

The new Directive on Non-Performing Loans (“NPLs”)

1. Background and intention

A significant new Directive came into force on 28 December 2021. As a part of the work to strengthen Europe’s Economic and Monetary Union, Directive (EU) 2021/2167 of the European Parliament and of the Council on credit servicers and credit purchasers (“NPL Directive”) aims at addressing high stocks of non-performing loans (“NPLs”), by developing a secondary market for NPLs originated by EU banks.

By 29 December 2023, EU Member States shall adopt and publish the laws, regulations and administrative provisions necessary to comply with the newly published Directive¹.

The increase of NPL tend to occur during periods of economic uncertainty or contraction. In fact, the 2008 crisis, and subsequent recessions, led to high levels of defaulting borrowers across Europe and the world. Covid-19 crisis is also no exception.

Typically, during large economic contraction periods more economic agents have greater difficulties in servicing debts, eventually leading towards default. This is a concern for both Banks and Supervisors as high ratios of NPL negatively affect the Banks’ balance sheet and thus their financial soundness, which ultimately may affect banks’ ability to lend to the economy.

According to the European Commission, NPLs are *“bank loans that are subject to late repayment or are unlikely to be repaid by the borrower”*².

High stocks of NPLs can weight on bank performance through two main channels. First and foremost, NPLs generate less income for a bank than performing loans and thus reduce the bank’s profitability and may cause losses that reduce its capital. Furthermore, NPLs tie up significant amounts of a bank’s resources, both human and financial, which reduces the bank’s capacity to lend, including to small and medium-sized enterprises (SMEs). Enforcement procedures require banks to set up and maintain internal structures allocated exclusively to deal with NPLs and, most of the time, with the inherent judicial proceedings, which involves the engagement of employees, lawyers and it triggers court and enforcement expenses.

¹ Cfr. article 33 of the Directive.

² [Non-performing loans \(NPLs\) | European Commission \(europa.eu\)](#).

SMEs are particularly affected by the reduced credit supply, as they rely on bank lending to a much greater extent than larger companies, since the latter can finance themselves more easily on the public capital markets by issuing bonds or raising equity financings.

SMEs have limited access to new funding and consequently to new investment opportunities, thereby affecting economic growth and job creation.

Therefore, the need for a reduction of NPLs has been discussed among national and international policymakers in recent years, given its possible influence in terms of banks' ability and willingness to finance the economy, with the potential to constitute a drag on economic growth.

The financial crisis and subsequent recessions, as well as the COVID-19 pandemic, led to a more widespread inability of borrowers to pay back their loans, as more companies and citizens faced continued payment difficulties or even bankruptcy. As a consequence of this, many banks saw a build-up of NPLs on their books.

To minimize the medium and long-term economic impacts resulting from the Covid-19 pandemic, EU Member States have implemented a broad range of measures, including some forms of moratorium on payments of credit obligations.

Now that COVID-19 support measures are over, Portuguese banks will likely be confronted by a new wave of non-performing loans.

After a gradual improvement in recent years, NPL ratio has unfortunately started to rise again, as a result of new defaults, as well as reduced NPL sales. By the end of the second quarter of 2020, the average NPL ratio for all EU banks was 2.8%³.

Notwithstanding some media coverage demonizing credit institutions for selling high stocks of NPLs, NPLs transactions are currently a normal part of the activity of credit institutions. An enhanced environment for banks to offload NPLs from their balance sheets through loan sales should be positive for SMEs, since it will create room for banks to lend to more credit to SMEs established in the European Union. In particular, in order to reduce the risk of new high stocks of NPL arising after the pandemic.

³ European Commission – Questions and Answers: Tackling non-performing loans to enable banks to support EU households and businesses.

2. Development of secondary markets

The Directive is intended to enable credit institutions to better deal with NPLs by improving conditions for the sale of the credit to third parties. Moreover, when credit institutions face a large build-up of NPLs and lack the staff or expertise to properly service them, they should be able either to outsource the servicing of those loans to a specialised credit servicer or to transfer the credit agreement to a credit purchaser that has the necessary risk appetite and expertise to manage it.

Therefore, the Directive aims to develop secondary markets for NPLs by introducing a common set of rules applicable to the key parties: credit servicers and credit purchasers⁴.

2.1 Credit servicers

Currently, there are no common standards for the regulation of credit servicers. In the absence of a coherent regulatory and supervisory regime, compliance costs operate as a barrier to the provision of cross-border services.

Therefore, the lack of competitive pressure on the market for purchasing credit and for credit servicing activities results in credit servicing firms charging credit purchasers high fees for their services and leads to low prices on secondary markets for credit. That reduces incentives for credit institutions to offload their stock of NPLs.

The Directive sets out a regulatory framework for credit servicers (i.e., any legal person that, in the course of its business, manages and enforces the rights and obligations related to a creditor's rights

⁴ Actually, the proposed text of the Directive aimed to prevent future build-up of NPLs on banks' balance sheets in two distinct ways. Firstly, by encouraging the development of secondary markets for NPLs. Secondly, throughout an improved efficiency of debt recovery procedures, as well as the availability of a distinct common accelerated extrajudicial collateral enforcement procedure ("AECE"). Often, the inefficiencies of the enforcement procedures and court systems in some EU Member States are a challenge for NPL resolution, mainly owing to the excessive length of proceedings. Out-of-court procedures are not available in all Member States and are very heterogeneous across Member States. However, the progress on the Accelerated Extrajudicial Collateral Enforcement (AECE) part was much slower than on the secondaries market part. Therefore, given the urgent need to encourage the development of a well-functioning secondary market for non-performing loans, the Council has decided to split the proposal and move forward with the part of the Directive related to secondary markets.

under a non-performing credit agreement, or to the non-performing credit agreement itself, on behalf of a credit purchaser, and carries out at least one or more credit servicing activities⁵). To ensure the freedom to provide services in the European Union, specific provisions on procedures and communication between home and host authorities are set in the Directive, as well as specific rules on how such cross-border servicers shall be supervised, by sharing the burden of supervision between home and host competent authorities. As regards these rules, we highlight the following:

- i)* credit servicers shall obtain an authorisation in a home Member State before commencing its activities within its territory in accordance with the requirements set out in the national provisions transposing the Directive and set forth in article 5⁶,
- ii)* any credit servicer to which the referred authorisation has been granted has the right to provide in the Union those services that are covered by that authorisation⁷, and
- iii)* credit servicers shall provide its services in respect of the management and enforcement of a creditor's rights under a non-performing credit agreement, or of the non-performing credit agreement itself, on the basis of a credit servicing agreement with the credit purchaser, when the latter does not itself perform credit servicing activities⁸.

2.2 Credit purchasers

The Directive also foresees a set of rules regarding credit purchases, of which the following are worth mentioning in particular:

- i)* credit institutions shall provide credit purchasers with necessary information regarding a creditor's rights under a non-performing credit agreement, or the non-performing credit agreement itself, and, if applicable, the collateral, so as to enable the credit purchaser to conduct its own assessment of the value of the creditor's rights under the non-performing credit agreement, or of the non-performing credit agreement itself, and the likelihood of recovery of the value of that agreement prior to entering into a contract for the transfer of that creditor's rights under the non-performing credit agreement, or of the non-performing credit agreement itself, with due respect to personal data protection rules⁹,

⁵ Cfr. article 3, 8) of the Directive.

⁶ Cfr. article 4 of the Directive.

⁷ Cfr. article 13 of the Directive.

⁸ Cfr. article 11, 1 of the Directive.

⁹ Cfr. article 15, 1) of the Directive.

- ii) credit institutions that transfer to a credit purchaser a creditor's right under a non-performing credit agreement, or the non-performing credit agreement itself, must provide the competent authorities of the host Member State with details of the credit purchaser¹⁰, and
- iii) the competent authorities of the host Member State may require credit purchasers to provide the referred information on a quarterly basis whenever deem necessary.

3. Entry into force

Pursuant to Article 32 of the Directive, EU Member States have until 29 December 2023 to adopt and publish, *i.e.*, transpose into their national law, the laws, regulations and administrative provisions necessary to comply with the Directive and until 30 December 2023 to start its application.

Nevertheless, entities already carrying out in accordance with national law credit servicing activities on 30 December 2023 shall be allowed to continue carrying out those credit servicing activities in their home Member State until 29 June 2024 or until the date on which they obtain an authorisation in accordance with the Directive, whichever is the earlier.

Finally, Member States that already have in place regimes that are equivalent to, or stricter than, those established in the NPL Directive for credit servicing activities may allow entities already carrying out credit servicing activities under those regimes on 30 December 2023 to be automatically recognised as authorised credit servicers by the national provisions transposing the Directive.

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¹⁰ Cfr. article 20, 1) of the Directive.

