# RegCORE Client Alert

**Financial Services: The EU's Credit Servicers Directive – the outlook ahead**

March 2022

# Financial Services

## The EU's Credit Servicers Directive – the outlook ahead

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### QuickTake

Directive (EU) 2021/2167 on credit servicers and credit purchasers (the **Credit Servicers Directive** or the **Directive**)[1] was published in the Official Journal of the European Union (**EU**) on 8 December 2021 and entered into force twenty days thereafter. For a project which has been in the works for a number of years, the end result has been mostly successful. Financial services providers (both originators of credit but equally investors i.e., credit purchasers – differentiated between EU and non-EU purchasers) as well as credit services providers themselves will now need to prepare for implementation of this new pan-EU regime.

In summary, the Credit Directive Servicers Directive aims to introduce a harmonised framework for servicing of non-performing credit agreements (**NPL**s) as well as encourage the development of a secondary market for NPL and thus easier means for credit originators (primarily credit institutions i.e., banks) to transfer NPLs to investors off their balance sheets. Given that NPL investors will usually delegate administration and collection activities (i.e., credit servicers) the Directive aims to provide a uniform EU-wide framework for such entities, who in turn will be authorised and regulated to perform such services (on a passporting basis) across the EU.

Importantly, unlike the EU's NPL Guidelines (which read like rules) issued by the European Banking Authority (**EBA**) and equally the European Central Bank (**ECB**) in its Banking Union capacity – both of which aim to cover non-performing exposures (beyond just loans) - the Credit Servicers Directive's application is anchored around the definition of a "credit agreement". This definition states that a credit agreement is "…an agreement as originally issued, modified or replaced, whereby a credit institution, grants a credit in the form of a deferred payment, a loan or other similar financial accommodation. The latter point allows for some leeway but also some uncertainty as to what may also fall into scope. That being said, the Directive is likely to serve a

[1] Available here

welcome framework for credit servicers to also act in relation to other non-performing exposures that are not in scope of the Directive.[2]

This Client Alert assesses the core components of the Credit Services Directive, key considerations for relevant firms given the outlook ahead. This Client Alert should be read in conjunction with other coverage from PwC Legal's EU RegCORE related to EU and Banking Union specific reforms on loan origination standards as well as dealing with NPLs.

## Scope and timeline

The original 2018 European Commission proposal for pan-EU rules on credit servicers, stemming from workstreams from the EU's Action Plan on NPLs, advocated application of this new regime to "all" credit agreements that were issued by EU credit institutions. In 2019 it was decided that two workstreams were needed, one for the secondary market for NPLs and one on accelerated extrajudicial collateral enforcement (**AECE**). By 2020 the latter point, designed to speed up the recovery of collateral, was proving to be rather contentious.

By 2021 it was clear that the Credit Servicers Directive would only apply to "non-performing credit agreements" and as originated by a European "credit institution" – i.e., an undertaking whose business is to take deposits or other repayable funds from the public and to grant credits for its own account. This is the version ultimately adopted in the final version of the Directive. Equally, Title V of the Directive, as originally set out in the Commission's March 2018 legislative proposal, planned to deal with AECE. In order to not derail the delivery of the Directive from proposal into law, policymakers agreed to remove all references to the AECE mechanism and split these out in a separate legislative proposal. It remains to be seen whether these will resurface and be advanced or ultimately be shelved completely.

As such, the current Directive only covers NPLs, but it does require a lot, inasmuch as it leaves a number of questions unanswered even if there is a clear path to operationalisation of this new framework. Article 32 on transposition of the Directive stipulates that Member States shall adopt and publish, by 29 December 2023, the laws, regulations, and administrative provisions necessary to comply with the Directive and shall immediately communicate the text of those measures to the European Commission (**EC**). The EC in turn has the same deadline to produce a report on the review of the Directive, accompanied by a legislative proposal if appropriate.

Entities carrying on credit servicing activities on 30 December 2023 have a deadline of 29 June 2024 to obtain an authorisation under the Directive as implemented in each of the Member States of the EU.

## Key requirements

The EU's Capital Requirements Regulation (**CRR**) defines NPLs as loans where the payments are more than 90 days past due, or are assessed as unlikely to be repaid by the borrower. NPLs are bad for banks as aside from taking up space on their balance sheets, they also generate less income and can tie up significant amounts of a bank's human and financial resources, which reduces the bank's capacity to lend. NPL ratio in the EU had been steadily increasing since the 2008 Global Financial Crisis.

The Directive's goal was to prompt banks with high volumes of NPLs to "outsource" their servicing to (specialised) credit servicers or to sell the NPLs to credit purchasers in the secondary market and provide a uniform means of doing so.

In the end, the first workstream aimed at developing the NPL secondary market and introducing common rules for both credit servicers and credit purchasers was the one left standing. Naturally, the rules covered in it have been retained in the final version of the Directive, which lays down a common framework and requirements for:

- credit servicers of a creditor's rights under NPLs, or of the NPL itself, issued by a credit institution (or by one of its subsidiaries) established in the EU who act on behalf of a credit purchaser. Key elements of the framework for credit servicers include requirements on:

[2] This is the case as the Directive's definition is thus narrower than that in the EBA and ECB rules as well as in national rules (notably the Irish and Spanish rules that formed the basis of the EBA and ECB's efforts and also the foundation for the Directive) both in terms of what financial exposures are covered but also in relation to the originator i.e., the credit institution (or its subsidiary).

    - obtaining authorisation before carrying out credit servicing activities;
    - outsourcing by credit servicers;
    - communications from credit servicers to borrowers;
    - a passporting regime permitting authorised credit servicers to provide cross-border services; and
- credit purchasers of a creditor's rights under a NPL, or of the NPL itself, issued by a credit institution (or one of its subsidiaries) established in the EU. Key elements of the framework for credit purchasers include requirements on:
    - information provided by creditors to credit purchasers before the transfer of the NPL;
    - additional obligations for non-EU credit purchasers; and
    - notifications to competent authorities concerning credit servicers, enforcement and transfers of NPLs.

Unlike credit servicers, credit purchasers do not require authorisation provided they are not creating new credit. If they do, then existing principles of whether the regulatory perimeter is triggered apply.[3]

The Directive also encourages credit institutions to employ a credit servicer, especially in the event of involvement of an unregulated credit purchaser or in relation to the sale of NPLs to third parties. This Directive should, therefore, establish an EU -wide framework for both purchasers and servicers of NPLs whereby credit servicers should obtain authorisation from, and be subject to the supervision of, the competent authorities of Member States.

Similarly, to other important EU legislative texts, the EC is empowered to adopt implementing technical standards, developed by EBA, to specify the templates to be used by credit institutions for the provision of information required under the Directive.

**Application**

Article 2(1) of the Directive makes it clear that it applies to purchasers and servicers of NPLs that were originally issued by EU credit institutions or their subsidiaries. For these purposes the nature of the borrower is irrelevant.

According to Article 2(5), the Directive does not apply to: (1) the servicing of a credit agreement carried out by:

- a credit institution and its subsidiaries in the EU (that is, it does not apply to the purchase and servicing of NPLs by banks themselves);
- an alternative investment fund manager (**AIFM**);
- a UCITS management company or a UCITS investment company; or
- a non-credit institution subject to supervision by a competent authority of a member state in accordance with the Consumer Credit Directive (2008/48/EC) (**CCD**) or the Mortgage Credit Directive (2014/17/EU) (**MCD**), when performing activities in that Member State.

Nor does it apply to (2) the servicing of creditor's rights under a credit agreement or of the credit agreement itself that was not issued by an EU credit institution established; or (3) the purchase of creditor's rights under a non-performing credit agreement or of the non-performing credit agreement itself by an EU credit institution established in the Union; or (4) the transfer of a creditor's right under a credit agreement or of the credit agreement itself transferred before the date on which Member States are expected to apply measures implementing the Directive.

**Credit servicers – requirements in detail**

**The Directive defines (Art. 3(8) and (9) of the Directive) a credit servicer as a legal person i.e., an entity that in the course of its business conducts both of the following activities:**

- It manages and enforces the rights and obligations related to the creditor's rights under a non-performing credit agreement or to the non-performing credit agreement itself on behalf of the credit purchaser; and
- It carries out at least one or more "credit servicing activities".

A "credit servicing activity" is one or more of the following:

- Collecting or recovering from the borrower, in accordance with national law, any payments due related to a creditor's rights under a credit agreement or to the credit agreement itself;
- Renegotiating with the borrower, in accordance with national law, any terms and conditions related to a creditor's rights under a credit agreement or of the credit agreement itself in line with the

[3] See commentary in the following press release from the European Parliament available here.

instructions given by the credit purchaser, where the credit servicer is not a credit intermediary as defined in the EU's Consumer Credit Directive or the EU's Mortgage Credit Directive;
- Administering any complaints relating to a creditor's rights under a credit agreement or to the credit agreement itself; and
- Informing the borrower of any changes in interest rates or charges or of any payments due related to a creditor's rights under a credit agreement or to the credit agreement itself.

The key elements for credit servicers include:

- Articles 4-9 and 13-14 – Authorisation and passporting. Credit servicers need to obtain authorisation from the home Member State to carry out credit servicing activities. Member States are required to publish a list of authorised credit servicers. Credit servicers authorised in one Member State can provide credit servicing activities in other Member States provided the original Member State is notified;
- Article 10 – Relationship with borrowers. Credit servicers should avoid misleading borrowers and should take care to notify borrowers of an NPL sale and ahead of the first debt collection, providing specific information, including the date of transfer, identification, contact details and authorisation of the new credit servicer or credit service provider;
- Article 11 – Contract between the credit servicer and credit purchaser. Records there should be kept for 10 years (please see below in Article 12 too); and
- Article 12 – Outsourcing and record keeping. Credit servicers remain full responsible for all obligations event if third parties perform the activities normally taken by the credit servicer. Credit servicers should also keep records for a period of 10 years of all correspondence with the credit purchaser and the borrower, all instructions received from the credit purchaser, and all instructions provided to credit service providers.

**Credit purchasers – requirements in detail**

**The Directive defines (Art. 3(6) of the Directive) a credit purchaser as any** natural or legal person other than a credit institution, or a subsidiary of a credit institution, that purchases a creditor's rights under a non-performing credit agreement or the non-performing credit agreement itself in the course of their trade, business or profession:

For credit purchasers, the key elements include:

- Article 10 – Relationship with borrowers. Similarly, to credit servicers, credit purchasers are subject to specific obligations in respect of borrowers. Credit purchasers (and credit servicers) are subject to specific obligations in respect of borrowers. They should always act in good faith, treat borrowers fairly and respect their privacy. They should not harass nor give misleading information to borrowers. They should provide specific information to borrowers in advance of the first debt collection, concerning any transfer of a creditor's rights. The information should include a date of transfer, identification, contact details and authorisation of a new credit servicer or a credit service provider, as well as detailed information on the amounts due by the borrower;
- Article 15 & 16 – Right to information regarding the credit agreement. Creditors must provide all necessary information to credit servicers before entering a contract to transfer a credit agreement, including the likelihood of recovery of the value of the NPL prior to the sale, the creditor's rights under the NPL agreement, and, if applicable, information regarding the collateral;[4]
- Article 18 – Information on credit servicing. Credit purchasers must provide the relevant member state authority with details of the appointed credit servicer;
- Article 19 – Non-EU credit purchasers. A non-EU credit purchaser acquiring EU originated NPLs must designate a representative that is established in the EU. The representative will be responsible for the credit purchaser obligations; and
- Article 20 – Transfer of credit agreements. Credit purchasers must inform the relevant Member State authority if it transfers a credit agreement to another credit purchaser.

**Supervision**

Member States are required to designate competent authorities to carry out the functions and duties set by the national provisions implementing the Directive and ensure that they are given necessary supervisory, investigatory and sanctioning powers. Member States are also required to establish appropriate penalties

[4] The EBA is mandated to develop draft implementing technical standards (ITS) specifying the formats to be used by credit institutions to provide such information (Article 16). The EBA indicated in a discussion paper published in May 2021 on a review of its standardised data templates for NPL transactions (EBA/DP/2021/02) that any consultation on these ITS would be based on the revised templates to be developed following the discussion paper.

and remedial measures for credit servicers and credit purchasers that fail to comply with specific obligations under the Directive.

**Safeguards for consumers and duty to co-operate**

In order to protect consumers, competent authorities must establish a procedure for handling complaints by borrowers concerning credit purchasers, credit servicers and credit service providers. NCAs are also expected to co-operate and share information relating to the operation of the Directive. Both of these are enshrined in the text of the Directive.

**Amendments to the Mortgage Credit Directive[5] (MCD) and the Consumer Credit Directive[6] (CCD)**

Articles 27 and 28 of the Directive make the following revisions to the MCD and the CCD:

- New Articles 27a of the MCD and 11a of the CCD will require that creditors communicate specific information to a consumer before modifying the terms and conditions of a credit agreement. This information is to include:
  - clear and comprehensive description of the proposed changes;
  - timescale for the implementation of the changes; and
  - mechanisms by which the consumer may make a complaint relating to the changes.
- Article 28 of the MCD and new Article 16a of the CCD will require creditors (i.e., credit purchasers) to have adequate policies and procedures so they can exercise, where appropriate, reasonable forbearance before initiating enforcement proceedings.
- New Article 28a of the MCD is to provide that, where there is an assignment to a third party of the creditor's rights under an agreement covered by the MCD, the consumer is entitled to plead against the credit purchaser any defence that was available to them against the original creditor. It also creates an obligation for the consumer to be informed about an assignment.

**Evaluation and review**

As mentioned above, the Commission is required to submit a report to the European Parliament and the Council of the EU, accompanied by a legislative proposal if appropriate, within 24 months of the Directive entering into force, i.e. by end of 2023. The report should cover:

- The adequacy of the regulatory framework regarding a potential introduction of caps on charges arising from the default applicable to credit agreements concluded with (i) natural persons for purposes related with trade, business or profession of that persons; (ii) micro, small or medium-sized enterprises (SMEs); and (iii) any borrower, provided that the credit is guaranteed by a natural person or is secured by assets or property belonging to that person.
- Relevant aspects, including potential forbearance measures, of credit agreements concluded with (i), (ii) or (iii).
- The need and feasibility to develop implementing or regulatory technical standards or other appropriate means to introduce common reporting formats for communication to borrowers.

Additionally, the Commission is mandated to conduct an evaluation of the Directive and present a report by 29 December 2026, which should consider:

- The number of authorised credit servicers in the EU and the number of credit servicers providing their services in a host Member State.
- The number of creditor's rights under non-performing credit agreements or of the non-performing credit agreements purchased from credit institutions by credit purchasers domiciled or established in the same Member State as the credit institution, in a different Member State than the credit institution, or outside of the EU.
- The assessment of the existing money laundering and terrorist financing risk associated with the activities performed by the credit servicers and credit purchasers.

The cooperation between competent authorities.

## Considerations

There are two years between the entry into force and implementation of the Directive, which should, in ordinary markets, give enough time to Member States and actors to assess whether the introduced measures

[5] Available here.
[6] Available here.

do indeed create great uniformity and ease the process or create unnecessary administrative burdens instead.

Parties may also have questions on how to conduct a portfolio trade - from a purchaser's perspective, licenced credit servicers will need to comply with conduct of business rules towards borrowers. Specifically, these borrower protections could benefit from greater guidance and even refinement to differentiate to how they apply to debt owed by consumers versus a commercial loan to a retail client (in particular given some of the new rules' options to potentially hinder the transfer of "its" loan or obstruct enforcement action post-sale.

Moreover, selling banks may have to provide all necessary information to credit purchasers to enable them to assess the value of the loan assets offered for sale and the likelihood of recovery. It remains to be seen whether this could be better served by a centralised transaction repository, similar to efforts that have been implemented in other parts of the EU's Capital Markets Union.[7] The nature of loan portfolio sales more often than not involves efforts by sellers to retrieve information from internal storage media, an added difficulty here would be to see whether sellers are able to get comfortable that they have met this test. The same is also the case as under Article 20 of the Directive, secondary market transactions i.e., one credit purchaser (including those ex-EU-27 – see discussion below on representatives) have to notify the home Member State competent authority of the credit purchaser selling, as buyer, a portfolio (or creditor's rights thereunder) on the details of the new credit purchaser, as buyer. This includes providing details of the legal entity identifier of the new buyer (and/or the representative) as well as:

- the aggregate outstanding balance of the creditor's rights under the non-performing credit agreements, or of the nonperforming credit agreements transferred;
- the number and size of the creditor's rights under the non-performing credit agreements or of the non-performing credit agreements transferred; and
- whether the transfer includes a creditor's rights under a non-performing credit agreement, or a non-performing credit agreement itself, concluded with consumers and the types of assets securing the non-performing credit agreement, when applicable.

A centralised NPL transaction repository would be potentially quite helpful (for both the secondary market, market participants as well as pan-EU as well as national competent authorities) to have a centralised resource driving transparency on cost-efficient basis.

In addition to the above, the very definitions in the Directive also leave (much) room for interpretation. Different market participants might not interpret 'credit servicers' and 'credit service providers' in the same way, which is important for the licensing requirements. The categorisation of NPLs is also not as precise as it could be. Notably as to whether it covers various credit activity in the context of trading in financial instruments such as margin lending, whether it covers crypto-asset lending and ultimately, perhaps more fundamentally how to deal with the sales (and servicing) of portfolios of NPLs and performing loans. The question of how to deal with other non-NPL but equally non-performing exposures equally remains unresolved by the Directive (at least for the moment).

Lastly, it should also be remembered that some Member States already have their own credit servicing laws in place (in various degrees of prescriptiveness of detail) and would now need to include the new rules in their national frameworks, which could present a host of additional problems for national legislative policymakers and thus drive rather than reduce fragmentation. If the latter is the case, then the European Commission may well have to request further subsidiary rulemaking instruments to be drafted by the EU-level authorities so as to ensure that this newest chapter of the EU's Single Rulebook for financial services in the area of NPLs (both in terms of credit servicers and secondary markets) truly is harmonised and thus a Single Market.

## Next steps for those outside the EU-27

Those market participants from outside the EU, most importantly the US and the UK, dealing with distressed credit, will do well to consider whether to appoint an existing EU affiliate as their representative, establish a new affiliate or appoint a third party for that purpose in line with the requirements of Article 19 of the Directive. In particular this Article requires that a credit purchaser, who is not domiciled in the EU or who does not have its registered office or head office in the EU, will have to designate, in writing, a representative, domiciled in

[7] Notably in the case of the EU's (and equally the UK's now onshored version) of the Securitisation Regulation that has cemented the Securitisation Repository as a much needed resource available to originator and (prospective) investors as well as other stakeholders with a legitimate interest to have access to all relevant information in a centralised space.

the EU. Such representative shall be the point of contact for and thus answerable to the relevant competent authorities for the credit purchaser's compliance with the Directive.

All firms however will need to get familiar with the rules on information, disclosure and conduct of business obligations that will be imposed in the EU NPL market. Those from the EU (and potentially the UK) on the other hand may additionally be subject to local licensing requirements if they perform credit servicing activities in relation to local borrowers. That is unless an EU credit servicer is appointed to administer the loans but equally, in certain jurisdictions (such as Germany) where following the purchase of a NPL (portfolio) new credit (including top-ups) are granted by the purchaser to the borrower.

## Outlook

The new rules will require assessing for creditors which credit servicers they can and want to work with, reviewing existing and drafting new "credit services agreements" as well as ensuring originators' but also credit servicers' (who will then owe obligations to originators and, on purchase, to the purchasers) compliance with EBA and ECB rules and expectations. Firms will need to generally review their existing arrangements as well as processes and proposals for new arrangements to be put in place.

Financial services firms operating into or from the EU-27 may also want to consider stepping up their preparatory measures including their horizon risk management. This might help firms in forward-planning the impact but also differences between the national approaches of competent authorities as well as their and equally those supervisory expectations set by the EU-level authorities across the EU, in particular the EBA's and ECB's frameworks.

While some of these rules and expectations may be overlapping, and some may stem from common EU principles or rulemaking, there are still a number of jurisdiction-specific requirements but also unintended conceptual divergences that firms are nevertheless expected to comply with, irrespective of EU-level aims of improving supervisory convergence of both the body of rulemaking, including in its Single Rulebook for financial services across the EU's Single Market but also the supervisory culture across relevant authorities.

# About us

PwC Legal is assisting a number of financial services firms and market participants in forward planning for changes stemming from these proposals.

If you would like to discuss any of the developments mentioned above, or how they may affect your business more generally, please contact any of our key contacts or PwC Legal's RegCORE Team via de_regcore@pwc.com or our website.

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