30 August 2022

European Banking Authority
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Dear Sirs

RE: Directive (EU) 2021/2167 on credit servicers and credit purchasers (the "Directive") was published in the OJ on 8 December and the consultation paper (the "Consultation Paper") published by the EBA on its draft ITS specifying disclosure templates to be used for the provision of information in connection with the sale of non-performing loans ("NPL's").

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed. This matter has been considered by a working group convened for this purpose whose members are listed in the Schedule to this letter.

Uncertainties arising from the Directive are set out below.

1. The scope of the Directive covers NPLs issued by credit institutions established in the EU. Since large, syndicated corporate loans are not excluded, the question arises as to how these are to be treated. It is unclear, for example, if the involvement of a single EU bank in the initial lending syndicate will bring the whole loan into scope or only that portion of the loan funded by the EU bank. The issue risks becoming particularly acute for facility and security agents where the loan becomes non-performing, as the definition of a credit servicer is broad enough that it might be read to include those roles where the underlying loan becomes an NPL. This has the potential to become extremely awkward where the agents are non-EU entities (since only EU entities are permitted to service NPLs under the Directive) but there are EU banks in the syndicate. Industry raised these issues during the legislative process but they do not seem to have been addressed. As it stands, exempt entities (including EU credit institutions) acting as facility agents or security trustees are not credit servicers. Non-exempt entities acting as facility agents or security trustees may be able to establish that they don't fall within the definition although the position is not clear. But EU credit institutions and EU supervised consumer credit firms and mortgage lenders may still be subject to some obligations although it is not clear that this was intended.

2. A similar issue arises where there are multiple EU banks in a lending syndicate but they don't all classify the loan as non-performing in accordance with Article 47a CRR at the same time or at all.

3. Further, bringing a loan into scope on the basis of its classification in accordance with Article 47a CRR raises the issue of whether a loan can become non-performing

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for purposes of the Directive where it is held in the trading book, since Article 47a CRR assessments are only carried out with respect to loans in the banking book. *A fortiori* it raises the question of whether a loan can come into scope of the Directive if it becomes non-performing when held by a non-bank, since they do not carry out Article 47a CRR assessments at all.

4. The servicing framework set out in the Directive largely exempts servicing by regulated financial institutions from needing separate licensing. Credit institutions, alternative investment fund managers and even entities supervised under consumer credit legislation (in each case where regulated in the EU) may carry on servicing of debt without their servicing activities requiring separate authorisation under the Directive (although they may be subject to some regulatory obligations under the Directive). Notably absent from this list, however, is MiFID investment firms, who regularly manage assets on behalf of clients. It is unclear why they have not also been exempted in the same way.

5. The definition of a "credit purchaser" is broad enough to cover group entities of credit institutions provided they are not themselves credit institutions, meaning credit institutions may find they have lost flexibility in how to manage NPLs within their consolidated groups.

6. The definition of "credit purchaser" is also broad enough to cover special purpose entities, meaning parties to securitisations may have to provide for loans becoming non-performing ahead of time by, e.g. ensuring the servicer on the transaction is permitted to service NPLs. They may also need to ensure they have the information required to complete any templates required to be filled in for loans that later become NPLs. This would also present challenges to non-EU securitisation special purpose entities (SSPEs) that hold loans originated by EU credit institutions. Given that SSPEs have, by design, limited ability to take action on their own, it would be much more difficult to address these issues after the transaction is live.

7. The framework set out in the Directive seems to assume a world where a loan would be kept on the originating credit institution's books until the point it is sold as an NPL, ignoring the active secondary market in performing loans of all kinds. No lender other than the originating credit institution is likely to have the information required to fill in the relevant templates (assuming they look something like the ones the EBA consulted on in its May 2021 Discussion Paper on NPL transaction data templates (EBA/DP/2021/02)). The implication of this is that purchasers of all loans (performing or otherwise) originated by credit institutions may have to insist on receiving the data templates. Otherwise, buyers of performing loans take the risk they may not be able to sell a loan that later becomes non-performing because they will not have the information they would be required to provide under the Directive, and the originating credit institution may no longer exist or – even if it does – it may no longer have the relevant records or an incentive to provide any information it does have.

8. Recital 38 of the Directive indicates that the data disclosure obligation is intended to "apply to transfers of [NPLs] only, and does not encompass complex transactions where [NPLs] are included as a part of such a transaction, including sales of branches, sales of business lines or sales of clients' portfolios not limited to [NPLs] and transfers as part of an ongoing restructuring operation of the selling credit institution within insolvency, resolution or liquidation proceedings". However, the only operative provision that implements this seems restricted to sales of NPLs to credit institutions, not credit purchasers. In addition, while the principle of limiting application of the framework to sales of NPL portfolios is sensible, it is not clear

why this limitation should only apply to the data disclosure obligations. It does not necessarily seem sensible that an entity buying a whole business line should have to appoint a credit servicer just for the NPLs that form part of that business line.

9. The Directive also acknowledges that securitisation is one route commonly used for banks to dispose of NPLs and that there is a consequent need to avoid overlap between the Directive's requirements and those arising out of regulation specific to securitisation. In this sense, Recital 38 provides that "…in the case of securitisation transactions, where mandatory transparency templates are provided for, any double reporting as a result of this Directive should be avoided." This is promising, but does not appear to be reflected in the operative text of the Directive, meaning it will not be clear whether or how this eminently sensible principle will be implemented in practice. It is possible this might be addressed in the EBA's technical standards with disclosure templates, but that seems unlikely to be confirmed for at least several months.

10. There are a number of transitional issues, including the transitional provisions around the requirements for data provision. Article 15(1) sets out the general obligation to provide information, and Article 16 sets out various rules around the data templates, which are presumably meant to fulfil the Article 15(1) obligation to provide information to prospective credit purchasers. Unfortunately, the transitional provision in Article 16(7) specifies only how the data templates apply to "credits issued" on or after 1 July 2018 that become non-performing after the Directive enters into force. It does not specify whether the general disclosure obligation in Article 15(1) still somehow applies to credits issued prior to 1 July 2018 or to credits issued on or after that date and that become non-performing before the Directive enters into force and, if so, how. However, credit institutions will be subject to the reporting obligation under Article 15(2) when they sell any existing loan after the date the obligations under the Directive begin to apply.

In addition to clarifying these issues in the Draft ITS we recommend interpretive guidance be issued by the EBA and or the joint Committee of the ESA's.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours faithfully,

Brian Gray
FMLC Chief Executive[1]

[1] FMLC acknowledges the assistance of Andrew Bryan of Clifford Chance LLP, Sanjev Warna-kula-suriya of Latham & Watkins LLP, the Loan Market Association and the International Capital Market Services Association in writing this letter.

Financial Markets Law Committee

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[2] Note that Members act in a purely personal capacity. The names of the institutions that they ordinarily represent are given for information purposes only.