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NEW EU RULES ON NON-PERFORMING LOANS:
EBA CONSULTS ON DISCLOSURE TEMPLATES

NEW EU RULES ON NON-PERFORMING LOANS: EBA CONSULTS ON DISCLOSURE TEMPLATES

The European Banking Authority (EBA) is consulting on the new disclosure templates to be used by EU banks selling non-performing loans (NPLs). The EBA's proposals under the recent EU directive on credit servicers and credit purchasers will impose onerous disclosure obligations on EU banks selling NPLs and EU banks may need to make significant changes to their systems to comply with the new requirements. EU banks that cannot provide the required information to buyers may not be able to sell their NPLs and providing inaccurate information may expose banks to fines and damages claims from buyers.

Key issues

- EBA is consulting on disclosure templates to be used by EU banks selling NPLs
- Comment deadline is 31 August 2022
- New rules will apply from 30 December 2023 with relief for some existing NPLs
- EBA proposes exemptions for some complex transactions and securitisations
- EU banks will have to disclose extensive information to buyers using templates
- Fewer requirements will apply for NPLs with a carrying value below €25,000
- EU banks will need new systems to manage data and disclosures
- EU banks that cannot comply with new rules may not be able to sell NPLs
- EU banks that disclose inaccurate information may be liable for fines and damages claims

The EU **directive** on credit servicers and purchasers was published in the Official Journal on 8 December 2021 and entered 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. For more information on the directive, see our December 2021 briefing: Implementing the new EU rules on non-performing loans, available **here**.

Among other things, the directive will require EU banks selling NPLs to non-bank 'credit purchasers' to disclose to prospective buyers the necessary information regarding the creditor's rights and any collateral to enable prospective purchasers to assess the value of those rights and the likelihood of recovery (overriding general 'caveat emptor' rules that sellers are not obliged to provide information to buyers). EU banks will have to use prescribed data disclosure templates for this purpose and will also have to use the same templates if they transfer NPLs to other banks.

The EBA has now published its **consultation paper** setting out draft implementing technical standards (ITS) under the directive that include the templates to be used by banks to provide information on credits held in their banking books. The EBA has asked for comments by 31 August 2022 and is holding a public hearing on the proposals on 15 June 2022. The EBA expects to submit its finalised proposals to the European Commission by the end of 2022 following which the Commission will adopt the ITS (with or without amendments).

The objective of the draft ITS is to provide a common standard for NPL transactions across the EU to enable cross-country comparison and thus reduce information asymmetries between sellers and buyers of NPLs. EU banks will have to provide granular loan-by-loan information to enable prospective buyers to conduct their analysis, financial due diligence and valuation of NPLs. However, the ITS may also make it more difficult and riskier for EU banks to sell NPLs and thus may impede the process of moving NPLs off bank balance sheets.

What is an NPL?

In summary, the directive regulates the sale and purchase and servicing of NPLs, that is to say:

- credit agreements and rights under credit agreements;
- originated by credit institutions established in the EU (EU banks); and
- classified as non-performing in accordance with article 47a of the EU capital requirements regulation (CRR).

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.

When must banks use the data templates?

EU banks will have to use the data templates for transfers of NPLs held in their banking book taking place on or after 30 December 2023 where the loans were originated on or after 1 July 2018 and became non-performing after 28 December 2021. However, for NPLs originated between 1 July 2018 and the entry into force of the ITS, EU banks need only complete the data templates with the information already available to them. The recitals to the draft ITS also state that banks selling other existing NPLs should have regard to the requirements of the ITS and complete the templates with available information on a best-efforts basis.

EU banks originating loans after - or purchasing loans originated after - the ITS enter into force may need to ensure that their systems can generate the required information if they wish to sell the loans after they become non-performing. They may also need to review their systems to check that they can establish what information on earlier loans is available to them should they subsequently wish to sell those loans. The ITS will probably enter into force in early 2023 but EU banks may not have much notice of the exact date of entry into force – the draft specifies that the ITS will enter into force 20 days after publication in the Official Journal.

NPL originated	Loan became non-performing	Information required to be provided
After entry into force of ITS	After entry into force of ITS	Information specified in templates
On or after 1 July 2018 but before entry into force of ITS	On or after 28 December 2021	Information specified in templates already available to seller
On or after 1 July 2018 but before entry into force of ITS	Before 28 December 2021	Information specified in templates already available to seller on a best efforts basis*
Before 1 July 2018	At any time before sale	

*According to recitals to draft ITS.

The draft ITS do not state whether the date of the loan agreement or, where rights are acquired by novation, the novation date (or another date) should be treated as the date of origination of an NPL for the purposes of these transitional provisions. However, it may be possible to refer to the draft templates for guidance. These require EU banks to disclose information on the 'inception date' of a loan, defined as the date on which the contractual relationship originated, i.e., the date on which the contract agreement became binding for all parties.

The draft ITS also provide that EU banks will not be required to complete the templates for:

- sales of NPLs as part of sales of branches, sales of business lines or sales of clients' portfolios which are not limited to non-performing loans and transfers of non-performing loans as part of an ongoing restructuring operation of the selling bank within insolvency, resolution or liquidation proceedings; and
- sales or transfers of NPLs through securitisation where the Securitisation Regulation applies and provision of the related information is governed by the regulatory and implementing technical standards adopted under that regulation.

The consultation paper does not discuss any of the other remaining uncertainties mentioned in our December 2021 briefing relating to the application of the disclosure obligations, such as whether any disclosure obligations apply where EU banks sell NPLs held on their trading books, where EU banks sell NPLs that represent exposures to non-EU borrowers, or where non-EU banks originate or sell NPLs. These may be addressed through the consultation process, guidance from the EBA or national regulators, common industry approaches or national implementing rules.

What information must be provided to prospective buyers?

The draft ITS create five templates with a total of 157 data fields that must all be completed by the selling bank on a loan-by-loan basis. Some templates or fields may need to be completed more than once, e.g., where there are multiple borrowers or guarantors or multiple types of collateral for a loan.

In summary, the five templates require the following information:

1. ***The counterparty template*** requires the bank to provide information identifying the counterparties to the exposure ('borrower', 'tenant' and 'protection provider'). For corporate borrowers, the data fields include the legal name, address, name of corporate group, data from the counterparty's latest available financial statements, date of last contact and details of insolvency and restructuring proceedings.
2. ***The relationship template*** requires the bank to specify the identifiers, roles and group of counterparties and the contract, instrument and protection identifiers to help establish the relationship between the other completed templates.
3. ***The loan template*** requires disclosure of information on the loan agreement and the loan, including the inception date, governing law, currency, amortisation and interest terms, outstanding nominal amount and carrying value, percentage collateralised and details of non-performing status and forbearance measures.

4. ***The collateral, guarantee and enforcement template*** requires disclosure of information on the collateral or protection provided for the loan, including the location, surface area, percentage completed and value of energy performance certificate for real estate, the ISIN of securities collateral, internal and external valuations and details of the enforcement processes underway.
5. ***The historical collection and repayment template*** requires the bank to provide details of historical collections over the last two years and the expected repayment schedule related to the loan over the next 36 months (monthly for the first year and annually thereafter).

The templates are accompanied by a data glossary and instructions for filling in the templates, including links to corresponding definitions in the ESMA templates used for non-performing loan securitisations, the ECB's ANACREDIT framework, the FINREP supervisory reporting requirements, CRR and IFRS/IAS. Some information is to be disclosed as of a reference date (the cut-off date) selected by the bank.

The draft ITS provide that data fields are either mandatory or non-mandatory. EU banks must complete all mandatory fields with the required data or indicate that the requirement is not applicable in accordance with prescribed criteria. EU banks must use reasonable endeavours to complete the non-mandatory fields and, where data is not available, must explain why using specified 'no-data' codes (which would require the bank to have systems to ensure that the correct code is used). EU banks may not be able to sell NPLs without incurring penalties or other sanctions under the directive if they are unable to provide prospective buyers with the information required by the templates.

However, to introduce an element of proportionality, the draft ITS specify a smaller number of mandatory data fields for NPLs with a carrying amount (at the cut-off date) below a materiality threshold of €25,000 euros.

Template	No. of fields	Of which, mandatory for:	
		Larger NPLs*	Other NPLs*
1. Counterparty	45	34	19
2. Relationship	6	6	6
3. Loan	50	46	27
4. Collateral, guarantee and enforcement	46	39	32
5. Historical collection and repayment	10	10	7
Total	157	135	91

*Larger NPLs are those with a carrying amount as of the cut-off date over the €25,000 threshold.

The draft ITS specify fewer fields than the 230 fields envisaged by the EBA's May 2021 discussion paper (although that had only specified 30 to 70 fields as 'critical'). However, many of the proposed requirements would present significant challenges for EU banks. For example, it would be mandatory to use 'legal entity identifiers (LEIs)' to identify corporate counterparties on larger loans and ISINs to identify any shares or debt

securities provided as collateral (even though these identifiers might not be available for many privately-held companies) and to disclose the bank's latest internal and external valuations of collateral (even though this will raise concerns about the bank's liability and its ability to disclose external valuations).

What other requirements would apply?

The draft ITS envisage that EU banks selling NPLs must:

- ensure that all required data provided to prospective buyers is complete, consistent and accurate (and not use the 'no-data' codes to circumvent the ITS requirements);
- set up adequate and effective internal governance and data governance arrangements to ensure the completeness, consistency and accuracy of the information, including processes for independent internal validation of information and an appropriate managerial approval process;
- provide the required information to prospective buyers before entering into a contract for the sale of the NPLs (the recitals state that the information should be provided before the prospective buyer commits to the price) and, unless otherwise agreed by the buyer, in an electronic and machine-readable form;
- comply with the General Data Protection Regulation in relation to any personal data disclosed and identify and ensure adequate protection of any disclosed information that is subject to bank secrecy or other confidentiality requirements, including by entering into appropriate confidentiality agreements with prospective buyers (and the recitals state that banks should also protect confidentiality by only providing detailed information to potential buyers expressing a serious interest and committed to the purchase);
- use secure channels complying with applicable industry standards to provide required information to prospective buyers (and, if use is made of virtual data rooms or similar electronic means, ensure that they are provided by reputable technology providers); and
- where they identify errors in any information already provided to prospective buyers, inform the buyers and provide, without undue delay, a corrected set of information.

Will buyers request additional information from banks selling loans?

Credit purchasers may request additional information from banks selling loans so that the credit purchasers can comply with their own obligations under the directive (such as their obligations to appoint a credit servicer or, for non-EU credit purchasers, an EU representative). For example, credit purchasers may need to know whether the loans being sold fall within the definition of an NPL so as to trigger the credit purchaser's own obligations under the directive, whether any NPLs being sold have been accelerated and whether the borrowers of any NPLs include individuals who are 'consumers' or (for non-EU credit purchasers) other natural persons or micro, small and medium-sized enterprises. They may request additional information from banks selling NPLs

depending on how Member States exercise the national option to extend the obligations of credit purchasers under the directive.

Similarly, buyers that are EU banks may request additional information from banks selling loans so that the buying bank can comply with its own obligations under the directive, at least if the buying bank will hold the loan on its banking book (and thus might be required to complete the templates on any resale if the loan becomes non-performing). For example, banks buying loans that are not already classified as NPLs may wish to know whether the loan being purchased was originated by an EU bank (and the date of origination) and to receive sufficient information to be able to complete the disclosure templates if they subsequently sell the loan after it has become non-performing.

Buyers may also continue to request other information, such as copies of the credit documentation, which is not required to be disclosed by the ITS.

What are the consequences of providing incorrect information?

The directive requires Member States to adopt national rules for effective, proportionate and dissuasive administrative penalties and remedial measures where EU banks fail to comply with their disclosure obligations under the directive (but they may impose criminal penalties for non-compliance instead).

In addition, EU law may require Member States' courts to provide buyers of NPLs with a right to compensation if the bank fails to comply with the requirements of the ITS, on the basis that they are designed to protect the interests of buyers. It would be for national law to define the rules providing for compensation, whether a buyer also has rescission or other remedies and whether the bank and buyer are free to agree to exclude or limit the bank's liability by contract.

What will be the impact on secondary market trading documentation?

EU banks subject to the disclosure obligations will need to consider the impact on documentation they use when selling NPLs, in particular whether their existing confidentiality agreements, and any limitations or exclusions of liability, are adequate in the context of the new requirements.

EU banks subject to the disclosure obligation may prefer to enter into contracts with prospective buyers which are governed by English law and subject to the exclusive jurisdiction of the English courts on the basis that the English courts would generally give effect to limitations on or exclusions of liability in contracts with wholesale counterparties even if the bank's or buyer's home state courts would not.

EU banks will also need to put in place new systems to comply with the associated directive requirements to file reports with regulators on their sales of NPLs to credit purchasers (which will in practice mean ensuring that banks obtain the LEI of any credit purchaser).

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