Opinion of the European Economic and Social Committee on

Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures

[COM(2018) 134 final — 2018/0060 (COD)]

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

[COM(2018) 135 final — 2018/0063 (COD)]

(2018/C 367/09)

Rapporteur: **Juan MENDOZA CASTRO**

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1. **Conclusions and recommendations**

NPL package

1.1. The EESC welcomes the Commission's package, a centrepiece in the EU offensive to address the persisting issue of NPLs and fundamental to progress towards the Banking Union.

1.2. The EU's financial institutions have made progress both in the quality of loan portfolios and in the total volume of non-performing loans (NPLs); however, additional measures are required at EU level to prevent NPLs from accumulating in the future.

1.3. Any EU comparison of the level of NLPs should take into account the fact that banks in some countries benefited from substantial amounts of state aid in the early phase of the crisis (2008-2012), while others were unable to do so due to changes in the state aid rules.

1.4. The EESC draws attention to the social consequences of the financial crisis in terms of exclusion, social justice and obstacles to the completion of the internal market.

1.5. Removing impaired debts from the financial institutions' accounts is vital in order to avoid the consequences of over-indebtedness in the future. The EESC also calls for responsible lending by credit institutions.

Statutory prudential backstops

1.6. The EESC agrees with the application of statutory prudential backstops as a preventive measure to ensure that credit losses on future NPLs are sufficiently provisioned.

1.7. The EESC takes notice of the Commission's rationale for the proposal, adding that backstops would be justified by the different objectives pursued by the accounting framework relative to the prudential regulation.

1.8. However, the EESC must also point out that that:

— The 'one size fits all' approach, does not take into account the differences that still exist national civil laws and the length of procedures in civil courts.

— The calendar for the provisioning of new NPLs may force the banks to sell them quickly, rather than waiting for the financially distressed company/firm to return to a more viable situation.

1.9. The Commission should consider, if possible, the specific situation of smaller and specialised firms with a less complex asset structure.

1.10. The EESC considers that IFRS 9 should be mandatory for all EU banks.

1.11. The EESC proposes launching a specific impact analysis aimed at estimating the potential impact of the proposed regulation on banks, on the transmission of credit to households, on SMEs and on GDP growth.

1.12. The EESC notes that the ECB has already issued its addendum, without considering the Pillar 1 rules to be issued by the Parliament/Council/Commission and without waiting for the European Banking Authority (EBA) guidelines.

Development of secondary markets

1.13. The EESC recognises that the Commission gives an answer to many of the problems of fragmented NPLs secondary markets in the EU and highlights the specific proposals in this aspect. However, it is of the view that regulators must not encourage the sale of NLPs.

1.14. The EESC's suggestions regarding the consequences of credit transfers are as follows:

— Consumer protection: in general the Commission's proposals are welcomed. The authorities must pay attention to specific measures and recommendations to protect debtors' rights.

— Workers' protection: the competent authorities must take account of the mobility and protection of the workers of the companies involved in transfers of companies according to EU and national laws.

Accelerated extrajudicial collateral enforcement

1.15. The EESC highlights, in a positive sense, the right to a fair trial in a national court if it is necessary and if the application of this procedure as proposed in the directive is restricted.

1.16. In many Member States the enforcement process is already efficient. The solution to the problem of NPLs lies mainly in strengthening judicial procedures across the whole EU.

2. **European Commission proposals**

2.1. On 14 March, the Commission presented a proposal for a regulation ([1]) amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures (NPEs), together with a proposal for a directive ([2]) on credit servicers, credit purchasers and the recovery of collateral.

([1]) COM(2018) 134 final — Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures.

([2]) COM(2018) 135 final — Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral.

2.2. Both proposals were accompanied by Commission staff working documents and impact assessments, and on the same day the Commission also published its Second Progress Report ([3]) on the Reduction of Non-Performing Loans in Europe and a Blueprint ([4]) providing technical guidance on how to set up national Asset Management Companies (ACMs).

2.3. These proposals are important components of the Commission's efforts to strengthen Europe's Economic and Monetary Union (EMU) and are essential to completing the Banking Union. Addressing high stocks of non-performing loans (NPLs) and non-performing exposures (NPEs), as well as their possible accumulation in the future, is an integral part of the Union's efforts to further reduce risks in the banking system and enable banks to focus on lending to businesses and citizens.

2.4. In the proposal for a regulation, the Commission proposes to establish a statutory prudential backstop by setting common minimum levels of coverage for newly originated loans that turn non-performing, with the aim of preventing any excessive future build-up of NPLs without sufficient loss coverage on banks' balance sheets and making their resolution easier.

2.5. In the proposal for a directive, the Commission aims to increase the efficiency of debt recovery procedures through the availability of a distinct common accelerated extrajudicial collateral enforcement procedure (AECE). The proposal also encourages the development of secondary markets for NPLs by harmonising requirements and creating a single market for credit servicing and the transfer of bank loans to third parties across the EU.

3. **General comments**

3.1. The EESC welcomes the Commission's package, a centrepiece in the EU offensive to address the persisting issue of NPLs ([5]) and fundamental to progress towards the Bank Union.

3.2. Given that solvency and stability in the financial system is fundamental for the EU, the large volume of NPLs accumulated in the banks of some Member States during the crisis and ensuing recession is bad for the financial system as a whole, detrimental to the economy and has, in certain cases, incurred heavy costs for the taxpayer.

3.3. In recent years, the EU's financial institutions have made progress both in the quality of loan portfolios and in the total volume of NPLs; however, the latter remain at the high level of gross EUR 813 billion ([6]). Banks and supervisors have the necessary tools to reduce the number of defaulted or impaired loans, but additional measures are required at EU level to prevent them accumulating in the future.

3.4. The EESC points out that banks in some countries benefited from substantial amounts of state aid in the early phase of the crisis (2008-2012), while others were unable to do so due to changes in the state aid rules for the financial sector. For this reason, any comparison of the level of NPLs should take into account these differences.

3.5. The EESC draws attention to the social consequences of the financial crisis in terms of exclusion, social justice and obstacles to the completion of the internal market. In some Member States, NPLs are a reflection of how severely families and SME entrepreneurs have been affected, including being at risk of losing their homes or subject to foreclosure.

3.6. Removing impaired debts from the financial institutions' accounts is vital in order to avoid the consequences of over-indebtedness in the future, and the ECOFIN plan must contribute to this objective. The EESC also calls for responsible lending, which will require credit institutions to pay greater attention to the needs and situations of their individual borrowers and to find the financial instrument most appropriate to each one's circumstances ([7]).

([3]) COM(2018) 133 final — Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank — Second Progress Report on the Reduction of Non-Performing Loans in Europe.

([4]) SWD(2018) 72 final — AMC Blueprint — Commission Staff Working Document accompanying the Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank — Second Progress Report on the Reduction of Non-Performing Loans in Europe.

([5]) Council Conclusions on Action plan to tackle non-performing loans in Europe (11 July 2017).

([6]) EBA risk dashboard Q4 2017 data.

([7]) EESC Opinion on Credit and social exclusion in an affluent society (OJ C 44 of 16.2.2008, p. 74).

4. **Specific comments**

4.1. ***Statutory prudential backstops***

4.1.1. The EESC agrees with the application of statutory prudential backstops as a preventive measure to ensure that credit losses on future NPLs are sufficiently provisioned.

4.1.2. To reduce NPLs and NPEs ([8]), the proposed amendment of the Capital Requirements Regulation (CRR) includes a progressive calendar for secured (up to eight years) and unsecured (two years) loans.

4.1.3. The Commission's rationale for the proposal is ([9]):

— Loan loss work might not always be adequate from a prudential perspective, which has a different scope, objective and purpose.

— IFRS 9 ([10]) is expected to bring much closer alignment with prudential standards than IAS 39 ([11]) and to contribute to addressing the issue of delayed and inadequate provisions, as it operates on an 'expected loss' approach. However, the new standard still leaves room for discretion in the evaluation of NPLs and of the underlying collateral and, as a consequence, in the determination of provisions.

— Prudential regulation empowers the bank supervisor to influence a bank's provisioning level (including as regards NPLs) within the limits of the applicable accounting framework and to require specific adjustments to the own funds calculations of that bank. Binding measures and requirements, however, can only be applied by the supervisor on a case-by-case basis depending on the individual circumstances of the bank (referred to as Pillar 2 measures).

— Individually tailored supervisory measures on a case-by-case assessment by the competent supervisor are appropriate for dealing with the specific NPL-related risks of individual banks.

4.1.4. The EESC would add that backstops would be justified by the different objectives pursued by the accounting framework relative to the prudential regulation.

4.1.5. However, the EESC must also point out that:

— The proposed regulation, which follows a 'one size fits all' approach, does not take into account the still existing differences in national civil laws and the length of procedures in civil courts.

— The calendar for the provisioning of new NPLs may force the banks to sell them quickly, rather than waiting for the financed distressed company/firm to return to a more viable situation. This could reduce the possibility of allowing for a debt restructuring and a giving entrepreneurs a second chance, with a potentially high negative social impact and negative impact on the employment ratio.

— According to one analysis ([12]), smaller and specialised firms with a less complex asset structure are likely to be more severely affected by the concurrent introduction of IFRS 9 and prudential backstops for NPE. The Commission should consider whether it is necessary to fine-tune the proposal to address this problem.

([8]) European Banking Authority (EBA) definition: 'NPE is every exposure that is 90 days past-due or unlikely to be paid without collateral realisation, even if it is not recognised as defaulted or impaired. Defaulted and impaired exposures according to Article 178 CRR and the applicable accounting framework, respectively, are always considered as non-performing. In addition, any exposure to a debtor has to be considered non-performing when its on-balance sheet 90 days past-due reaches 20 % of the outstanding amount of total on-balance sheet exposure to that debtor ("pulling effect"). The total NPE is given by the sum of non-performing loans, non-performing debt securities and non-performing off-balance sheet items'.

([9]) Consultation document on statutory backstops.

([10]) International Financial Reporting Standard. In force from 1.1.2018.

([11]) International Accounting Standards.

([12]) Eurofinas: response to European Commission consultation on statutory prudential backstops.

4.1.6. Even though the proposed backstops can mitigate the differences in provisioning stemming from the adoption of different accounting frameworks (IFRS 9 as opposed to National GAAPs ([13])), the EESC considers that IFRS 9 should be mandatory for all EU banks.

4.1.7. The EESC suggests launching a specific analysis aimed at estimating the potential impact of the proposed regulation on banks, on the transmission of credit to households, on SMEs and on GDP growth.

4.1.8. Other risks may produce similar problems to those of NPLs, in particular the risks connected to heavy complex derivatives and level 2 and level 3 repossessed assets. In view of this, the EESC is of the opinion that these risks should be included in the priority list for risk reduction.

4.1.9. The EESC notes that the ECB has already issued its addendum, without considering the Pillar 1 rules to be issued by the Parliament/Council/Commission and without waiting for the EBA guidelines (still under discussion) to be finalised. This could violate the better regulation principles. The ECB addendum on NPLs should therefore be adapted to the future Pillar 1 framework on NPLs, so as to continue to ensure the consistency of European rules.

4.2. ***Measures to further develop secondary markets for NPLs***

4.2.1. In the EU, secondary markets transactions are relatively small ([14]). The causes include: fragmented regulation; legislative limitations on holders of some asset classes, on the scope for the involvement of servicer companies and on types of investor (in some cases only other banks may be able to service or buy NPLs); and differing views on the economic outlook between local banks and foreign investors. The EESC considers that the Commission offers an answer to many of these problems.

4.2.2. One of the key challenges for the NPL market is the lack of high quality data on NPLs, resulting in information asymmetries. The EESC welcomes the data templates aimed at providing uniform and standardised data for non-performing credit agreements.

4.2.3. However, the EESC considers that regulators must not encourage the sale of NPLs because managing impaired loans within banks could imply a higher value through their recovery than the prices collected for their sale.

4.2.4. The EESC would highlight and supports the following aspects of the Commission proposal:

— **Credit servicers**. The EU-wide rules set specific requirements and procedures for the granting, refusing or withdrawing of authorisation (Articles 5 to 7), including 'sufficiently good repute, clean police record and not currently subject to any insolvency procedure'. They also cover: the register (Article 8), the contractual relationship with the creditor (Article 9), outsourcing activities (Article 10) and cross-border servicing (Articles 11 and 12).

— **Credit purchasers**. The creditor shall provide all necessary information regarding the credit agreement (Article 13) according to technical standards that will be developed by the EBA (Article 14) and which cannot be submitted to any additional requirements other than those provided for under national laws of transposition (Article 15). They can enforce the credit directly (Article 18) or transfer it (Article 19).

— **Credit servicers, credit institutions or their subsidiaries,** which play an active role in operations related to NPLs, are included in Article 16.

— **Supervision**. A crucial aspect, because it calls for application of the same rules throughout the EU, a supervisory role of competent national authorities and administrative penalties (Articles 20 to 22).

([13]) Generally Accepted Accounting Principles.
([14]) KPGM: EUR 100 billion, less than 10 % of the outstanding stock.

— **Data protection**. A condition for the transfer of a loan is the 'respect for borrower rights and compliance with personal data protection rules in accordance with the laws governing the credit agreement' (Article 5(1)(c)).

4.2.5. *Consumer protection*

— The EESC considers it important to ensure a high level of consumer protection in the area of financial services.

— In this sense, it appreciates the general principle in the proposal, which is 'to ensure the same level of protection, irrespective of who owns or services the credit and irrespective of the legal regime in force in the Member State of the credit purchaser or the credit servicer'; in particular, the Mortgage Credit Directive ([15]), the Consumer Credit Directive ([16]) and the Unfair Contractual Terms Directive ([17]) must be observed.

— The EESC also highlights the obligations of the creditor towards the consumer in the event of modifications to the credit agreement (Article 34).

— The EESC observes that the transfer of a loan means that the debtor must deal with a non-financial company that has different personnel, different working methods and a different purpose. It is therefore appropriate that national authorities pay attention to measures and recommendations to protect debtors' rights, as is the case with the US Consumer Financial Protection Bureau ([18]).

4.2.6. *Workers protection*

In all instances of the credit transfers to external companies, the competent authorities must take account of the mobility and protection of the workers of the companies involved such transfers according to EU and national laws.

4.3. ***Accelerated extrajudicial collateral enforcement (AECE)***

4.3.1. The EESC highlights, in a positive sense, the obligation of the Member States to ensure that the business borrower has the right to challenge the use of this mechanism before a national court (Article 28). This should adequately protect the fundamental right of citizens and companies to a fair trial ([19]), especially in the event of unfair or abusive contractual terms.

4.3.2. Nevertheless, the EESC notes the doubts expressed by some Member States that such an instrument could significantly accelerate the enforcement process in those Member States where procedures in the courts are already handled in a short period of time; while out-of-court procedures may be beneficial for the creditor, the solution to the problem of NPLs lies mainly in strengthening judicial procedures across the EU.

4.3.3. In any case, the EESC positively highlights the restrictions on the application of AECE in the proposal. Firstly, only agreements concluded between creditors and business borrowers are included. Moreover, the following are specifically excluded:

— consumers engaged in non-professional activities ([20]);

— non-profit-making companies;

— financial collateral arrangements ([21]), and

— immovable residential property which is the primary residence of a business borrower ([22]).

([15]) Directive 2014/17/EU (OJ L 60, 28.2.2014, p. 34).
([16]) Directive 2011/83/EU (OJ L 304, 22.11.2011, p. 64).
([17]) Directive 93/13/EEC (OJ L 95, 21.4.1993, p. 29).
([18]) https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-reminds-mortgage-servicers-of-legal-protections-for-consumers-when-transferring-loans.
([19]) Charter of Fundamental Rights of the European Union, Article 47.
([20]) Directive 2008/48/EC on credit agreements for consumers, Article 3 a).
([21]) Directive 2002/47/EC on financial collateral arrangements, Article 2(1)(a).
([22]) 'The financial crisis, which has led to the insolvency of many home-buyers, forced to sell on their properties at rock-bottom prices'. EESC Opinion on the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property (OJ C 318 of 29.10.2011, p. 133).

4.4. ***Asset Management Companies (AMCs) Blueprint***

State aid rules

4.4.1. The EESC agrees with the Commission that AMCs have been an important part of solutions to clean up banks' balance sheets in some Member States, especially in the wake of the financial crisis. However, it also agrees that — in the case of publicly supported or guaranteed vehicles — they may also contribute to financial stability risks, including potentially reinforcing what is known as the 'sovereign feedback loop'.

4.4.2. The EESC therefore supports consistency with the EU legal framework, especially the Bank Recovery and Resolution Directive (BRRD) ([23]) and the Single Resolution Mechanism Regulation (SRMR) ([24]).

4.4.3. In practice, nearly all national AMCs have benefited from government support in some form, including: guarantees to meet any losses or to guarantee AMC funding (this can result in the AMC having a 'sovereign' rating, so that AMC securities are, for example, eligible as repo collateral); AMCs buying assets above their market value (the value an investor would pay), as a result of taking a longer-term view of economic value — the excess of economic value over market value constitutes state aid and requires bank-level approval by the European Commission; and the government recapitalising banks that participate in AMC schemes ([25]).

4.4.4. Even where some form of government assistance has been permitted, the most recent EU rules generally require that as a minimum the subordinated debt of a bank be bailed-in (written off or converted into equity), so that any recapitalisation burden is at least shared between the public and private sectors.

Brussels, 11 July 2018.

The President
of the European Economic and Social Committee
Luca JAHIER

([23]) Directive 2014/59/EU.
([24]) Regulation (EU) No 806/2014 (OJ L 225, 30.7.2014, p. 1).
([25]) KPGM.