

20 October 2017

Submitted electronically

European Commission
Directorate-General for Financial Stability,
Financial Services and Capital Markets Union
Rue de Spa 2
1049 Brussels, Belgium

Re: Consultation Document: *Development of Secondary Markets for Non-Performing Loans and Distressed Assets and Protection of Secured Creditors from Borrowers' Default*

Dear Sir or Madam,

The European Network of Credit Unions (ENCU) appreciates the opportunity to comment on the European Commission's consultative document *Development of Secondary Markets for Non-Performing Loans and Distressed Assets and Protection of Secured Creditors from Borrowers' Default*.¹ Credit unions are consumer-owned, not-for-profit financial cooperatives that promote financial inclusion in underserved European communities by offering their members affordable and easily understandable financial products. There are approximately 1,000 credit unions in the European Union with more than EUR 20 billion in total assets and 7 million physical person members.²

Questions:

SECTION I: SECONDARY MARKET FOR LOANS

A. TRANSFER OF LOANS

1. Would you consider the current size, liquidity and structure of secondary markets for NPL in the EU an obstacle to the management and resolution of NPLs in the EU? If yes, would you consider such obstacle to be significant?

No, the European Network of Credit Unions does not consider the current secondary market structure for Non-Performing Loans (NPLs) to be an obstacle. Existing national-level secondary markets for NPLs, where credit unions participate in these markets, operate efficiently. We support continuing the status quo regarding European secondary markets for NPLs existing at the national-level, especially because credit unions are deposit-taking financial institutions that are regulated under national-level rulebooks pursuant to Article 2(5) of CRD IV.

¹ European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, *Consultation Document: Development of Secondary Markets for Non-Performing Loans and Distressed Assets and Protection of Secured Creditors from Borrowers' Default* (July 2017), available at https://ec.europa.eu/info/consultations/finance-2017-non-performing-loans_en.

² See "Credit Unions in Europe," http://creditunionnetwork.eu/cus_in_europe.

2. What are the key considerations for banks in deciding whether loan sales should be a significant part of their strategy to manage its NPLs?

In answering please specify

- bank internal factors (i.e. any factors inside the bank including the type and characteristics of the NPL portfolio, management capacity etc.)***
- external factors (i.e. any factors outside of the bank that are important considerations in this context.***

Some credit unions sell defaulted unsecured loans to debt-collection firms or securitisation vehicles, although restrictions in national law related to credit union member-borrower's status as the owners of the co-operative credit union can sometime prohibit alienation of a credit unions' NPLs, depending on the Member State's credit union law. Poland, for example, has recently reduced restrictions on credit unions' sales of loans in the secondary market, such as to securitisation vehicles.

Sale of a portfolio of secured loans would also be a useful way to help close out the credit union's exposure to legacy assets, however, the European Network of Credit Union's members do not report challenges in this area.

5. What are the specific advantages to the development of secondary markets when the acquiring investor is a bank, an investment fund or another type of entity?

In particular, would you see specific advantages for

- helping banks overcome legacy assets;***
- creating investment opportunities for specialised investors?***

We do not believe that EU-level intervention in the secondary market for NPLs is warranted at this time, although we do support the ability of financial institutions to be able to exit legacy asset positions in order to enhance a financial institution's safety and soundness.

7. What are potential benefits and risks from a public policy point of view when considering the appropriate legal framework for secondary markets for loans, and especially NPLs?

Please rank the following dimensions (in order of importance):

- debtor protection,***
- privacy,***
- data secrecy,***
- promoting increased market size and depth and equal treatment of investors***

- 1) promoting increased market size and depth and equal treatment of investors;
- 2) data secrecy
- 3) privacy
- 4) debtor protection

8. How can one best strike the balance between such dimensions?

The European Network of Credit Unions believes that existing, national-level legal frameworks for loan secondary markets have struck the appropriate balance for the Member State in question based on the Member State's economic realities and legal traditions, including the Member State's constitutional rights, rights under debtor-creditor law and rights under insolvency law. These markets operate efficiently and we do not support EU-level intervention at this time.

9. Do differences in these benefits and risks across Member States justify national differences in the framework for secondary markets for loans? If yes, in which way?

Yes, material and significant differences exist based on Member States' debtor-creditor and insolvency laws, as well as legal procedures related to the enforcement of security rights, which are often based on deeply seeded Member State legal traditions and constitutional rights. For example, the Republic of Ireland's common law legal system is significantly different from the civil law legal systems in most other Member States, and many civil law Member States' civil law systems are materially different from one-another. While there are some similarities in commercial law across Europe attributable to medieval Lex Mercatoria, Member States' present-day differences in terms of debtor-creditor law and insolvency law, including with respect to the procedures to perfect security interests and the procedures for enforcing those interests, justify national differences in the secondary loan market. Moreover, such national-level differences are necessary to maintain the existing rights of debtors and creditors under national law.

10. Would you consider current rules applicable in Member States pertaining to secondary markets for NPL in the EU a significant obstacle to the further development of these markets?

No, the European Network of Credit Unions does not believe that the current rules applicable to secondary markets for NPLs to be an obstacle to further development of these markets. These markets operate efficiently for credit unions. We do not support an EU-level intervention in these markets because national-level differences in NPL secondary markets are necessary because of differing debtor-creditor and insolvency laws and procedures that are based on the Member States' economic realities, legal traditions and constitutions. EU-level standardisation of NPL secondary markets would therefore necessitate structural adjustment of debtor-creditor and insolvency laws across Europe, which would likely disrupt credit markets and have unintended consequences such as reducing consumers' and small businesses' access to credit.

11. What is the most suitable manner to protect a debtor in the case of transfer of a loan and/or collateral by the creditor to a third party?

The European Network of Credit Unions believes that existing, national-level debtor-creditor and insolvency laws strike the appropriate balance regarding debtors' rights and creditors' rights including in the context of an NPL negotiated by one creditor to another. We do not support EU-level intervention at this time.

14. Do you consider that an EU regulatory framework (Directive or Regulation) regulating certain aspects of the transfer of loans would be useful? What are in your view the key elements that should be addressed in such a framework?

No, the European Network of Credit Unions does not believe that an EU regulatory framework regarding the transfer of loans would be useful. Our members report that the existing national-level markets for NPLs are efficient and support maintaining the status quo.

We do not support an EU-level intervention in these markets because national-level differences in NPL secondary markets are necessary because of differing debtor-creditor and insolvency laws and procedures that are based on the Member States' economic realities and laws. EU-level standardisation of NPL secondary markets would therefore necessitate structural adjustment of debtor-creditor and insolvency laws across Europe, which would likely disrupt credit markets and have unintended consequences such as reducing access to credit for consumers and small businesses.

15. Please provide any other comments that you find useful in relation to this section.

The European Network of Credit Unions believes that existing, national-level legal frameworks for NPL secondary markets have struck the appropriate balance for the Member State in question based on the Member State's economic realities and legal traditions, including the Member State's constitutional rights, rights under debtor-creditor law and rights under insolvency law. These markets operate efficiently and we do not support EU-level intervention at this time.

The European Parliament's 13 July 2017 report on NPLs "Non-performing loans in the Banking Union: state of play" ([http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/602072/IPOL_BRI\(2017\)602072_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/602072/IPOL_BRI(2017)602072_EN.pdf)) also indicates that high-levels of NPLs in the European Union are a problem in a limited number of Member States, particularly Cyprus and Greece.

To the extent that intervention by European Union institutions is warranted to address NPLs in these Member States, we urge the Commission to focus only on the particular Member States with disproportionately high NPL levels and suggest national-level solutions that are tailored to the Member State's local economic realities and legal system.

B. REMOVING POSSIBLE CONSTRAINTS TO THE DEVELOPMENT OF SECONDARY MARKETS FOR LOANS

25. Are you aware of significant differences in business practices in different markets and jurisdictions, for example through voluntary codes of conducts, industry standards, etc.? If yes, does this, and how, constitute an obstacle to your business?

Yes, there are significant differences in Member States' debtor-creditor and insolvency legal frameworks, as well as local business practices, that would make a standardisation of NPLs difficult at the EU-level. But, no, these differences do not constitute an obstacle to credit unions' business or secondary market sales of NPLs.

The European Network of Credit Unions believes that existing, national-level legal frameworks for loan secondary markets have struck the appropriate balance for the Member State in question based on the Member State's economic realities and legal traditions,

including the Member State's constitutional rights, rights under debtor-creditor law and rights under insolvency law. Further, we believe that EU-level intervention in this area will disrupt credit markets and produce other unintended, negative consequences such as reduced access to credit for European consumers and small businesses.

These markets operate efficiently and we do not support EU-level intervention at this time.

26. As a market participant, are you actively partaking in several national markets? If so, do you encounter obstacles to operate internationally in an efficient manner? Please specify.

Yes, credit unions operate in several Member States including Croatia, Estonia, Ireland, Latvia, Lithuania, the Netherlands, Poland, Romania, and the UK. However, European credit unions do not operate on a cross-border basis and do not encounter obstacle to international operation. Credit unions in the EU only have branch offices in their home Member State because their "common bond of association" for membership eligibility is typically limited to individuals who live or work in a particular local jurisdiction, who are employees of a particular company or government agency, or members of an association. Credit unions are also subject to national-level regulation and supervision pursuant to Article 2(5) of the CRD IV. Credit unions are only legally allowed to do business with their members, who are also the owners of the credit union.

This means that only individuals who live in the credit union's home Member State and fall within the credit union's common bond (or who lived in the credit union's home Member State and met its common bond requirements when they joined the credit union but have now moved to a different Member State) are members of the credit union and do business with it. While credit unions do usually have websites and often offer online banking services to their members, they cannot accept new members online who do not meet the institution's common bond requirements.

29. Do you consider that the development of a common EU approach would have an added value in the areas of:
a. the sale and transfer of loans?

No, the European Network of Credit Unions believes that existing, national-level legal frameworks for loan secondary markets have struck the appropriate balance for the Member State in question based on the Member State's economic realities and legal traditions, including the Member State's constitutional rights, rights under debtor-creditor law and rights under insolvency law. We believe that EU-directed structural adjustment to harmonise these legal rights is not warranted because it would disrupt local lending markets and introduce additional credit-risk to financial institutions, including credit unions, that have built their existing loan books based on national-level legal requirements. These markets operate efficiently and we do not support EU-level intervention at this time.

30. Please provide any other comments that you find useful on this section.

The European Network of Credit Unions believes that existing, national-level debtor-creditor and insolvency laws, as well as national-level laws on sales of NPLs, are efficient and strike the right balance between the respective rights of debtors and creditors pursuant to local economic realities and legal traditions. We believe that EU-directed structural adjustment to harmonise these legal rights is not warranted because it would disrupt local lending markets

and introduce additional credit-risk to financial institutions, including credit unions, that have built their existing loan books based on national-level legal requirements. We believe that EU-level intervention in this area to change the status quo is likely to have unintended, negative consequences both for community-based financial institutions, including credit unions, as well as likely reduce access to credit for consumers and small businesses.

SECTION II: POTENTIAL MECHANISM TO BETTER PROTECT SECURED CREDITORS FROM BORROWER DEFAULT

C. THE RATIONALE FOR A POSSIBLE EU ACCELERATED LOAN SECURITY

32. Do you see benefits in ensuring that every Member State makes available an instrument along the lines of the 'accelerated loan security' facility?

No. The European Network of Credit Unions believes that existing Member State debtor-creditor and insolvency legal mechanisms are efficient and that the rights of second-lien creditors as well as the rights of consumers and small business borrowers would be negatively affected by new accelerated loans security facilities. We urge the Commission not to propose a requirement for Member States to make available an accelerated loan security instrument.

33. Do you see the accelerated loan security as a valuable instrument to avoid future accumulation of NPLs in banks' balance sheets?

No. We believe that an accelerated loan security instrument would be counterproductive vis-à-vis limiting European credit unions' credit losses on NPLs. Credit unions in the European Union can only lend to their members. Credit union members are most commonly physical persons who are consumers and small-business owners (such as sole traders) but can also include legal entities such as small and medium-enterprises (SMEs), co-operatives, and non-profit organisations.

Credit unions make unsecured loans, loans secured by deposits or co-operative shares used as loan collateral (which the credit union holds for safekeeping), second-lien loans secured by real estate or business equipment, and first-lien loans including real estate mortgages to their members.

Creditors making unsecured loans or loans secured with second-liens, which represent the majority of loans made by European credit unions, will be harmed by an accelerated loan security instrument because the accelerated loan security instrument would give greater priority to primary-lien holders at the expense of other creditors. We urge the Commission not to propose an accelerated loan security instrument requirement.

E. FUNCTIONING OF A POSSIBLE ACCELERATED LOAN SECURITY INSTRUMENT

34. Do you agree with the possible main features of an accelerated loan security as described above?

If not, what are the features that you do not agree with and why?

No, the European Network of Credit Unions opposes creating an accelerated loan security process in the EU that applies to loans to small businesses or consumers. As proposed, the accelerated loan security instrument would apply to loans to businesses—including “small

businesses and corporates”—but not to loans made to consumers. We support carving out consumer loans from the application of an accelerated loan security instrument, but we also strongly urge the Commission to exclude small-business borrowers from the scope of an accelerated loan security instrument as well.

Small-business owners are typically physical person consumers who are self-employed and have usually either borrowed as a physical person (such as in the case of a sole trader) or have personally guaranteed loans to their small business if they have incorporated the small business as a legal entity. In either scenario, extending the proposed accelerated loan security instruments to small business loans will necessarily impact physical persons and European households in much the same way as if this new procedure applied to consumer loans, a scenario that the Commission says it is seeking to avoid because of social equity grounds. The social equity grounds that militate against applying an accelerated loan security instrument to consumer loans also apply to loans made to small businesses.

Credit unions can only make loans to their members, who are typically consumers and/or small businesses (such as sole traders and small business legal entities that are eligible to join the credit union under its “common bond of association”). Credit unions most frequently make unsecured loans but also make loans secured by deposits or co-operative shares, by real estate, or by personal property such as business equipment. In many cases involving secured credit union loans, especially with respect to loans secured by real estate, credit unions have a second-position lien that is subordinate to another creditors’ claims, such as a second-lien mortgage on a home.

Unsecured creditors, secured creditors with secondary liens, small businesses and consumers would be harmed by the lack of due process of law resulting from a new extra-judicial process for seizing and disposing of a small businesses’ or consumer’s loan collateral outside of the Member State’s current debtor-creditor or insolvency legal process.

Second-lien creditors will be harmed because secured creditors would receive a priority claim on the debtor’s assets outside of the Member State’s judicial process, meaning that the primary lien holder would in practice likely dispose of collateral on its own at a price that makes only the primary lienholder whole, with no or little residual value remaining for second-lien creditors or borrowers even if there was significant equity in the collateral in question. National-level debtor-creditor and insolvency regimes typically have mechanisms to ensure that second-lien holders’ claims are satisfied in a collateral sale and that any leftover equity is returned to the borrower. We believe that it is essential for a well-functioning and equitable European economy that the economic interests of second-lien creditors and borrowers vis-à-vis their claims on collateral be respected.

We believe that second-lien creditors would have better recoveries on secured NPLs under national-level debtor-creditor and insolvency laws than under an accelerated loan security instrument that would circumvent national-level procedural legal due process requirements and thereby advantage primary lien-holders at the expense of credit unions and other lenders who have second-lien claims on the same collateral. We also think that borrowers will be more likely to be able to recovery residual equity in their collateral under existing, national-level debtor-creditor and insolvency systems.

Unsecured creditors and small businesses would be harmed because secured creditors, as a practical matter, will have increased leverage to pressure small business debtors into paying to redeem secured collateral—such as equipment necessary to carry on their

business—with the threat of extrajudicial seizure of collateral, whether or not the secured creditor would have a priority claim under the Member State's laws.

Further, if a working-person's or small businessperson's tools of trade or employment are seized—including business equipment and furniture that are often protected under national-level insolvency law—he or she will be unable to earn a living and unable to pay other debts, which would cause losses for unsecured creditors that would not likely otherwise occur, as well as mean that the small businessperson or worker, and his or her family, would be unable to support themselves.

36. Do you agree with the proposed restriction on the scope of a possible accelerated loan security instrument to loans to businesses and corporates, and on the exclusion of primary residence of borrower even in the case of these loans? Please explain the reasons for your answer.

The European Network of Credit Unions supports excluding loans to consumers from the scope of any accelerated loan security instrument, but we urge the Commission also to exclude small businesses from the scope of the accelerated loan security instrument.

Small businesses, as well as consumers, should be exempted from an accelerated loan security instrument because consumers and small businesses are often indistinguishable. Sole traders by definition do not operate their businesses as a legal entity, and, even if the small business is incorporated, many small business lenders require personal guarantees from the small business' owners if the business is a legal entity. Small business borrowers are essentially owned and run by consumers who are self-employed and are generally personally liable for their business debts, and who deserve legal protections like other consumers.

Further, small businesspersons' secured borrowings are often used to finance tools and equipment necessary to carry out their trade. Tools of trade and employment, including equipment and furniture used by a workingperson to carry out his or her trade, are often protected from creditors under national law and should be exempt from an accelerated loan security interest to ensure that these and similar rights under national law are respected.

The European Network of Credit Unions appreciates the opportunity to comment on the Commission's consultative document *Development of Secondary Markets for Non-Performing Loans and Distressed Assets and Protection of Secured Creditors from Borrowers' Default*. Please do not hesitate to contact me or Jim Rusagara by email at info@creditunionnetwork.eu or phone at +32 2 626 9500 or +32 488 809 437 (mobile) should you have any questions regarding our comments.

Thank you and have a nice day.

Sincerely,



Michael S. Edwards
Vice President and General Counsel
European Network of Credit Unions
World Council of Credit Unions