, the draft law includes, in the definition of credit facilities, those that have been granted either to: (a) natural persons where the total balance of the credit facilities, at the time of the transfer, does not exceed one million euro; or (b) micro and small enterprises as defined under Union law where the total balance of the credit facilities to that enterprise or group of connected enterprises, at the time of the transfer, does not exceed one million euro[4]. Loans that do not meet these criteria can be sold to any legal entity without the CBC's approval.

1.2 The draft law provides that only certain specified legal entities are permitted to acquire credit facilities: (a) a credit-acquiring company incorporated in Cyprus and authorised by the CBC under

1 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).

2 In other words, a branch of a credit institution authorised and supervised in accordance with the law of a Union or European Economic Area (EEA) Member State.

3 See Article 3(1) of the draft law.

4 See Article 3(2) of the draft law. However, certain provisions under the draft law, e.g. those relating to obligations of selling institutions towards borrowers will apply to credit facilities exceeding those limits.

the draft law; (b) a credit institution incorporated in Cyprus and authorised under Cypriot law; (c) a credit institution authorised and supervised by the competent authority of another Union/EEA Member State that has the right to provide services or establish a branch in Cyprus; and (d) a financial institution that is a subsidiary of a credit institution incorporated in a Union/EEA Member State and that provides its services in Cyprus or operates in Cyprus through a branch, under the relevant provisions of Cypriot law[5]. The draft law further stipulates that these legal entities may subsequently sell the acquired credit facilities to either other legal entities referred to above or to other entities that obtain the CBC's prior written approval.

1.3 The draft law sets out the application procedure that a company must go through in order to obtain authorisation from a credit-acquiring company incorporated in Cyprus, including the documentation that the applicant company must submit to the CBC, and stipulates that the CBC shall only grant an authorisation if a number of conditions are met. The CBC must be satisfied that the company: (a) is in a position to fully comply with the draft law; (b) has shareholders and directors of good repute and with sufficient expertise to carry out their responsibilities; (c) has the organisational structure to enable it to provide its services in accordance with the draft law; (d) operates in such a manner that there are no concerns as to whether its activities may adversely impact financial stability in Cyprus; and (e) has no close links through professional or other relationships with any other entity or individual that, in the CBC's opinion, may prevent the CBC from carrying out effective supervision[6]. There are also provisions requiring persons to notify the CBC of changes to their qualifying holdings in a credit-acquiring company[7].

1.4 The draft law also sets out the CBC's supervisory powers over credit-acquiring companies under the draft law, and other supervisory requirements relating to minimum capital requirements, the assessment of the company's management body and key function holders, reporting to the CBC, the CBC's access to the company's books and records, the CBC's confidentiality duties and the imposition of supervisory measures and sanctions[8].

1.5 Without prejudice to the CBC's duty to keep information obtained under the draft law confidential, the draft law authorises the CBC to use any of the information provided to it under the draft law for the publication of anonymous, aggregated statistical data, which the CBC may publish[9].

1.6 The draft law empowers the CBC, pursuant to its own directives or guidelines, to regulate, inter alia: (a) the procedures for granting, suspending and revoking authorisation; (b) the criteria for the fitness and probity of shareholders, directors and key function holders; (c) the internal organisation and governance of the credit-acquiring company; (d) outsourcing; and (e) the process for reviewing, managing and restructuring non-performing loans[10].

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5 See Article 4(1)(a) of the draft law.

6 See Article 5(2) of the draft law.

7 See Article 6(1) of the draft law, which sets out the relevant qualifying thresholds.

8 See Articles 10 to 15 and 20 to 23 of the draft law.

9 See Article 15(2) of the draft law.

10 See Article 17(1) and (2) of the draft law.

1.7 The draft law provides that credit-acquiring companies must pay an annual fee of three thousand euro to cover the costs that the CBC incurs while carrying out its supervisory functions[11].

1.8 Finally, the draft law requires a credit or financial institution or a credit-acquiring company that decides to sell or dispose its portfolio of credit facilities to inform the borrower concerned. All the transferor's rights and obligations, including with respect to collateral underpinning the credit facility, are automatically transferred to the acquirer[12].

2. General observations

2.1 As stressed in previous urgent ECB opinions, given the very short timeframe within which the ECB has been consulted on this legislation, it has not been possible to thoroughly assess all legal, policy and regulatory issues that the draft law raises[13]. This opinion is based on the text of the draft law that was formally sent to the ECB by the consulting authority and does not address substantive amendments introduced in the draft law during the legislative process. If, prior to the ECB adopting its opinion, amendments were made that fundamentally change the draft law in areas in which the ECB has a specific interest, the ECB expects the consulting authority to submit the amended draft legislative provision to it as soon as possible, so that the opinion can be based on the most recent text[14].

2.2 The ECB understands that the adoption of the draft law is essential as it will enable credit institutions to dispose of non-performing loans, of which there are currently a high number in Cyprus with the understanding that the loans are transferred at an appropriate price. Allowing these loans to be disposed of would be beneficial in preserving financial stability in Cyprus, on the understanding that the loans are transferred at an appropriate price[15].

2.3 The ECB understands that by giving the CBC specific regulatory and supervisory authority over the activity of acquiring and managing credit facilities, the draft law intends to ensure that this activity is properly carried out, and more generally that the stability of the financial system in Cyprus is safeguarded.

2.4 The draft law extends the CBC's powers to the regulation and supervision of credit-acquiring companies, thus complementing the CBC's current responsibilities for supervising the activities of authorised credit institutions and the macro prudential supervision of the financial system to safeguard financial stability. The ECB underlines that, in the context of a proposed conferral of tasks on a central bank within the European System of Central Banks (ESCB), it is necessary to assess such a conferral against the prohibition of monetary financing under Article 123 of the Treaty. The ECB has developed the guidance set out in paragraphs 2.4.1 to 2.4.3 of this opinion, in the form of general and specific considerations, on the basis of which it may decide whether a new

11 See Article 16 of the draft law.

12 See Articles 18, 19 and 24 of the draft law.

13 See paragraph 3.3 of Opinion CON/2010/92. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

14 See, for example, paragraph 3 of Opinion CON/2004/16.

15 It is noted that the draft law would be applicable to both performing and non-performing loans.

task conferred on an ESCB national central bank (NCB) is to be considered a central banking task or a government task for the purposes of assessing such a conferral against the prohibition of monetary financing under Article 123 of the Treaty[16]. The concrete assessment of whether the CBC's task of supervising credit acquiring companies is to be considered a central banking task or a government task is then undertaken in paragraph 3.1 of this opinion.

2.4.1 *General considerations*

First, genuinely new tasks or those tasks that did not form an integral part of the central banking tasks already assigned to the NCB in the past must be systematically categorised as central banking or government tasks. In recognition of the different Member States' legal frameworks, central banking traditions and national set-ups, the tasks that an NCB currently carries out as central banking tasks are not reviewed and re-categorised, but may be reassessed if they are subject to substantial legislative amendments.

Second, the principle of financial independence requires that the Member States may not put their NCBs in a position where they have insufficient financial resources to carry out their ESCB- or Eurosystem-related tasks.

Third, central banking tasks comprise in particular those tasks that are related to the tasks listed in Article 127(2), (5) and (6) of the Treaty.

Fourth, new tasks conferred on an NCB that are atypical of an NCB's tasks, or which are clearly discharged on behalf of and in the exclusive interest of the government or of other public entities, should be considered as government tasks. In that context, a distinction should be drawn between the liquidity- and solvency-related tasks of NCBs. Whereas for the purposes of the prohibition of monetary financing, solvency support is a government task, liquidity-related tasks that have the ultimate objective of financing the economy are central banking tasks.

2.4.2 *Specific considerations*

Banking supervision and macro-prudential tasks are central bank tasks when carried out by an NCB, provided they do not undermine its independence in accordance with Article 130 of the Treaty.

An important criterion for qualifying a new task as a government task is the impact of the task on an NCB's institutional, financial and personal independence. In particular, the following should be taken into account.

First, it should be assessed whether the performance of the new task will create conflicts of interests with existing central banking tasks, and whether the new task actually complements those existing central banking tasks. If a conflict of interest arises between existing and new tasks, there should be sufficient mitigation measures in place to adequately address that conflict. Complementarity between the new task and existing central banking tasks should not, however, be interpreted extensively, so as to lead to an indefinite chain of ancillary tasks being created. Complementarity should also be examined in terms of how those tasks are financed.

16 See Opinion CON/2015/22.

Second, it should be assessed whether the NCB's financial and organisation capacity is disproportionate to the amount of time and resources it will need to perform the new task without additional financial resources and whether this could have a negative impact on the NCB's capacity to properly perform its existing central banking tasks.

Third, it should be assessed whether the performance of the new task fits into the NCB's institutional set-up when considering central bank independence and accountability.

Fourth, it should be assessed whether there are substantial financial risks inherent in the performance of the new task.

Fifth, it should be assessed whether the performance of the new task exposes the members of the NCB's decision-making bodies to political risks that: (a) are disproportionate, (b) could also have an impact on their personal independence; and in particular, (c) could possibly jeopardise the guarantee of their term of office under Article 14.2 of the Statute of the European System of Central Banks and of the European Central Bank.

2.4.3 Any final assessment on the qualification of a task given to an NCB as either falling within the scope of a central banking task or a government task should be guided by the objective of ensuring that the prohibition of monetary financing within the Eurosystem and the ESCB is consistently applied, to the extent that it applies to its members.

3. Specific observations

3.1 *Conferral on the CBC of the task of supervising credit acquiring companies*

The draft law designates the CBC as the supervisory authority for credit-acquiring companies, thus broadening its current functions and activities. In the light of the guidance set out in paragraphs 2.4.1 to 2.4.3, it must be assessed whether the CBC's new tasks constitute a breach of the prohibition of monetary financing.

3.1.1 *Principle of financial independence*

The principle of financial independence requires NCBs to have sufficient means to carry out not only their ESCB-related tasks from an operational and financial point of view, but also their national tasks[17]. In this regard the draft law provides that credit-acquiring companies must pay an annual fee, which is fixed at a level specified in the law, in order to cover the CBC's costs incurred in carrying out its supervisory functions[18]. As the impact of these new tasks on the financial position of the CBC is not clear at this stage, a more flexible mechanism for the determining the fee level would be more appropriate, with a view to safeguarding CBC's financial independence.

3.1.2 *Links to tasks listed in Article 127(5) of the Treaty*

Supervision over credit-acquiring companies can be considered a task related to those referred to in Article 127(5) of the Treaty, based on the understanding that it is complementary to the supervisory tasks exercised by the NCB, particularly where, as in this case, the CBC already

17 See the ECB's 2014 Convergence Report, p. 25.

18 See Article 16 of the draft law.

carries out supervision of credit institutions, including asset management activities[19], and has the task of ensuring the stability of the financial system[20]. The purchase of problematic loan portfolios by entities specialised in asset management can be a useful and effective tool that financial institutions can use to deal with non-performing loans on their balance sheets. Member States are not required to have a legal framework for supervising credit-acquiring activities under Directive 2013/36/EU[21]. However, point 11 of Annex 1 to Directive 2013/36/EU lists portfolio management as an activity that is subject to mutual recognition. To the extent that portfolio management covers credit acquisition and management activities, credit institutions authorised and supervised by the competent authorities of another Member State may carry these out in other Member States, provided that the appropriate credit institution has given the relevant authorisation for such activities.

3.1.3 *Atypical tasks*

The purchase and sale of assets such as loan portfolios typically forms a significant part of the business of an authorised credit institution or other specialised financial institutions, including, e.g., an asset management company. Generally, the ECB has accepted the fact that NCBs are allocated financial supervisory tasks related to specific areas, provided they do not interfere with the performance of the NCB's ESCB-related tasks[22]. An NCB's tasks with regard to the supervision of credit-acquiring companies can therefore be regarded as typical tasks of a central bank, particularly if, as in the CBC's case, it has a statutory responsibility for bank supervision and financial stability[23]. Moreover, the complementarity between the supervisory tasks already carried out by the CBC and the new task of supervising such companies is reflected in the common system of financing the CBC's supervisory tasks through contributions from the supervised entities.

3.1.4 *Discharge of tasks on behalf of and in the exclusive interest of the Government or of other public entities*

The CBC is designated as the sole supervisory authority for credit-acquiring companies in its own name and not on behalf of any other authority. There is no indication that, in carrying out its supervisory function, the CBC acts exclusively in the interests of another public entity.

3.1.5 *Extent to which conflicts of interests with existing CBC tasks are addressed and the performance of tasks fits into the CBC's institutional set-up in the light of central bank independence and accountability*

The conferral of these tasks on the CBC does not, at first glance, raise any issues with regard to conflict of interest. The performance of these tasks fits into the CBC's institutional set-up, and does not raise any issues as regards central bank independence and accountability.

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19 In accordance with Article 6(2)(d) of the Laws of 2002 to 2007 on the Central Bank of Cyprus, the CBC exercises supervision of banks. Banks are allowed to provide asset management services by virtue of item 11 in Annex IV to the Laws of 1997 to 2015 on the business of credit institutions.

20 Article 6(2)(e) of the Laws of 2002 to 2007 on the Central Bank of Cyprus.

21 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

22 See Opinion CON/2009/57.

23 See Article 6(2)(d) and (e) of the Central Bank of Cyprus Laws of 2002 to 2007.

3.1.6 *Extent to which the performance of tasks is proportionate to the CBC's financial and operational capacity and its ability to perform its ESCB-related tasks*

As noted above, in order to remain financially independent, NCBs must have sufficient means to carry out not only their ESCB-related tasks from an operational and financial point of view, but also their national tasks. In this regard the ECB welcomes the fact that the draft law provides that the CBC's costs for supervising credit-acquiring companies will be covered by such companies. However, as mentioned above, the ECB considers a more flexible mechanism for the determination of the fee level to be more appropriate in order to safeguard the CBC's financial independence. For example, it may be useful to include a provision in the draft law that will allow the fees to be increased, if needed.

3.1.7 *Extent to which the performance of tasks harbours substantial financial risks*

The draft law is silent on the issue of the CBC's liability with regard to its supervision of credit-acquiring companies. The draft law does not contain any provisions excluding or limiting the liability of the CBC as the authority responsible for the supervision of credit acquiring companies. In contrast, the CBC's liability with regard to its supervision over credit institutions is excluded, unless it is shown that the act or omission was not done in good faith or was the result of gross negligence[24]. The ECB considers that it would be useful to align the CBC's liability under the draft law with its liability concerning its supervision of credit institutions, given that potential liability issues could represent financial risks for the CBC.

3.1.8 *Conclusion and summary regarding conferral on the CBC of the task of supervising credit acquiring companies*

The ECB considers that there are grounds for regarding the CBC's task of supervising credit-acquiring companies as a central banking task in the sense that it complements the CBC's existing bank supervisory functions. The fact that the performance of the new supervisory function will be financed by supervised entities has a positive impact on the CBC's financial capacity to assume those tasks. However, the ECB considers that the draft law potentially creates financial risks for the CBC because it does not limit the CBC's liability as a public authority, for damages caused in the course of the exercise of its new supervisory powers, in ways similar to the CBC's liability in connection with its bank supervisory tasks. It would be useful to align the CBC's liability under the draft law with its liability when conducting its supervisory powers over credit institutions. Additionally, the ECB considers that a more flexible mechanism for determining the fee level would be more appropriate with a view to safeguarding CBC's financial independence. For example, it may be useful to include a provision in the draft law that allows an increase in the level of fees, if needed.

3.2 *Free movement of capital*

In the case of credit-acquiring companies that are not credit or financial institutions as defined in the draft law, the acquiring company would be required not only to obtain CBC authorisation for

24 Article 32(1) of the Laws of 1997 to 2015 on business institutions. See also Principle 2 of the principles established by the Bank for International Settlements, setting out that the supervisor and its staff should be protected against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.

such activity but also to be incorporated in Cyprus[25]. To the extent that a credit acquiring company incorporated in a Member State other than Cyprus seeks to carry on credit acquiring activities in Cyprus, the consulting authority is invited to consider, subject to the competences of the European Commission, whether this additional requirement is in line with the provisions on the free movement of capital under the Treaty.[26]

3.3 *Concerns over a level playing field and opportunities for regulatory arbitrage*

The draft law subjects credit-acquiring companies to notional minimum capital requirements, as well as other regulatory requirements. The ECB understands that the Cypriot authorities opted not to impose express limits on leverage and liquidity requirements at this stage, in order to offer wider opportunities for new companies entering the market for such services, with a view to facilitating private debt restructuring.

3.4 *Credit institutions directly supervised by the ECB*

With regard to credit institutions directly supervised by the ECB, the powers given to the CBC should be in line with the ECB's competence under Council Regulation (EU) No 1024/2013[27].

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

Done at Frankfurt am Main, 12 November 2015.

[signed]

The President of the ECB

Mario DRAGHI

25 See Article 4(1)(a) of the draft law.

26 Articles 63-65 of the Treaty

27 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).