

C L I F F O R D
C H A N C E

**IMPLEMENTING THE NEW EU RULES ON
NON-PERFORMING LOANS**

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The new EU directive on credit servicers and credit purchasers will regulate the sale, purchase and servicing of non-performing loans originated by EU banks. The new regime will have a significant impact on trading, investment and securitisation transactions involving non-performing loans. The new rules will take effect on 30 December 2023, but market participants will have to take steps to implement the new rules well before then.

What is the planned timing?

This new **directive** was published in Official Journal on 8 December 2021 and enters into force on 28 December 2021. Member States are required to adopt and publish their implementing rules by 29 December 2023 and to bring those rules into effect on 30 December 2023. However, the directive could begin to affect the market for both performing and non-performing loans well before that as market participants prepare to comply with the disclosure, reporting, borrower protection, systems and controls, authorisation and other obligations that will apply when the new rules take effect (including the obligation on non-EU purchasers of non-performing loans to appoint an EU representative). The directive may also have an impact on the documentation used for loan trading and servicing.

What is the objective of the new directive?

The directive is part of the EU action plan to reduce the current stock of non-performing loans in the EU and to prevent the build-up of that stock in the future. It aims to improve the secondary market for non-performing loans by improving the information available to buyers, reducing the regulatory impediments to non-banks buying loans across the EU and creating a new category of authorised entity that can provide loan servicing support across the EU, while protecting borrowers and improving supervisory oversight. However, there is a risk that the new obligations on banks selling non-performing loans and on non-bank purchasers and servicers of those loans may deter some banks from selling or some non-bank purchasers from buying non-performing loans.

What is the scope of the new requirements?

The directive will regulate the sale and purchase and servicing of non-performing loans (NPLs), that is to say:

- credit agreements and rights under credit agreements;
- ‘issued’ by credit institutions established in the EU (EU banks); and

Key issues

- New EU directive on credit servicers and credit purchasers
- Applies to non-performing loans originated by EU banks (NPLs)
- Covers bilateral and syndicated loans to commercial and consumer borrowers
- New disclosure and reporting requirements for banks selling NPLs
- New obligations for non-bank purchasers of NPLs, including obligations to appoint an authorised credit servicer
- Non-EU credit purchasers of NPLs must appoint an EU representative
- Some relaxation of existing national licensing rules for non-bank purchasers of NPLs
- Entities servicing NPLs on behalf of non-bank purchasers require authorisation, but only EU credit servicers can be authorised
- Credit servicers subject to broad range of new obligations, including as to the terms of appointment
- The new rules will take effect on 30 December 2023

- classified as non-performing in accordance with article 47a of the EU capital requirements regulation.

The definition of a credit agreement covers any syndicated or bilateral agreement under which an EU bank grants a credit in the form of a deferred payment, a loan or other similar financial accommodation to a borrower, including both commercial and consumer borrowers.

The directive will impose new obligations on:

- banks selling NPLs, whether to bank or non-bank purchasers;
- non-bank purchasers of NPLs (credit purchasers);
- entities servicing NPLs on behalf of credit purchasers (credit servicers).

The directive will also reduce licensing restrictions that apply to credit purchasers buying NPLs in some Member States.

In addition, the directive amends the EU consumer credit and mortgage credit directives.

What are the new obligations for banks selling NPLs?

Banks selling NPLs will be subject to new pre-sale disclosure and post-sale reporting obligations.

Mandatory pre-sale disclosure

The directive will impose an obligation on banks selling NPLs to credit purchasers to disclose to the prospective purchaser the necessary information regarding the creditor's rights and any collateral to enable the prospective purchaser to assess the value of those rights and the likelihood of recovery (contrary to the current general rule that the seller is not obliged to provide information to a buyer). Banks will have to use prescribed data disclosure templates for this purpose and will also have to use the same templates if they sell NPLs to other banks.

The European Banking Authority (EBA) will be tasked with consulting on and developing the draft disclosure templates to be used by banks. The EBA is to send the draft templates to the Commission by 29 September 2022 for the Commission to adopt (with or without amendment).

The EBA issued a [discussion paper](#) in May 2021 on draft NPL transaction data templates that included 230 data fields of which 30 to 70 would be treated as critical depending on the asset class. Banks will need to consider how they will ensure access to the data they will need to sell both existing and new NPLs, although the directive will provide relief in relation to sales of some NPLs originated before the new rules begin to apply.

Post-sale reporting

Banks selling NPLs to credit purchasers will have to report details of their sales to their home state authority and to authorities in the relevant 'host' Member State (biannually or, if required by the authority, quarterly). The minimum reportable details of sales will include:



The new regime applies to NPLs to both commercial and consumer borrowers



Banks selling NPLs will be subject to new disclosure and reporting obligations



- the legal entity identifier of the purchaser or, where applicable, its EU representative (or, if not available, the identity of the purchaser or its board members and the persons holding qualifying shareholdings in the purchaser and its address or, if applicable, the address of its EU representative);
- the aggregate outstanding balance of the seller's rights under the NPL;
- the number and size of the seller's rights sold to the purchaser; and
- whether the transfer includes NPLs with consumers and the type of collateral, if applicable.

What are the new obligations of credit purchasers?

Credit purchasers will be subject to new obligations including the following:

- Non-EU credit purchasers will have to appoint an EU representative responsible for performance of their obligations under the directive.
- Credit purchasers will have to appoint an authorised credit servicer or an EU bank or an EU supervised consumer credit or mortgage creditor to service their NPLs. This obligation only applies to EU credit purchasers in relation to NPLs to consumers and to non-EU credit purchasers in relation to NPLs to any natural person or micro, small or medium-sized enterprises. However, Member States may extend this obligation to other credit agreements.
- Credit purchasers will have to comply with certain obligations as to the fair treatment of borrowers of NPLs, the information to be given to borrowers of NPLs about their purchase of the NPLs and the terms of any appointment of a credit servicer.
- Credit purchasers must notify their Member State of any appointment of a credit servicer or an EU bank or EU supervised consumer credit or mortgage creditor to service their NPLs.
- Credit purchasers will have to report sales of NPLs to their Member State authority (biannually or, if required by the authority, quarterly). The reports must include the minimum reportable details described above in relation to banks' reporting obligations.

However, Member States will not be able to impose additional licensing restrictions on credit purchasers in relation to the purchase of NPLs if the loan is more than 90 days past due and has been accelerated. This may to some extent liberalise the market for NPLs in some Member States that currently impose licensing requirements on purchasers of NPLs not authorised as EU banks, but Member States must ensure that the transfer of NPLs to a credit purchaser does not diminish the protections afforded to borrowers by EU or national law.

What are the new obligations of credit servicers?

The directive defines credit servicers as legal persons that in the course of their business:

- manage and enforce the rights and obligations related to a creditor's rights under NPLs on behalf of a credit purchaser; and



Non-EU credit purchasers will have to appoint an EU representative



- carry out one or more of the following 'credit servicing activities':
 - collecting and recovering payments due;
 - renegotiating with the borrower the terms of the loan (except where the servicer is a credit intermediary under the EU consumer credit directive or the EU mortgage credit directive);
 - administering complaints relating to a creditor's rights;
 - informing the borrower of changes to interest rates or any payments relating to a creditor's rights.

Credit servicers will have to be authorised by an EU national supervisory authority in their EU home Member State and only EU entities will be able to obtain this authorisation. Authorised credit services will have a 'passport' to provide services across the EU without the need to obtain additional authorisations in other Member States.

The directive gives existing credit servicers a six-month grace period after the rules come into effect during which they can carry on business pending authorisation, but this only covers business in the servicer's home Member State.

Credit servicers will be subject to ongoing obligations when servicing NPLs on behalf of credit purchasers, including obligations as to:

- the fair treatment of both consumer and commercial borrowers, including complaints handling processes;
- information to borrowers about the purchase of the loan by their credit purchaser;
- the terms of their agreement with the credit purchaser;
- record-keeping;
- the holding of client funds;
- outsourcing to third parties; and
- compliance on behalf of their credit purchasers with certain obligations imposed on those credit purchasers under the directive and, if Member States require, national law.

The obligation to obtain authorisation and the ongoing obligations of credit servicers do not generally apply to:

- an EU bank;
- an alternative investment fund manager (AIFM) authorised or registered under the EU AIFM directive, a UCITS management company or an investment company authorised under the EU UCITS directive (provided that the investment company has not designated a management company under that Directive) on behalf of the fund it manages;



**Only EU entities can
be authorised as
credit servicers**



- a non-bank creditor supervised in the EU under the EU consumer credit directive or EU mortgage credit directive when it is performing activities in the Member State in which it is supervised.

Member States can exempt notaries, bailiffs and lawyers from the obligations applying to credit servicers (and may allow credit purchasers to engage individuals to service their NPLs). There are no similar exemptions for EU or non-EU investment firms or non-EU fund managers acting as credit servicers for funds or other accounts that purchase NPLs.

However, EU banks and EU supervised consumer credit and mortgage lenders appointed to perform servicing activities on behalf of credit purchasers will be subject to the same obligations as credit servicers as to the information to be provided to borrowers about the purchase of the loan by the credit purchaser and compliance on behalf of their credit purchasers with certain obligations imposed on those credit purchasers under the directive and national law.

The directive states that it does not affect national rules on servicing NPLs when the credit purchaser is a securitisation special purpose entity if those laws do not affect the level of consumer protection provided by the directive and ensure that national authorities receive the necessary information from credit servicers.

What are the amendments to the EU consumer credit and mortgage credit directives?

The directive will also amend the existing rules for consumer credit and mortgages:

- to impose new duties on creditors to provide information to borrowers before any amendment to the terms of the loan;
- to require creditors to have adequate policies and procedures so that they make efforts to exercise, where appropriate, reasonable forbearance before foreclosure proceedings are initiated;
- to bring the rules on assignment of mortgage loans into line with those for consumer credit, by allowing the borrower to rely, as against the assignee, on set-off or other defences available to the borrower as against the original creditor and ensuring that the borrower is informed of an assignment (except where the original creditor continues to service the credit under an agreement with the assignee).

What are the remaining uncertainties as to how the directive applies?

There are several uncertainties about how the new rules will operate in practice. For example, there are uncertainties as to:

- the application of the new rules to non-performing loans to non-EU borrowers originated by EU banks (and the resulting extraterritorial impact on non-EU purchasers or servicers of those loans);
- whether and how the obligations on banks and credit purchasers will apply to non-EU banks (in particular, those with a branch in the EU);



There are several uncertainties about the new rules will operate in practice



- how to identify that loans were originated by EU banks and the responsibility and time for determining that loans are non-performing, particularly in the context of resales of loans and where banks hold loans in their trading books;
- the application of the rules to transfers of portfolios that include both performing and non-performing loans;
- the treatment of sub-participations or collateral arrangements involving NPLs;
- the application of the rules to securitisation special purpose entities and their interaction with existing transparency obligations under the regulatory framework for securitisations;
- whether there are circumstances in which facility agents or security trustees might be subject to the duties of credit servicers;
- transitional issues for banks selling NPLs originated before the date when the new rules begin to apply, for credit purchasers that purchased loans before that date and credit servicers (or EU banks and EU supervised consumer credit or mortgage lenders) that were appointed to service loans before that date.

These may be addressed through the disclosure templates, guidance from the EBA or national regulators, common industry approaches or national implementing rules. However, there is a risk that divergent approaches will be taken in different Member States, especially as the directive gives Member States several options as to how to implement its provisions.

What should market participants do now?

Market participants need to begin to scope their projects to implement the new directive, including forming their coordination groups and carrying out the preliminary impact assessments across potentially affected business lines and legal entities (including special purpose entities, group companies and funds and accounts managed by group entities).



Market participants need to begin to scope their implementation projects



CONTACTS

UK



Caroline Dawson
Partner
London
T: +44 207006 4355
E: caroline.dawson@cliffordchance.com



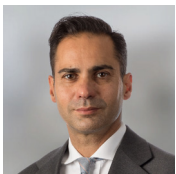
Simon Crown
Partner
London
T: +44 207006 2944
E: simon.crown@cliffordchance.com



Paul Ellison
Partner
London
T: +44 207006 3207
E: paul.ellison@cliffordchance.com



Kevin Ingram
Partner
London
T: +44 207006 2416
E: kevin.ingram@cliffordchance.com



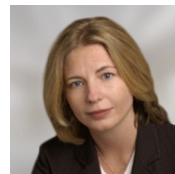
Faizal Khan
Partner
London
T: +44 207006 2158
E: faizal.khan@cliffordchance.com



Caroline Meinertz
Partner
London
T: +44 207006 4253
E: caroline.meinertz@cliffordchance.com



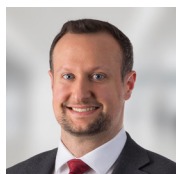
Monica Sah
Partner
London
T: +44 207006 1041
E: monica.sah@cliffordchance.com



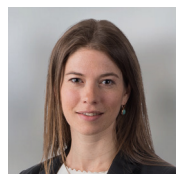
Nicola Wherity
Partner
London
T: +44 207006 2074
E: nicola.wherity@cliffordchance.com



Chris Bates
Special Counsel,
Consultant
London
T: +44 207006 1041
E: chris.bates@cliffordchance.com



Andrew Bryan
Knowledge Director
London
T: +44 207006 2829
E: andrew.bryan@cliffordchance.com



Laura Douglas
Senior Associate
London
T: +44 207006 1113
E: laura.douglas@cliffordchance.com



Toby Mann
Knowledge Director
London
T: +44 207006 8864
E: toby.mann@cliffordchance.com

CONTACTS

EU

Belgium



Lounia Czupper
Partner
Brussels
T: +32 2 533 5987
E: lounia.czupper@cliffordchance.com

France



Frédéric Lacroix
Partner
Paris
T: +33 1 4405 5241
E: frederick.lacroix@cliffordchance.com

Germany



Marc Benzler
Partner
Frankfurt
T: +49 69 7199 3304
E: marc.benzler@cliffordchance.com

Italy



Lucio Bonavitacola
Partner
Milan
T: +39 02 8063 4238
E: lucio.bonavitacola@cliffordchance.com

Luxembourg



Steve Jacoby
Managing Partner
Luxembourg
T: +352 48 50 50 219
E: steve.jacoby@cliffordchance.com

Netherlands



Jurgen van der Meer
Partner
Amsterdam
T: +31 20 711 9340
E: jurgen.vandermeer@cliffordchance.com

Poland



Anna Biała
Counsel
Warsaw
T: +48 22429 9692
E: anna.biala@cliffordchance.com

Spain



Eduardo García
Partner
Madrid
T: +34 91 590 9411
E: eduardo.garcia@cliffordchance.com

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