German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral of 14 March 2018 – COM(2018) 135

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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I. Preliminary remarks

The European Commission published its Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral (COM(2018) 135 final) on 14 March 2018.

The German Banking Industry Committee (GBIC) welcomes the efforts by the European Commission associated with the draft Directive to create a better framework for dealing with non-performing loans. However, the concrete proposals are not expedient and we therefore have concerns that the opposite effect will be achieved. Additionally, it will not be possible to eliminate the problem of prolonged proceedings to enforce loan collateral without a considerable improvement in the judicial systems of the Member States concerned – and hence also through measures instituted by those Member States.

It is correct in principle that credit institutions must be given opportunities to recover loan collateral more efficiently and more quickly in order to avoid any accumulation of non-performing loans. The GBIC therefore supports the Commission's goal of enhancing protection for secured creditors in the event of default by a borrower. We presume that enhanced protection for secured creditors and their loan collateral will also have a positive effect on borrowers and will thus give them easier and cheaper access to loans.

From the GBIC's perspective, German law already provides an instrument that allows creditor an opportunity for prompt recovery through the possibility of submission to immediate enforcement. The German Banking Industry Committee presumes that this instrument will continue to be available after the mechanism described in the draft Directive comes into force. No changes to the existing enforcement practice based on submission to immediate enforcement are necessary.

However, we believe that the Accelerated Extrajudicial Collateral Enforcement (AECE) mechanism proposed in the draft Directive is not expedient, in particular in combination with the Commission's Proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures (COM(2016) 723 – Restructuring Directive).

Rather, there is a risk that this can impair the supply of credit to the European economy. The combination of the two proposed directives will inevitably weaken the position of secured creditors and the protection of loan collateral. The banks will most likely see a drop in their proceeds from recovering collateral. The package of measures may also have a counterproductive effect by forcing the credit institutions to behave with even more restraint and greater risk-awareness when lending. This would see access to loans in future become both more difficult and more expensive.

It must be ensured that the new AECE enforcement mechanism does not negatively impact functioning national systems for collateral enforcement. For example, the German collateral enforcement system works very well. The AECE enforcement mechanism does not have any advantages over submission to immediate enforcement in the case of land charges under German law; equally, there are adequate mechanisms in the area of liens on rights to avoid complex court proceedings. It must be ensured that Member States are not forced by the Directive to modify existing, well-functioning national systems for collateral enforcement. In particular it must be clarified that the AECE enforcement mechanism is not designed to replace existing national systems for collateral enforcement.

Rather, the actual problem should be addressed, namely the inadequate functioning of some European judicial systems. An efficient judiciary is decisive for the accelerated enforcement of loan collateral. The focus at European level – depending on the starting situation in the Member State – should therefore be on revising the procedural requirements and on ensuring the availability of sufficiently qualified personnel for the courts and administrative authorities. By contrast, introducing new procedures would rather increase complexity and thus make efficient enforcement more difficult.

II. Comments on the scope and definitions

1. Article 2 – Scope

Credit servicers acting for credit institutions that are members of the same group of companies or members of a common institutional protection scheme should be exempted from the scope of the Directive. Such a scope exemption could be governed by a new point (c) following point (b) of Article 2(4), for example.

In addition, Articles 4 to 22 and 34 to 43 of the Directive should not apply to credit purchases within the same group of companies or between members of an institutional protection scheme if the credit institution transfers the credit agreement to a group company or a member of an institutional protection scheme or assigns the loan receivable to a group company or a member of an institutional protection scheme.

Since the definitions in Article 3 should also apply for the purposes of Article 2, Article 2(4) sentence 1 should read “Articles 4 to 22 and 34 to 43 of this Directive shall not apply to:” instead of “Articles 3 to 22 and 34 to 43 of this Directive shall not apply to:”, and Article 2(5) sentence 1 should read “Articles 23 to 33 and 34 to 43 of this Directive shall not apply to:” instead of “Articles 3, 23 to 33 and 34 to 43 of this Directive shall not apply to:”.

2. Article 3 – Definitions

Article 2(4) of the draft Directive lists exemptions for credit institutions and their subsidiaries established in the European Union that are credit servicers in accordance with point (a) or credit purchasers in accordance with point (c). However, the term “subsidiary” is not defined in Article 3 of the draft Directive. This can lead to differing interpretations of whether a company is a subsidiary in the Member States, because Directive 83/349/EEC and Directive 2013/34/EU allow options for the Member States. To ensure the consistent use of the term “subsidiary” in the European Union, we propose defining this term in accordance with point (16) (definition of “subsidiary) and point 37 (definition of “control”) of Article 4(1) of the Capital Requirements Regulation (CRR) (Regulation (EU) No 575/2013). This would also allow subsidiaries to be determined in accordance with IFRSs, which would apply to all listed institutions.

Furthermore, companies in the same network that are members of an institutional protection scheme have not been excluded from the scope. Article 113(7) of the CRR acknowledges this equal treatment of groups of companies and networks in the banking industry.

For this reason, a new number (12) should be added to Article 3 of the draft Directive with a definition of the term “subsidiary” in line with point (16) (definition of “subsidiary) and point 37 (definition of “control”) as well as a reference to Article 113(7) of the CRR.

III. Comments on Accelerated Extrajudicial Collateral Enforcement (AECE)

1. Recital 40

It must be ensured that Member States are not forced by the Directive to modify existing, well-functioning national systems for collateral enforcement. In particular it must be clarified that the AECE enforcement mechanism is not designed to replace existing national systems for collateral enforcement.

For this reason Recital 40 should be supplemented at the end to read that the AECE mechanism should not replace or modify existing national enforcement measures.

2. Article 23 – Conditions for the voluntary use of Accelerated Extrajudicial Collateral Enforcement

Notwithstanding the criticism in the following of the requirements of Article 23, the creation of a "directly enforceable title" proposed in the penultimate sentence of Article 23(1) of the draft Directive could have a positive effect.

The freedom of the parties to agree the enforcement event is provided for in Article 23(1)(a) of the draft Directive. In Germany, collateral can only be enforced once the secured loan has been terminated. For Germany, it would not be desirable if enforcement events prior to the due date could be agreed. If individual creditors (especially purchasers of NPLs) were able to recover collateral before the loan agreement is terminated, this would destroy the basis of promising pre-insolvency restructurings in particular.

In accordance with Article 23(1)(c) of the proposed Directive, the creditor must notify the borrower at least four weeks before the loan collateral will be enforced in the case of the accelerated extrajudicial collateral enforcement (AECE) mechanism. In doing so, the creditor is forced in a crisis to enter into a formalised enforcement process four weeks after the occurrence of the enforcement event. This robs the credit institutions of the flexibility they need for restructuring negotiations and could motivate debtors to file for insolvency in order to interrupt the process that has been initiated.

In addition, the second subparagraph of Article 23(1) of the proposed Directive should be revised. This sets out that if a borrower has repaid at least 85% of the loan amount, the repayment period for the remaining amount is extended by at least six months. This automatic deferral, which is only triggered by the AECE mechanism, runs counter to the nature of loan collateral and must therefore be rejected. Especially for a business borrower, there is no justification for the automatic deferral.

Article 23 is unclear in some points. In particular the term "enforcement event" in Article 23(1)(c) should be defined (due date of the receivable/the date when the collateral is ready for enforcement?), as the four-week notification obligation of the creditor depends on this.

In addition, a directly enforceable title that must be contained in the written agreement on extrajudicial enforcement is a condition for application of the mechanism. What is unclear, however, is whether this must happen in addition to any existing submission to immediate enforcement (Article 23, end of paragraph (1)).

We cannot understand why the debtor should benefit from a further stay of enforcement to avoid enforcement in accordance with Article 23(3) of the proposed Directive once the notification provided for in Article 23(1) of the proposed Directive has been made. This requirement should therefore be deleted.

3. Article 24 – Enforcement

According to Article 24(2), the Member States must provide for public auction and/or private sale to realise the collateral for each type of security right or collateral. However, the instrument of public auction in accordance with Article 25 should be limited to the enforcement of real estate collateral.

Article 24(3) sets out that the creditor may retain the asset, subject to an obligation to subsequently pay out any excess between the value of the collateral and the remaining loan amount outstanding to the business borrower. In particular if the value of the collateral is higher than the remaining amount outstanding and there is only a low risk of default for the lender, there is normally no reason for the lender to retain the collateral. As a general principle, however, a corresponding option to retain the asset may be advantageous. What is important is that the ability to retain the asset remains no more than an option, and that no obligation for the creditor to retain it is introduced ("Datio in solutum").

Article 24(4)(e) of the proposed Directive states that the borrower has the right to challenge the valuation before a court. Under the principle of equality of opportunity in civil procedures, this right should be extended not only to the borrower, but also to the lender, i.e. the bank.

Article 24 of the proposed Directive does not define the valuation standards in any detail, with the exception of the very vague requirement in Article 24(4(c) that the valuation has to be "fair and realistic". However, the proposed Directive does not specify precisely which conditions must apply for this to be the case. The GBIC therefore believes that the valuation standards should be defined in greater details.

When the enforcement is settled, Article 24(3) of the draft Directive requires that any positive balance (proceeds from realising the collateral/outstanding receivable) should be paid out to the debtor. However, the costs incurred to enforce the asset must first be deducted from the proceeds from realising the collateral. This is not currently provided for in the proposed Directive. We therefore urge supplementing Article 24(3) of the proposed Directive accordingly.

4. Article 25 – Public auction

Article 25 should be limited to the enforcement of real estate collateral. The following should be taken into consideration in this context: Article 25(1)(e) of the proposed Directive sets out that, as a rule, the asset may only be sold if the reserve price equals the valuation amount determined before the auction. In most cases, however, this value will not be reached because of the special circumstances surrounding a compulsory auction. German law prescribes a 7/10 or 5/10 limit here, meaning that only 70% of the value has to be reached, or only 50% of the value under certain circumstances, for the sale to go ahead. The values stated in Article 25(1) of the proposed Directive should be based on these more realistic limits to enable the practicable enforcement of collateral.

Additionally, Article 25(1)(f) of the proposed Directive only permits lower minimum proceeds of 80% of the determined value if no sufficient offer has been made in the course of the compulsory auction and there is a "threat of imminent deterioration of the asset". However, there is no definition of the criteria to be applied to such "imminent deterioration". To enable an assessment of when such a case applies, the factors that determine "imminent deterioration of the asset" should be defined in greater detailed.

5. Article 26 – Private sale

Sales by private negotiation are very successful in Germany without the need for any regulatory framework. Most collateral is realised by private sale in Germany. In this respect, the restrictions imposed by Article 26 of the proposed Directive appear to be especially problematic for Germany and hence unacceptable.

From the German perspective, there is thus no need for private sales to be regulated.

If, nevertheless, private sales will be regulated as set out in Article 26 of the proposed Directive, this Article should be modified and restricted to the realisation of real estate collateral: The requirements of Article 26 of the proposed Directive governing private sales largely correspond to the requirements for compulsory auctions in accordance with Article 25 of the proposed Directive. Our comments on Article 25 of the proposed Directive therefore apply here as well, with the necessary modifications.

Additionally, the aggregate period of 60 days for a private sale resulting from Article 26(2) of the proposed Directive may prove to be too long and thus obstruct enforcement of the collateral. It should be possible to reduce this period in individual cases.

6. Article 28 – Right to challenge the enforcement

Since Article 28 of the proposed Directive sets out a right of challenge for the business borrower, which is also likely to be necessary because of the principle of the rule of law, the right to the administration of justice and the right to effective legal protection, it will not be possible to achieve the intended acceleration of enforcement of collateral using the proposed mechanism. The reason for this is that a challenge before the national courts, and in particular the clarification by the court of the question of whether assets were valued correctly in accordance with Article 26, would considerably delay the mechanism. Nor does this Article make clear the legal consequences if the challenge is successful. Ultimately, any challenge should not be allowed to prevent or delay the extrajudicial enforcement process. If a challenge is successful, there should only be an obligation to pay compensation. The arguments we have advanced make clear that accelerated enforcement hinges crucially on an effective, fast-acting judicial system.

Any deficits in the enforcement of loan collateral in Member States of the European Union that lead to high levels of non-performing loans appearing in banks' balance sheets must principally be eliminated by improving the organisation of the judiciary. However, this is the primary responsibility of the Member State in question. Without a functioning and efficient judiciary in the Member States, it will not be possible to solve the problem that the European Commission seeks to resolve by means of the proposed Directive. This effect cannot also be countered by the introduction of an accelerated extrajudicial collateral enforcement (AECE) mechanism.

7. Article 30

For cases where the proceeds from the enforcement of loan collateral realised using the AECE mechanism are lower than the loan amount secured by that collateral, Article 30 of the proposed Directive sets out that all remaining liabilities will be settled.

This is the equivalent of introducing the remission of business borrowers' outstanding debt. Such a rule substantially contradicts the nature of loan collateral. Loan collateral should secure the repayment of a loan and not result, for example, in the forced remission of part of the loan amount. This rule puts a lender who has –voluntarily – agreed to use the AECE mechanism in a worse position than a lender who has not entered into such an agreement. Agreeing to use the AECE mechanism would have serious consequences and would entail a system change: the bank would no longer “just” bear the credit risk, but would also have to bear the risk of deterioration in the value of the loan collateral.

This rule also harbours a considerable risk of abuse. That is because the borrower, who is normally the only person who can affect the condition of the collateral asset, which is generally in his sphere of influence, could be tempted to provide a defective collateral asset and subsequently not to adequately ensure that the collateral asset is received free from defects.

8. Article 33

Article 33 imposes extensive new data collection obligations on credit institutions.

The effort required to capture and maintain the data referred to in Article 33 unilaterally burdens the credit institutions, on the one hand because they must adapt their IT systems to capture additional data at considerable cost and effort. On the other, working hours capacity will be lost for this statistical collection that would otherwise be available for the credit institution’s core tasks, such as the management and enforcement of loan exposures. This directly contradicts the goal of the Directive to enhance the efficiency of NPL recovery.

Additionally, we do not understand why third-party purchasers of credit agreement – i.e. credit investors – are given preferential treatment and are not subject to the data collection obligation, since they are permitted by Article 31 to use the same instruments. The result is a competitive disadvantage for the credit institutions that breaches the principle of equal treatment.

In light of the rules that already exist in many Member States, it is also unclear whether the data collection obligation also extends to existing instruments in the Member States that fall within the scope of the directives. If this is not the case, the question arises to an even greater extent of why this data should only be collected for those Member States that create these instruments for the first time.

Moreover, the data to be collected does not offer any evident advantage for the credit institutions’ business operations. On the contrary, a new “data bloat” will be created. Collecting additional data merely for an analysis to justify the activities of the EU lawmakers also directly contradicts the goal of the Directive (number 3 on page 14 of the draft Directive) to reduce administrative costs in the EU.

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