

European Mortgage Federation European Covered Bond Council (EMF – ECBC) Position Paper

EMF-ECBC Position Paper on EC Proposal for a Directive on Credit Servicers, Credit Purchasers and the Recovery of Collateral

Executive summary

1. The EMF-ECBC welcomes the European Commission's proposal for a directive on credit servicers, credit purchasers and the recovery of collateral, and supports the overall objective of preventing the accumulation of non-performing loans. We believe that the introduction of new possibilities to increase efficiency and to reduce the length of debt recovery procedures for credit institutions could be a good way to achieve this objective.
2. Improving the protection of secured creditors in the context of the Banking Union and the Capital Markets Union will furthermore have a positive impact on borrowers and their access to credit. We therefore support the Commission's aim to protect secured creditors through an accelerated out-of-court recovery of collateral (Accelerated Extrajudicial Collateral Enforcement (AECE)).
3. In order to accommodate national specificities of national market and legal frameworks the AECE must not replace national collateral enforcement procedures, including out-of-court procedures. Furthermore, in parallel to establishing alternative procedures, the EU should support Member States in ensuring more efficient judiciary and administrative systems.
4. The use of the AECE must remain discretionary for banks, which should be able to choose between AECE and traditional enforcement procedures at any moment in time.
5. Member States must not be given the possibility of providing for a discharge of the residual debt because this would encourage speculative behaviour among borrowers and introduce a dangerous derogation to the principle that debts are to be fully paid. This would also leave creditors that concluded an AECE agreement worse off, since they would have to bear not only the credit risk, but also the value risk of the collateral.
6. The AECE mechanism needs to be enforceable in insolvency/pre-insolvency processes. If the mechanism were not carved out from insolvency and pre-insolvency proceedings, insolvency could be triggered in a swifter manner, in which case the AECE would simply be a common type of collateral without additional practical use. The combination of AECE with the proposed Insolvency Directive is unlikely to strengthen the capability of creditors to recover value and may even weaken the position of secured creditors.
7. The limitation of the scope to business borrowers should not be for reasons of consumer protection, since this would not be in line with the Mortgage Credit Directive (MCD) and the Capital Requirements Regulation (CRR).

8. The realisation of the collateral through appropriation needs to remain an option for creditors and should not become an obligation for creditors to take over the property in the portfolio of the bank (“Datio in solutum”).
 9. In the case of appropriation, liabilities and mortgages or other transcriptions made on the immovable asset after the launching of the accelerated loan security should be excluded or automatically cancelled.
 10. In case of appropriation, the Directive should provide for the possibility to transfer not only to creditors, but also to other third parties indicated by creditors.
 11. The criteria for a “fair and realistic” valuation of the collateral to be enforced should be aligned with recognised valuation standards.
 12. Credit institutions should be granted the same right of the borrower to challenge the valuation before a court.
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General Remarks

1. It must be ensured that Member States are not obliged by the Directive to modify existing, well-functioning national systems for collateral enforcement. We would like to stress that in order to accommodate the specificities of national markets and legal frameworks, the common mechanism (AECE) **must not replace national collateral enforcement procedures** (including out-of-court procedures), but rather create a new alternative for creditors to recover value from loans. It should also be expressly provided that the AECE mechanism is not mandatory, but discretionary. Therefore, **banks should have the possibility to disregard AECE and to activate traditional enforcement procedures**, even after an AECE procedure has been launched. Furthermore, the choice of which enforcement procedure to use should be left exclusively to the creditor; the business borrower should not have this choice.
2. Further, an efficient judiciary is also important for the accelerated enforcement of loan collateral. In order to achieve the aim of reducing the stock of Non-Performing Loans, in parallel to establishing an accelerated alternative procedure, **the EU should support Member States in ensuring faster and more efficient judicial and administrative procedures with the availability of sufficiently qualified personnel for the courts and administrative authorities.**

Articles 2 & 3 (Scope & Definitions)

3. The limitation of the scope of application of the AECE to business borrowers is, in our view, coherent with the overall objective of the Capital Markets Union of improving access to finance for businesses. Furthermore, this is also in line with the Commission proposal on preventive restructuring frameworks and second chance, which focuses on businesses and entrepreneurs.
4. Without prejudice to point 2, the justification for limiting the scope to business borrowers should not be for reasons of “consumer protection”, since the ability of the creditor to enforce the collateral as a last resort is a fundamental pillar of the mortgage lending business, as well as a prudential requirement under the CRR. Furthermore, the exclusion of consumers from the scope of application of the AECE on the basis that the primary residence of the consumers should be protected is not aligned with the MCD – which introduced principles regarding “Arrears and Foreclosure” (Art. 28) – and with the EBA Guidelines on Arrears and Foreclosure.

Article 23 (Conditions for the voluntary use of AECE)

5. The EMF-ECBC supports the information requirements meant to avoid poorly informed credit decisions by business borrowers. We also strongly support the inclusion in the AECE agreement between creditor and borrower of a **directly enforceable title**, as per Article 23(1)1. However, certain conditions listed in Article 23 may add unnecessary burden on creditors and therefore undermine the fulfilment of the main objective of the proposal (i.e. to facilitate the recovery of value from loans).
6. For instance, under paragraph 1(b) of Article 23 the business borrower must be “*clearly informed about the application and consequences of the AECE prior to the conclusion*” of the written or notarised agreement foreseen under paragraph 1(a). **This additional obligation is unnecessary and should be removed**, because the business borrower will be aware of the application and consequences of the AECE as a result of the written or notarised agreement.
7. Moreover, under sub-paragraph (c)(i), a creditor is obliged to inform a debtor at least four weeks – or at a later point in time where so negotiated by the creditor and the business borrower – in advance of its intention to realise the asset through the AECE mechanism.
8. If the creditor has to grant a four-week period of prior notice, the borrower will be entitled to file for insolvency, stay or other remedies in order to prevent the creditor from enforcing the security, undermining the usefulness and efficiency of the procedure. Furthermore, obliging the creditor to respect this period of notice would require the creditor to immediately activate the AECE mechanism (to avoid negative consequences) resulting in any possibility of a settlement agreement with the debtor being lost. With this in mind, we strongly recommend refraining from defining such a period, or any other, in the directive.
9. The same applies for the six months period for cases where the borrower has repaid 85% of the debt. In order to achieve an expedited enforcement procedure, the enforcement should be as immediate as possible.

Article 24 (Enforcement)

10. Paragraph 24(2) states that Member States shall provide for at least one or both of the following means to realise the collateral as referred to in paragraph 1 for each type of security right and collateral: (a) public auction; (b) private sale. Under paragraph 24(3) where Member States establish the extrajudicial enforcement procedure by means of appropriation, the right of the creditor to retain the asset in or towards satisfaction of business borrower's liability shall be governed by the applicable laws in each Member State.
11. Since the use of AECE could imply that banks would have to consolidate newly acquired assets on their balance sheets to the detriment of e.g. capital allocation requirements, the **appropriation needs to remain an option for creditors** and should not become an obligation for creditors to take over the property in the portfolio of the bank (“Datio in solutum”).
12. In any case, as indicated in the general remarks, it should be expressly provided that the AECE mechanisms (sale and appropriation) are not mandatory but discretionary. In other words, **banks should have the possibility to disregard the accelerated loan security clause** even if this clause was agreed with the business borrower in the credit contract and to decide to activate the traditional enforcement procedures. This would allow banks to decide whether to use the accelerated loan security clause or the traditional enforcement procedures on a case by case basis. The business borrower should not have the option to choose which of the possible remedies the creditor will use.

13. In case of appropriation with the right of the creditor to retain the asset, the wording of the Directive should include also the possibility of transfer of the ownership of the asset to the creditor. In this way, the provision will be coherent with national legal frameworks where creditors do not maintain legal ownership of mortgaged assets.
14. In order to ensure widespread use of the AECE, Member States should allow creditors to realise the collateral through both of the means of public action and private sale, rather than “at least one” of them, leaving to the parties the choice as to which means to insert in the contract. Furthermore, where Member States establish the extrajudicial enforcement procedure by means of appropriation, they shall also ensure that creditors can subsequently use both the means of public auction and private sale to realise the collateral.
15. Where appropriation of a real estate property is foreseen under an AECE procedure, the Directive should also provide for the possibility to **transfer not only to creditors, but also to other third parties**. For example, if the bank has already found a potential buyer, it should be given the possibility to instruct that the asset be transferred to this party, in order to avoid a double transfer of the property.
16. In the case of appropriation and the transfer of immovable assets to creditors, liabilities and mortgages or other transcriptions made after the launching of the accelerated loan security should, respectively, be excluded or automatically cancelled, as is the case for the sale of immovable assets in the context of traditional enforcement procedures.
17. Subparagraph 24(4)(a) states that for the purposes of the realisation of the collateral, creditor and business borrower must agree on the valuer to be appointed in order to determine the reserve price in case of public auction and private sale. In our view, the valuer should be selected **before** the enforcement event occurs, ideally at the moment of granting the loan. In fact, in the event of enforcement, the borrower will most likely not cooperate with the creditor in selecting a valuer.
18. Moreover, the reference to “*fair and realistic*” valuation under subparagraph 24(4)(c) should be clarified, since this is not defined in the directive or elsewhere in EU legislation. In this respect, we would recommend that valuations be carried out in line with recognised valuation standards.
19. Subparagraph 24(4)(e) grants the business borrower the right to challenge the valuation before a court. However, as the valuation is performed by an independent valuer, **the same right should be granted to the creditor**.

Articles 25 (Public Auction) and 26 (Private Sale)

20. Under subparagraph 25(1)(b) the creditor must make reasonable efforts to attract the highest number of potential buyers in the event of a public auction. In our view, this provision places a disproportionate burden on the creditor. It should be specified that the responsibility of the creditor should be to ensure appropriate forms of advertising. The same applies to subparagraph 26(1)(a) for private sales.
21. Moreover, Member States should ensure that the business borrower grants access to all the relevant information regarding the asset (photographs, cadastral floor plan, building permits) in order to allow the creditor to advertise the asset before the auction.
22. It should be specified that the asset should be delivered to the buyer free of goods and people unless the asset is occupied in the execution of a regular lease contract. In the event of eviction, the costs should be not be covered by the creditor or by the buyer.

23. Both Articles require that a creditor informs a business borrower and “any third party with an interest in or right to the asset” at least 10 days in advance of the public auction or the private sale. Such a period entitles the borrower to file for insolvency or stay provisions to prevent and prejudice the enforcement of the collateral. We recommend deleting this requirement in order to ensure the usefulness of the accelerated procedure. Moreover, the reference to “any third party with an interest in or right to the asset” should be limited to interests and rights known to the creditor or which are registered in publicly accessible registers. Otherwise the creditor will, on paper, be required to give notice to third parties it is not and cannot be aware of, making the AECE susceptible to challenges before the courts. This requirement should therefore also be deleted.
24. According to Article 25 par.1 (e) the reserve price of the asset needs to be at least equal to the valuation amount determined prior to the public auction. In practice, this is a price, which will realistically not be achieved.
25. This is also not aligned with well-established national practices which necessarily reflect market characteristics. In most jurisdictions the price to be achieved is a percentage of the market value (usually between 70% and 50%). In certain jurisdictions the valuer is instructed to deliver a reserve price which takes into account the fact that a sale is to be achieved within a restricted defined marketing period (forced sale value). Therefore, we recommend providing Member States with adequate flexibility in determining how the minimum price is to be achieved in the context of an AECE procedure, especially when conditions under subparagraph 25 (1) (e) are met. The same applies for the guide price in a private sale under Article 26 par.1 (d).
26. The concept of “*imminent deterioration of the asset*” under both articles needs to be clarified, otherwise it will lead to uncertainties and possible claims. Moreover, the reference to letter (f) in subparagraph 25(1)(f)(i) is not clear. The same applies to the reference to (e) in subparagraph 26(1)(e)(i).
27. Finally, the private sale should not be limited to two attempts.

Article 27 (Competing security rights)

28. This provision is not clear because it does not specify the priority relationship with other forms of guarantee. We believe that the proposal should explicitly regulate this relationship in order to avoid misalignment with pre-existing guarantee instruments.

Article 28 (Right to challenge the enforcement)

29. We believe that the borrower’s right to challenge the enforcement is crucial to guarantee the rule of law, the principle of legality, access to justice and legal protection. It is however detrimental to the aim of the proposal to achieve an accelerated enforcement of the collateral. The possibility to challenge the use of the AECE (or namely the valuation of the asset) before a national court would significantly delay the enforcement procedure. The provision should therefore clarify that the challenge does not suspend the enforcement of the clause and that it should only be possible for the borrower to ask for a compensation of damages.
30. Moreover, in pursuit of equity and equality of rights, the possibility of challenging the enforcement should be extended to both creditor and borrower. The judicial process for challenging the enforcement mechanism before a national court may lead to a lengthy delay, particularly in Member States with lengthy judicial proceedings. Therefore, it is important to ensure that this procedure progresses quickly so as to

avoid that the business borrower uses the right of challenge in a specious way (only to slow down the procedure).

Article 29 (Restitution of the exceeding amount)

31. It should be clarified that all the expenses (of any type) related to the AECE mechanism (e.g. costs for the rent of the locations of the auctions, publicity costs, valuers' fees, transfer of ownership) should be deducted from the positive difference between the sum outstanding of the secured credit agreement and the proceeds of the sale of the asset.

Article 30 (Settlement of the outstanding amount)

32. Under Article 30, in cases where the amount realised after the use of the AECE procedure is lower than the amount of the secured credit agreement, Member States may provide for the settlement of all liabilities under the agreement.
33. **The settlement of all outstanding liabilities after the use of the AECE procedure must be an obligation.** A secured credit agreement represents a claim against the borrower as with any other type of credit. As is therefore the case for all claims, the borrower is liable for their **full repayment**. Should the forced sale not cover the outstanding debt, the borrower remains liable for the remaining debt.
34. Against this background, we strongly believe **this provision should be deleted** because the implication is otherwise that **Member States may allow for the discharge of residual debt** where the sum recovered through the AECE is less than the sum outstanding of the secured credit agreement. This would encourage speculative behaviour among borrowers and introduce a dangerous derogation to the principle that the debts are to be fully paid.
35. Moreover, a potential discharge of debt would leave creditors that have concluded an agreement within the AECE procedure in a worse position than those who have not, **substantially undermining any potential benefit of AECE for creditors**. Banks would in fact have to bear not only the credit risk, but also the value risk of the collateral. In addition, there is also a risk of misuse: the borrower, who is responsible for the state of the property, could be motivated to hand over a property of poor quality or to not sufficiently take care of the property at a later stage.

Article 32 (Restructuring & Insolvency proceedings)

36. Some aspects of the AECE rules defined in the proposal do not contribute to speeding up the enforcement of the collateral. In particular the interaction with the Commission's proposed Insolvency Directive (COM(2016)723) under Article 32 must be considered. The subjection of the AECE to a stay of individual enforcement actions where insolvency/pre-insolvency proceedings are initiated is unlikely to strengthen the capability of creditors to recover value and may even weaken the position of secured creditors. This kind of provisions may also have a counterproductive effect by forcing the credit institutions to behave with even more restraint and greater risk-awareness when lending.
37. One of the values of creating a new form of collateral in the form of the AECE mechanism would be for it to be **enforceable in insolvency/pre-insolvency processes**. If the mechanism were not carved out from insolvency and pre-insolvency proceedings, insolvency could be triggered in a swifter manner at the request of the debtor or third parties, in which case the AECE would simply be a common type of collateral without additional practical use.

38. According to Article 32 of the proposal, national rules and principles of pre-insolvency and insolvency proceedings would prevail over the AECE mechanism and when *“insolvency proceedings are initiated in respect of a business borrower, the realisation of collateral pursuant to national laws transposing the Directive is subject to a stay of individual enforcement action in accordance with applicable national laws”*. This means that the contractual security right for the bank would **only be enforceable as long as the debtor is not in financial distress**. This would severely limit the viability, effectiveness and relevance of the AECE mechanism, since such collateral is generally most relevant in times of financial distress for the borrower. If the full effect of the collateral is to be realised, the AECE mechanism should be enforceable even when a debtor enters into an insolvency or preventive restructuring proceeding. For these reasons **Article 32 should be deleted**.
39. Furthermore, if the AECE procedure is subject to the stay when a restructuring procedure is initiated, it is likely that banks will exercise the mechanism immediately after the enforcement event has taken place, in an attempt to avoid the prior opening of restructuring procedures. Therefore, **this provision would effectively discourage banks holding such security from supporting restructuring efforts for a debtor’s potentially viable business**.

Article 34 (Modification of the credit agreement)

40. Under Article 34, without prejudice to the obligation to inform the consumer pursuant to Directive 2014/17/EU, Directive 2008/48/EC and Directive 93/13/EEC, Member States shall ensure that prior to modifying the terms and conditions of a credit agreement either by consent or by operation of law, the creditor is required to communicate a series of information including the grounds of complaint available to the consumer regarding those modifications, the time period available for lodging any such complaint and the name and address of the competent authority where the complaint may be submitted.
41. In our view, this provision imposes excessive burdens on the creditor and it is not clear whether it allows the consumer the possibility to lodge a complaint in the case of modifications with the consent of the consumer or by operation of law. Moreover, obligations of transparency/information towards consumers are already regulated within other pieces of Eu legislation. Therefore, it would be appropriate to delete this article.

Article 35 (Complaints)

42. Under Article 35 Member States shall ensure that a credit servicer communicates, without delay, certain information to the borrower. The communication shall be in writing, or by electronic means where so permitted under Union or national law. Member States shall ensure that, in all subsequent communications with the borrower as well as in any communication by telephone, the credit servicer includes or states this information.
43. Given that the information provided is already communicated to the debtor in writing, in our view it is not necessary to repeat this information (c) in subsequent communication, also by telephone.