

The Consumer Voice in Europe

SECONDARY MARKET FOR NON-PERFORMING LOANS

The European Commission's proposal is a bad deal for distressed borrowers



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Why it matters to consumers

The European Commission has proposed to create a single secondary market for non-performing loans. Banks would be able to easily sell loans which have soured to third party investors, including the so-called vulture funds established in any EU country or outside the EU. This initiative is against the interests of borrowers who are in financial difficulty. They would be exposed to vulture funds and debt collectors located in other countries, and potentially to even worse treatment and repossession of homes.

Summary

Last March, the European Commission proposed a package of measures to remove non-performing loans (NPLs) from banks' balance sheets. The narrative is that high levels of NPLs reduce banks' profitability and prevent them from lending more to businesses and consumers, which in turn slows down EU economic growth.

The Commission proposed to create a single European secondary market for NPLs to enable banks to easily sell off loans taken out by businesses and consumers to third party investors and credit servicers (debt collectors) located anywhere within the EU. This is extremely dangerous for retail borrowers.

While it is commonly acknowledged that the NPL problem across the EU stems to a large extent from the past financial crisis and irresponsible lending practices by financial institutions, distressed borrowers are unacceptably pressed to foot the bill. A single EU secondary NPL market would open up new business opportunities for third-party credit servicers and investors, including non-EU investors, while distressed borrowers across Europe would be exposed to firms established abroad with potentially worse treatment and greater numbers of home repossessions. Vulture funds and debt collectors have a bad reputation because of their unfair and aggressive practices towards distressed retail debtors. Therefore, BEUC advocates for the exclusion of consumer loans from the scope of the Commission's proposal.

There are alternative, sustainable ways of addressing the NPL problem, while protecting borrowers in financial difficulties. Banks usually sell NPLs to third-party investors at hugely discounted prices. As a minimum, the concerned borrowers should be able to purchase their own debt at the discounted price, instead of it being sold to third-parties.

Besides that, strict responsible lending obligations should be imposed on all credit providers and intermediaries in future, so that loans are granted only to those borrowers who can afford them.

Finally, the activity of third-party credit servicers and credit investors needs to be restricted. Market actors who maximise their profits on the back of vulnerable consumers and businesses should not be supported, but should, instead, face restrictions.

1. What is it all about?

A decade after the start of the global financial crisis, the EU economy has not fully recovered. The key solutions of the crisis, such as structural reform of banks have not been tackled yet, while many legacies of the crisis remain unsolved. One of those legacies is the accumulation of problematic loans – the so-called non-performing loans (NPLs) – on banks' balance sheets.

According to a technical standard adopted by the European Banking Authority in 2014, a loan is classified as non-performing when repayments are more than 90 days past the due date or the debtor is assessed as unlikely to pay.¹ The total volume of NPLs across the EU is at around EUR 910 billion.

Consumer NPLs (unsecured loans and mortgage credit) constitute around one third of that amount.² There is little data on the composition of consumer NPLs, i.e. the respective shares of mortgage credit and unsecured loans is unclear. The volume of consumer NPLs is particularly high in the following Member States: Bulgaria, Ireland, Greece, Croatia, Italy, Cyprus, Hungary, Portugal, Romania, Slovenia.

In March 2018, the European Commission proposed a package of measures to tackle the pending NPLs and to prevent their future accumulation. The Commission's proposal is based on the assumption that high levels of NPLs reduce banks' profitability and prevent them from lending more to businesses and consumers, which in its turn slows down EU economic growth.³ Hence, reducing the volume of NPLs is high on the EU's political agenda.

As part of the package, the Commission proposes a directive on credit servicers, credit purchasers and the recovery of collateral which, *inter alia*, aims to **create a single European secondary market for NPLs** where banks can easily sell their NPLs to investors and make use of specialised credit servicers. **The secondary market would cover both consumer and business loans.**⁴

According to the Commission's analysis, the EU secondary market for NPLs is currently fragmented along national borders. This means banks cannot easily sell NPL portfolios to third-party loan servicers and investors within the EU market. It therefore proposes to grant an EU passport to credit servicers who act on behalf of third-party investors. This would be an authorisation to provide their services across all Member States based on a licence obtained in any Member State.

¹ 'EBA Final draft technical standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013', EBA, 24 July 2014, <https://www.eba.europa.eu/documents/10180/449824/EBA-ITS-2013-03+Final+draft+ITS+on+Forbearance+and+Non-performing+exposures.pdf>

² 'Second progress report on the reduction of non-performing loans in Europe', European Commission, 14 March 2018, http://ec.europa.eu/finance/docs/policy/180314-communication-non-performing-loans_en.pdf

³ 'Non-performing loans package', European Commission, March 2018, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/non-performing-loans-npls_en

⁴ 'Proposal for a directive on credit servicers, credit purchasers and the recovery of collateral', European Commission, 14 March 2018, https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-135_en
The following measures are also part of the Commission's NPL package: (i) Provide banks with a mechanism of out-of-court value recovery from secured loans. This mechanism will apply to business loans. Consumer loans are excluded. (ii) Proposal for a regulation introducing common minimum capital requirements for newly originated loans that become non-performing. The aim is to prevent future NPL crisis from happening; A non-binding guidance to national authorities on how they can set up national asset management companies (bad banks) dealing with NPLs.

2. Who are credit servicers and credit purchasers?

'Credit servicers' and 'credit purchasers' are important players in secondary markets for NPLs. Credit purchasers are specialised firms which purchase portfolios of distressed debt from banks at a discounted price, and then try to collect the total amount of debt, plus fees and penalties, from the debtor. Credit servicers act as intermediaries on behalf of credit purchasers. They are in charge of collecting the money from debtors.

Most credit purchasers are specialised funds, known as 'vulture funds'. Almost all the big actors in this market are American companies. They purchase NPL portfolios from banks at hugely discounted prices, around 40%-50% for secured loans (mortgages), and up to 90% for unsecured loans.⁵

Vulture funds and debt collectors have a bad reputation because of their unfair and aggressive practices towards distressed debtors - consumers, businesses, and even governments. For example, it is widely known how vulture funds have made juicy profit margins using legal proceedings against states in financial distress. It is worth mentioning that in 2015, Belgium adopted a law strictly limiting the business of vulture funds as regard government debt. Vulture funds are worried that similar laws might be replicated in other countries. Therefore, one of the biggest US vulture funds appealed to the Belgian constitutional court against this law.⁶

3. BEUC demands

a. No promotion of an EU secondary market for non-performing consumer loans

There should be no single secondary market for consumer NPLs. The Commission's proposal is mainly focused on the soundness and profitability of banks, while consumer interests are side-lined. Furthermore, the proposal would open up new business opportunities for third-party credit servicers and investors, including non-EU investors, while distressed individual borrowers across Europe would be exposed to those firms established abroad and potentially to bad treatment and home repossessions. We therefore call on the European Parliament and the Council to exclude consumer loans (personal credit and mortgage credit) from the scope of the directive.

◆ ***NPL definition interfering with national legislation?***

According to the proposal, loans are classified as non-performing when repayments are more than 90 days past due or the debtor is assessed as unlikely to pay. Yet, this definition may be incompatible with national laws aimed at better protecting distressed debtors.

⁵ 'Impact assessment on the development of secondary markets for non-performing loans by removing of undue impediments to loan servicing by third parties and the transfer of loans', European Commission, 14 March 2018, pp. 114-116, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2018%3A75%3AFIN>

⁶ 'Les fonds vautours tentent de faire la loi en Belgique', 15 March 2018, <http://www.cadtm.org/Les-fonds-vautours-tentent-de>

For example, our German member vzbv reports that in Germany, lenders may not cancel a credit contract due to missed payments unless certain criteria are met. These criteria go far beyond a simple time limit in order to prevent unnecessary cancellations.⁷ The criteria to be met are the following:

- a minimum of two *consecutive* entirely missing or inadequate payments have occurred plus;
- with credits relating to residential property, at least 2.5% of the credit amount is overdue (higher percentages apply here with other forms of consumer credit) plus;
- the consumer borrower has been warned and given a final two-week timeline to settle the open payments before the actual cancelling of the contract is enacted. Furthermore, the lender is obliged to offer at the latest, with this notice, an invitation to discuss the contract in order to find a solution by a mutual consent.

The above provisions are perfectly in line with Article 28 of the Mortgage Credit Directive which says that "*Member States shall adopt measures to encourage creditors to exercise reasonable forbearance before foreclosure proceedings are initiated.*"⁸ The EU-level NPL definition seems, however, to ignore national consumer-protection provisions.

◆ ***NPL volumes declining: The creation of a secondary market for NPL is unnecessary***

The total volume of NPLs across the EU is at around EUR 910 billion. At the end of September 2017, it declined to 4.4% of the total volume of loans, compared to 5.4% one year earlier. The average ratio of NPLs has decreased by more than one third since 2014. A similar trend happened with regard to consumer NPLs: 4.4% in the third quarter of 2017 versus 5.5% in the third quarter of 2016.⁹

This progress has been made possible by the joint efforts of the Commission, European Central Bank, European Banking Authority and national authorities, who have incentivised banks to manage and reduce their NPLs, and pushed for bank restructuring and liquidation, where needed.

One can assume that the existing downward trend in NPL volumes will continue and ultimately reduce them to insignificant levels in the coming years. Thus, a creation of the EU secondary market for NPLs is unnecessary.

◆ ***Consumers are not responsible for the NPL crisis***

To a large extent, the NPL issue in Europe originated with the 2008 financial crisis, the resulting economic crisis and huge unemployment levels. Financial institutions played a significant role in that respect. For example, the real estate bubbles in several Member States were caused by irresponsible lending practices and over-reliance on the growth of house prices. Another example is the foreign currency loans crisis in Central and Eastern Europe which happened because consumers were pushed to take loans in foreign currencies that were promoted at lower interest rates than loans in local currencies.

Individual consumers are not responsible for the financial crisis or the NPL crisis. On the contrary, millions of consumers have been victims of the reckless behaviour of financial firms. The Commission's proposal is disproportionate as it aims to address the NPL issue

⁷ 'German Civil Code Bürgerliches Gesetzbuch', § 498 BGB

⁸ 'Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010', Art 28, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0017>

⁹ 'Second progress report on the reduction of non-performing loans in Europe', European Commission, 14 March 2018, http://ec.europa.eu/finance/docs/policy/180314-communication-non-performing-loans_en.pdf

partly on the back of distressed borrowers who will be exposed to the pressure of vulture funds and debt collectors.

◆ ***The Commission's narrative doesn't stand up the scrutiny***

The two main theses behind the Commission's proposal are:

1. high NPL volumes impact banks' profitability and stability;
2. high NPL volumes prevent banks from granting more loans to businesses and consumers.

While the first argument seems obvious (this is actually the essence of the EC initiative), the second one is arguable.

Numerous academic and empirical studies question the level of the financial sector's contribution to the real economy and growth. Some even indicate that the growth of the financial sector comes to the detriment of non-financial sectors that are more value-creating, e.g. many high skilled people are more attracted to the high salaries paid by financial institutions than by salaries in other sectors.¹⁰ Thus, it is questionable whether banks would lend more to the real economy in the absence of the NPL problem, or whether those funds would be rather allocated to speculative activities or distributed to shareholders.

◆ ***The Commission's impact assessment is surprisingly vague on the impact on distressed borrowers***

The Commission's proposal is mainly focused on the soundness and profitability of banks. Consumer interests seem to be side-lined.

The impact assessment accompanying the legislative proposal offers a detailed analysis of barriers to cross-border sales of NPLs portfolios by banks, information about how to overcome those barriers, and a calculation of efficiency gains for banks, third-party credit servicers and NPL investors.

However, when it comes to the potential impact on distressed borrowers, the impact assessment states that "*The potential impact on highly indebted households is hard to foresee as it will depend on the behaviour of loan servicers. If the latter help indebted social groups more than banks to arrive at a more suitable payback profile of their loans, debtors may benefit. The opposite is possible if loan servicers apply existing debtor protection rights in a stricter way than banks.*"¹¹

The above suggests that consumer protection is not a high priority in this legislative proposal.

◆ ***There are bad experiences of consumers with debt vultures***

¹⁰ 'Does London's financial centre boost or harm the UK economy?', 25 February 2014, <https://www.theguardian.com/business/economics-blog/2014/feb/25/london-financial-centre-boost-or-harm-uk-economy>

¹¹ 'Impact assessment on the development of secondary markets for non-performing loans by removing of undue impediments to loan servicing by third parties and the transfer of loans', European Commission, 14 March 2018, page 77, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2018%3A75%3AFIN>

According to the European Banking Authority, since 2013, NPL transactions were observed in only 13 (Czech Republic, Germany, United Kingdom, Croatia, Ireland, Italy, Latvia, Norway, Poland, Portugal, Romania, Slovenia, Spain) out of 27 countries surveyed.¹²

Some Member States have rules in place regulating and/or restricting the activity of credit servicers and credit purchasers. The Commission considers that those specific rules constitute a barrier for business and will have to be removed: "...those Member States that require banking licenses (DE, FR, HU, MT, AT, SK) would no longer be able to do so; those that have different licensing regimes for performing and non-performing loans (BG, FR, PT, RO) would be expected to change the rules. A number of Member States (BE, BG, ES, HU, FI) would need to review the constraints they had put on some investment funds to buy NPLs and BG may need to generalise the permission to transfer consumer loans."¹³

Our Austrian member Arbeiterkammer reports a case in **Austria** involving the sale of loans of a major Austrian bank to third parties several years ago. It resulted in a wave of complaints being filed with consumer and debt advice organisations. Debt collection agencies and lawyers intervened quite rigorously, even pushing for payment despite ongoing payment plans that had been set by the court in private bankruptcies.¹⁴

Belgian law forbids certain practices of debt collectors, e.g. calling or visiting the debtor late in the evening, visiting neighbours, family and employer of the debtor, misleading information on the consequences of non-payment.¹⁵ However, debt collectors, especially bailiffs specialising in collecting non-financial debt (utility bills, parking fines, etc.), use legal loopholes to charge excessive fees to debtors.¹⁶

In **France**, several hundred debt collecting firms operate on the market. Even though their activity is regulated, there are many abuses. For example, to exert pressure on debtors, some collectors pose as court bailiffs. Debt collectors are remunerated by a commission; thus, they are motivated to recover the full amount from the debtor as quickly as possible.¹⁷

Vulture funds entered the **Irish** market after the start of the financial crisis as many consumers have been unable to repay their mortgage debt. Currently, a big Irish bank which is 75% state-owned, intends to sell 18,000 NPLs to vulture funds. There is a risk that mortgage debtors will lose their homes as vulture funds may quickly start repossession procedures, even with respect to debtors who have restructuring arrangements with the bank.¹⁸ Several other banks are also in the process of selling NPL portfolios to vulture funds.

¹² 'EBA report the dynamics and drivers of non-performing exposures in the EU banking sector', EBA, 22 July 2016, <https://www.eba.europa.eu/documents/10180/1360107/EBA+Report+on+NPLs.pdf>

¹³ 'Impact assessment on the development of secondary markets for non-performing loans by removing of undue impediments to loan servicing by third parties and the transfer of loans', European Commission, 14 March 2018, page 44, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=SWD%3A2018%3A75%3AFIN>

¹⁴ 'Bank Austria stößt faule Kredite in Höhe von 850 Mio. Euro ab', 17 December 2007, <https://diepresse.com/home/wirtschaft/economist/349508/Bank-Austria-stoesst-faule-Kredite-in-Hoehe-von-850-Mio-Euro-ab>

¹⁵ 'Bank Austria sells bad loans', 11 April 2012, <http://wiev1.orf.at/stories/276052>

¹⁶ 'Recouvrement de dettes', SPF Economie, <https://economie.fgov.be/fr/themes/services-financiers/credit-la-consommation/endettement/recouvrement-de-dettes>

¹⁷ 'Ces huissiers spécialisés dans le business de dettes', 31 janvier 2013, <http://www.levif.be/actualite/belgique/ces-huissiers-specialises-dans-le-business-des-dettes/article-normal-135443.html>

¹⁸ 'Les méthodes musclées de « chasseurs de dettes »', 2 avril 2013, https://www.lemonde.fr/societe/article/2013/04/02/les-methodes-musclees-des-chasseurs-de-dettes_3151843_3224.html

¹⁹ 'Vulture fund legislation will not stop repossessions, TD warns', 6 March 2018, <https://www.irishtimes.com/news/politics/oireachtas/vulture-fund-legislation-will-not-stop-repossessions-td-warns-1.3417498>

In **Latvia**, 15% of consumer complaints received by the Consumer Rights Protection Centre in 2012 were related to debt collection services.¹⁹

As reported by ALCO in February 2018, a consumer group and BEUC member in **Lithuania**, forced debt collection was under way in 252,882 cases (the total population of Lithuania is 2,8 million inhabitants). This means that 1 in 6 households is affected. Around 152,000 people earning a minimum wage had more than one case where half of their salary is taken by the debt collectors; if the indebted person earns more than minimum wage, another 70 percent of the difference is being appropriated.²⁰

It is also useful to note that, in Lithuania, the average net monthly income of a bailiff's office is 9,900 euros. This is a significant amount considering that the minimum monthly wage is 400 euros. Currently 118 bailiff offices operate in the country²¹, while it is estimated that many more debt vulture firms operate without a licence.

In **Portugal**, in recent years, some credit institutions have sold NPLs, both consumer credit and mortgages. There is no specific legislation that foresees consumer protection in these cases. In addition, there is no regulatory regime on debt collection activities.

Due to the existence of several debt collection services and the absence of regulation, Portuguese consumer group DECO witnessed various abusive practices, such as debt collection agents pretending to be debt execution officers, solicitors, or lawyers. The aim is to force the debtor to repay or to agree to a payment plan under the threat of an immediate foreclosure of assets and income attachment. There are other threats made, such as several phone calls per day to the debtor's home or workplace, to friends, family members, or neighbours, putting at risk the person's mental health, the right to work, relaxation, and privacy of the debtor. Another detrimental practice is the informal agreement of payment plans, not in the written form, which translates into uncertainty for the debtor as he/she is not aware of contract terms or of where payments made are going.

◆ ***Risk of supervisory arbitrage by the rogue players to the detriment of consumers***

The draft directive establishes several requirements for granting the authorisation to credit servicers. One of the requirements is that credit servicers must ensure the fair and diligent treatment of borrowers, including taking into account their financial situation and, where available, the need for such borrowers to be referred to debt advice or social services. In addition, credit servicers would need to respect the rights and obligations of the initial credit agreement.²²

Yet, given that the interests of credit servicers/credit purchasers and consumers are diametrically opposed, it is highly doubtful that those firms will respect all legal obligations and put consumer interests above their own. Especially since those firms typically do not enjoy a high reputation and do not run significant reputational risk. The consumer would be exposed to credit servicers and credit purchasers established abroad, which creates further risks.

It is the role of the national competent authorities to enforce legislation, but, in fact, the quality of supervision and enforcement varies widely across Member States. According to

¹⁹ 'Consumers complain most often about Swedbank', 31 January 2013, <http://bnn-news.com/consumers-complain-swedbank-87019>

²⁰ Ministry of Justice of Lithuania, <http://en.tm.lt/>

²¹ Chamber of Judicial Officers of Lithuania, <http://www.antstoliurumai.lt/en/lietuvos-antstoliu-rumai>

²² 'Proposal for a directive on credit servicers, credit purchasers and the recovery of collateral', European Commission, 14 March 2018, Art 5(c) and 5(d), https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-135_en

the Commission's proposal, credit servicers would be supervised by their home country authority, where the EU passport is obtained.²³ This means that credit servicers will have a strong incentive to obtain the EU passport in Member States with weaker supervisory standards. In other words, there is a significant risk of supervisory arbitrage that will ultimately impact the protection of distressed borrowers.

b. Alternative, sustainable ways of addressing NPLs and protecting consumers

Continue with the existing mechanism of reducing the NPLs. NPL volumes across most EU countries are gradually decreasing thanks to the joint efforts of the Commission, European Central Bank, European Banking Authority and national authorities, who have incentivised banks to manage and reduce their NPLs, pushed for bank restructuring and liquidation, where needed. Those efforts should be continued.

Grant forbearance measures to borrowers in financial difficulties. In accordance with the Mortgage Credit Directive²⁴ and the EBA guidelines on arrears and foreclosure²⁵, credit providers should grant forbearance measures to distressed borrowers, such as restructuring loan terms. The Commission's proposal on secondary NPL market seems to interfere with the Mortgage Credit Directive obligation imposed on lenders. EU and national competent authorities must monitor the lenders' compliance with that obligation.

Writing off loans instead of selling off at a huge discount? Banks are usually selling NPLs to third-party investors at hugely discounted prices. An EU-level reflection should be launched on whether it would not be more appropriate to write off those loans instead. That could be made conditional on certain criteria, to be defined. As a minimum, the concerned borrowers should be able to purchase their own debt at the discounted price, instead of selling to third-parties.

Impose strict responsible lending obligations on credit providers and intermediaries. Credit is not a substitute for income and should be granted only to those borrowers who can afford it. Responsible lending obligations already exist with respect to mortgage credit²⁶, but such requirements are missing in relation to unsecured loans. The expected review of the Consumer Credit Directive next year is a good opportunity to close the regulatory gap.

Build a backstop against future NPLs. We welcome the Commission's proposal on capital requirements related to future NPLs.²⁷

Impose restrictions on the activity of third-party credit servicers and credit purchasers. Market players who maximise their profits on the back of vulnerable

²³ Idem, Art 12

²⁴ Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010', Art 28, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0017>

²⁵ 'Guidelines on arrears and foreclosure', EBA, 1 June 2015, <https://www.eba.europa.eu/documents/10180/1092172/EBA-GL-2015-12+Guidelines+on+arrears+and+foreclosure.pdf/a16dfe3a-932c-4ff3-b4ff-8cf9f54799ca>

²⁶ Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010', Art 18, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0017>

²⁷ 'Proposal for a Regulation on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures', European Commission, 14 March 2018, https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-134_en

consumers and businesses should not be promoted, but should, instead, face restrictions. The European Banking Authority, in cooperation with the national competent authorities, should launch an investigation into the activity of credit servicers and credit purchasers, assess to what extent those firms comply with the existing EU legislation, collect data on consumer detriment and its causes, and propose measures to better protect individual borrowers in financial difficulty.

END



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