July 2018

ACC and BAI Position Paper on the Proposed Directive of the European Parliament and of the European Council on credit servicers, credit purchasers and the recovery of collateral

The Alternative Credit Council (ACC)[1] and the Bundesverband Alternative Investments (BAI)[2] welcome the initiative of the European Commission (the 'Commission') to address the high levels of non-performing loans ('NPLs') and promote a resilient financial system. The proposed Directive of the European Parliament and of the European Council on credit servicers, credit purchasers and the recovery of collateral (the 'Directive')[3] seeks to (i) promote a healthy secondary market for NPLs and (ii) improve the efficiency of debt recovery procedures. We support the Commission's objectives and are pleased to share our comments on how the proposed Directive can achieve these goals:

- **Scope of the proposals:** Promoting a healthy secondary market for NPLs should be achieved through the introduction of targeted reforms that address the specific issues in this market. Many of the requirements introduced by the Directive would apply to transfers of loans originally issued by an EU credit institution, irrespective of whether the loan is performing or non-performing. There is no evidence to suggest that the secondary market for performing loans requires reform. We recognise the Commission's desire to minimise disruption in the secondary market for credit, but the inclusion of performing loan transfers within the scope of the Directive is unnecessary and disproportionate. The secondary market for bank loans supports the provision of finance to the real economy by providing liquidity to the EU banking sector and helping to diversify credit risk. The costs and disruption that would be imposed on this market outweigh the potential benefits to the secondary market for NPLs that may result.

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[1] The ACC is a global body that represents asset management firms in the private credit and direct lending space. It currently represents over 130 members that manage $350bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

[2] The Bundesverband Alternative Investments e.V. (BAI) is the advocacy association for the alternative investments industry in Germany. The BAI links German institutional investors and recognized providers of alternative investment products worldwide. Our goal is to enhance the environment for German professional investors when diversifying their financial assets into alternative investments, especially as many of those investors are responsible for safeguarding long-term retirement pensions. Another objective of the association is to increase public awareness and understanding of alternative asset classes and strategies. The BAI maintains an active dialogue with political institutions as well as supervisory bodies. Furthermore, the BAI cooperates with various national and international organizations and industry associations by advocating for legal reforms to design an attractive and competitive regulatory environment for the alternative investments industry in Germany. At present, BAI counts 190 members from all areas of the professional Alternative Investments industry. You can find information about BAI and its Members on our website www.bvai.de.

[3] https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-135_en

We urge policymakers to amend the scope of these proposals so they only apply to the transfer of NPLs.

- **Definition of Credit Servicer:** The proposed definition of 'credit servicer' is currently very broad and would inadvertently capture asset managers of clients (including funds) purchasing loans from EU banks. These asset managers are already authorised under the Alternative Investment Fund Managers Directive ('AIFMD')[4] or Undertakings for Collective Investment in Transferable Securities ('UCITS') Directive[5] and are not legally permitted to be authorised as anything else. It is therefore impossible for them to also be authorised as a credit servicer and asset managers would need to cease any activity that falls within the proposed definition of credit servicer. Asset management clients are significant purchasers of NPLs from EU banks and this eventuality would have a negative impact on their participation in this market. The AIFMD and UCITS Directives provide a comprehensive supervisory and monitoring framework for asset managers of clients who are purchasing loans from EU banks. It is unnecessary for this activity to be subject to a further authorisation regime and the definition of credit servicer should be amended to explicitly exclude asset managers.

- **Reporting obligations:** There are a number of areas where the Directive imposes reporting obligations and procedural requirements in relation to the transfer of credit agreements that will hinder, rather than support, the market for NPLs. Competent authorities already receive substantial information on the activities of credit institutions and asset managers from disclosure requirements within the existing regulatory framework. If the Commission believes that the current disclosure of information to competent authorities in relation to the transfer of NPLs is inadequate, this should be addressed through reform of the existing disclosure requirements under the Capital Requirements Regulation ('CRR'), AIFMD or UCITS Directive, rather than through the introduction of additional disclosure requirements under this Directive.

- **Extra-territoriality:** The Directive requires non-EU based credit purchasers to designate a representative who is domiciled or established in the EU. Non-EU entities have to comply with national law related to borrower protections in the same way as EU-based credit purchasers. Requiring third country purchasers to appoint an entity responsible for regulatory compliance appears to be discriminatory. This requirement will have a detrimental impact on the secondary market by making the purchase of EU NPLs less attractive for non-EU entities. The Directive should be amended to remove this requirement on non-EU credit purchasers.

- **Accelerated Extrajudicial Collateral Enforcement ('AECE'):** The proposed AECE mechanism has the potential to promote confidence in the creditor protection regime for investors in NPLs. We would, however, caution that further consideration is required as to how these proposals will interact with existing legal frameworks across Member States. There are several areas where the Directive may require Member States to amend existing extrajudicial enforcement

[4] AIFMD 2011/61/EU.

[5] UCITS Directive 2014/91/EU.

mechanisms that are currently well regarded by creditors. While we understand that these proposals are intended to supplement rather than supplant existing practices, it will be important to ensure that any reforms do not inadvertently reduce confidence in the legal framework for creditors.

- Securitisation: A substantial amount of NPL transfers are portfolio sales and these are often undertaken via a securitisation. Some aspects of the recently passed Securitisation Regulation[6] have reduced demand amongst potential purchasers of NPL portfolios from European banks as, depending on the nature of the transfer, NPL portfolio sales may be characterised as a 'securitisation'. This has weakened demand for EU NPL portfolios which has, in turn, prevented banks from de-leveraging and divesting risk from their balance sheets. This means that bank capital remains tied up and unavailable for other lending activity. Further consideration should be given to the interaction of these proposals with the Securitisation Regulation to ensure there is consistency between the two pieces of legislation, and that they combine to support a healthy secondary market for NPLs.

We hope you find our comments useful. We would be happy to discuss these further with you and/or your colleagues should that be desirable.

Yours faithfully,

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[6] Securitisation Regulation EU 2017/2402

ANNEX

Comments from ACC and BAI on the proposal for a Directive COM (2018)135

Scope of the proposals

Many requirements in the Directive would apply to the transfer of both performing loans and NPLs. The stated rationale for this approach is to prevent fragmentation of the secondary market for bank loans by introducing different requirements for performing loans and NPLs.[7] We believe that including both performing loans and NPLs within the scope of this Directive is disproportionate. There is no evidence to suggest that the markets for performing credit are not currently working well and that existing market practices in relation to disclosure, reporting and authorisation are in need of reform. Many of the provisions within this Directive would impose substantial costs on firms active in the market for performing credit despite no case being made that this market requires reforms, or evidence that these reforms would support an effective secondary market for NPLs.

The scope of the Directive should be amended so that the requirements only relate to the transfer of loans that are categorised as NPLs. NPLs should be defined in the same manner as Commission Implementing Regulation (EU) 2015/227 for the purposes of this Directive. If this scope is not reduced to only include the transfer of NPLs, it is likely that the requirements of the Directive will have a negative impact on the secondary markets for bank loans. The secondary market for bank loans supports the provision of finance to the real economy by providing liquidity to the EU banking sector, helping to diversify credit risk and lowering the cost of finance for EU borrowers. The costs and disruption that would be imposed on this market outweigh the potential benefits to the secondary market for NPLs that may result. We urge policymakers to amend the scope of these proposals so that they only apply to the transfer of NPLs.

We would also request that further consideration is given to the status of syndicated lending arrangements where banks and asset managers participate in the syndicate as an initial lender. There are several references to 'credit agreements issued by a credit institution based in Union or its subsidiaries'. This would suggest that the Commission's intention is that the Directive will only apply in instances where a credit institution is the sole lender, and not in the case of syndicated loans. The Directive should be amended to confirm this.

Definition of credit servicer

The definition of 'credit servicer' in the Directive (Article 3(8)) is currently too broad and would inadvertently capture asset managers of clients who are purchasing NPLs from EU banks. Asset management clients (including funds) are significant purchasers of both performing and non-performing loans. Their investment in these loans frees up capacity within the banking sector to make additional loans to European borrowers and promotes a resilient financial system.

[7] See Recital 17.

Asset managers generally act as agents of funds or special purpose vehicles (SPVs). It is the funds (or SPVs owned by funds) that are usually the credit purchasers. In this scenario, the asset manager carries out a number of tasks, many of which fall under the proposed definition of a 'credit servicer'. For example, 'monitoring the performance of the credit agreement' (Article 3(8)a) is an essential activity for any asset manager acting on behalf of their clients in the purchase of a loan.

These asset managers are already authorised under the Alternative Investment Fund Managers Directive (AIFMD)[8] or Undertakings for Collective Investment in Transferable Securities (UCITS) Directive[9] and are not legally permitted to be authorised as anything else. It is therefore impossible for them to also be authorised as a credit servicer and asset managers would need to cease any activity that falls within the proposed definition of credit servicer. Asset management clients are significant purchasers of NPLs from EU banks and this eventuality would have a negative impact on their participation in this market. Asset managers in the EU managing loans are already regulated under the AIFMD or UCITS Directives, which ensures there is sufficient transparency for supervisors and investors about their investment activity. In addition, a significant number of asset managers outside the EU allocate part of their portfolios to EU loans. These managers and their activities are already regulated in their home jurisdictions. It is therefore unnecessary for this activity – i.e. the purchase of loans by asset managers acting on behalf of funds or clients – to be subject to an additional authorisation and/or disclosure process. The definition of credit servicer should be amended to explicitly exclude asset managers.

It is our understanding that this aspect of the Directive is likely to be an unintended consequence. We would urge that this be clarified through an amendment to the Directive that explicitly excludes asset managers from the definition of credit servicer.

Reporting obligations

The Directive would impose reporting and procedural requirements in relation to the transfer of loans that would impose substantial operational costs on creditors for little discernible benefit. The most significant of these is the requirement under Article 13 for creditors to provide all 'necessary information' to enable a credit purchaser to assess the value of the credit agreement and likelihood of recovery.

In many instances, a creditor may simply not have access to all this information or be unable to provide this information to the credit purchaser due to existing privacy legislation or banking secrecy laws, which preclude the disclosure of information to third parties. This approach is also counter to existing market practice whereby the purchasers of loans do so on a 'buyer beware' basis. Imposing these requirements on credit institutions and credit purchasers will also create additional operational costs for credit institutions and credit purchasers involved in the transfer of credit agreements. Additional costs may make this activity uneconomic and reduce demand for NPLs among investors.

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[8] Directive 2011/61/EU

[9] Directive 2014/91/EU

The Directive would require credit institutions to report information about the loan and borrower to a competent authority when loans are transferred to a credit purchaser (Article 13). Credit purchasers would also be required to inform competent authorities that they intend to enforce a credit agreement and provide information about the loan and the borrower (Article 18). It is unclear what purpose these reporting obligations would serve in relation to the stated objectives of this Directive and why it is deemed necessary for competent authorities to be provided with this information.

Competent authorities already receive substantial information on the activities of credit institutions and asset managers from disclosure requirements within the existing regulatory framework. If the Commission believes that the current disclosure of information to competent authorities in relation to the transfer of NPLs is inadequate, this should be addressed through reform of the existing disclosure requirements under the Capital Requirements Regulation (CRR), AIFMD or UCITS Directives, rather than through the introduction of additional disclosure requirements under this Directive.

Extra-territoriality

Article 17 of the Directive requires non-EU based credit purchasers to designate a representative who is domiciled or established in the EU for the purposes of compliance with this Directive. Non-EU based entities are substantial purchasers of EU NPLs. The requirement for them to establish an EU presence to demonstrate their compliance with the Directive is likely impose significant additional costs on these firms, which do not appear to be justified or proportionate.

Today, non-EU entities have to comply with national law related to borrower protections in the same way as EU-based credit purchasers. Requiring third country purchasers to appoint an entity that is also responsible for regulatory compliance therefore appears to be discriminatory. This will affect how viable it is for them to invest in NPLs and may reduce their appetite to do so. The consequence of this would be a reduction in the number of buyers for NPLs, making it harder for banks to sell on these loans and deleverage their balance sheets. It should also be noted that the market for NPLs or distressed debt is global, and that any cost increases will make EU NPLs less attractive in comparison to other markets for distressed loans. A further consequence of this will be for NPLs – and the credit risk they carry – to remain concentrated in EU financial institutions.

We believe that this requirement will have a detrimental impact on the EU NPL market by making it less attractive for non-EU investors. This outcome is therefore inconsistent with the Commission's stated objective to promote a resilient financial system and support a healthy market for NPLs. The Directive should be amended to remove this requirement on non-EU credit purchasers.

A further extra-territorial aspect of the Directive relates to the inclusion of credit agreements made to non-EU borrowers within the scope of the Directive. As currently drafted, the requirements of the Directive will apply to all loans originally issued by an EU credit institution, irrespective of whether the borrower is based in the EU or not. It is unclear how some aspects of the Directive can be applied where the loan involves a non-EU borrower. For example, Articles 13 and 18 both require the reporting of information to the competent authority of the Member State where the

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borrower is established. For non-EU borrowers there is no EU Member State of reference. Some of the requirements in the proposed AECE mechanism are also likely to conflict with non-EU insolvency or borrower protection laws to which the borrower or creditor may be subject. The Directive should be amended to exclude credit agreements made between EU credit institutions and non-EU borrowers.

AECE

The proposed AECE mechanism has the potential to promote confidence in the creditor protection regime for investors in NPLs, but we would caution that further consideration is required as to how these proposals will interact with existing legal frameworks across Member States. There are several areas where the Directive may require Member States to amend existing extrajudicial enforcement mechanisms that are currently well regarded by creditors. While we understand that these proposals are intended to supplement rather than supplant existing practices, it will be important to ensure that any reforms do not unduly reduce confidence in the legal framework for creditors. The proposed AECE mechanism itself may also create practical and operational problems for creditors. For example, the requirements to prepare a valuation report and the procedures envisaged for the AECE mechanism will limit the effectiveness of this for creditors seeking to recover collateral. We look forward to further discussion with policymakers on the proposed AECE mechanism to ensure it promotes further confidence in the creditor protections regime across Europe.

Securitisation

A substantial amount of NPL transfers are portfolio sales and these are often undertaken via a securitisation. Some aspects of the recently passed Securitisation Regulation have reduced demand amongst potential purchasers of NPL portfolios from European banks as, depending on the nature of the transfer, NPL portfolio sales may be characterised as a 'securitisation'. This creates a complicating factor for purchasers of NPL portfolios that can also increase the economics of the transaction. This has weakened demand for EU NPL portfolios which has, in turn, prevented banks from de-leveraging and divesting risk from their balance sheets. This means that bank capital remains tied up and unavailable for other lending activity.

The information obligation in Article 13 of the Directive requires a creditor to provide "all necessary information to a credit purchaser to assess the value of the credit agreement and the likelihood of recovery of the value of that agreement". Where securitisation is used as a form of financing loan purchases (for example, where a Guarantee on Securitisation of Bank Non Performing Loans (GACS) is used), this obligation may be inconsistent with the Securitisation Regulation. Article 9 of the Securitisation Regulation requires an originator purchasing third-party exposures to verify that the "same sound and well-defined criteria for credit-granting" was applied to the purchased exposures "as they apply to non-securitised exposures". Further clarity is required in relation to how the obligations under Article 13 of the Directive will enable a creditor to also comply with the requirements of Article 9 of the Securitisation Regulation.

We would urge policymakers to give further consideration to the interaction of these proposals with the Securitisation Regulation to ensure that they align and support the Commission's objective to support a healthy market for NPLs.