



Mr Olivier Guersent  
Director General  
DG FISMA  
Ms Tiina Astola  
Director General  
DG JUST

27/02/2018

**Subject: Non-performing loans (NPLs) – letter to European Commission**

Dear Mr Guersent, dear Ms Astola,

The Financial Services User Group (FSUG)<sup>1</sup> was set up by the Commission to involve users of financial services in policy-making. The FSUG's roles include: advising the Commission in the preparation and implementation of legislation or policy initiatives affecting the users of financial services; proactively identifying key issues affecting users of financial services; and advising and liaising with financial services user representatives and representative bodies at the EU and national level.

We are writing to you to express our concerns about the position of borrowers whose loans have been categorised as non-performing and sold on to third party debt buyers, and the Commission's current initiative to promote further sales of non-performing loans (NPLs).

**Background**

The European Commission has embarked on a major initiative to deal with the issue of NPLs in the European Union<sup>2</sup>. There are a number of objectives including:

- Encouraging the establishment of national asset management companies;
- Promoting a wider secondary market for NPLs;
- Enhancing the protection of secured creditors by allowing them more efficient methods of recovering value from secured loans; and

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<sup>1</sup> For more information on the work of the FSUG, please see [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-reforms-and-their-progress/regulatory-process-financial-services/expert-groups-comitology-and-other-committees/financial-services-user-group-fsug\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-reforms-and-their-progress/regulatory-process-financial-services/expert-groups-comitology-and-other-committees/financial-services-user-group-fsug_en)

<sup>2</sup> [http://europa.eu/rapid/press-release\\_MEMO-18-310\\_en.htm](http://europa.eu/rapid/press-release_MEMO-18-310_en.htm)

- Fostering greater transparency on NPLs in Europe by improving data availability and comparability with regards to NPLs, and potentially supporting the development by market participants of NPL information platforms or credit registers.

NPL ratios have already been significantly reduced through sales of loans to third party debt buyers. The overall aim of this new initiative is to further clear the balance sheets of major EU lenders of NPLs which are believed to be acting as a drag on their lending efficiency. Efficient lending is one of the four primary functions of the financial system and markets<sup>3</sup> and is necessary to support a well-functioning economy. So, we can understand in principle the rationale underlying this Commission initiative.

### **FSUG concerns**

But, the FSUG also has serious concerns about this initiative. Behind the headline data on NPLs are millions of ordinary EU citizens and enterprises who may well have been victims of aggressive, irresponsible or unfair lending practices in the first place (resulting in overindebtedness). These borrowers were, and still are, in a very vulnerable financial position. Their debts may be sold on to third parties (possibly without their consent or consultation) and may find themselves at risk of being victims of further aggressive, irresponsible or unfair treatment and practices by poorly regulated debt buyers and debt collectors/servicers.

There is clearly an interest in this market. From the available data, it would seem that the main buyers of NPLs are investment funds – particularly US hedge funds<sup>4</sup>. These funds are not known for their social responsibility values and clearly see the potential for generating large returns on their investment. There is a risk that these returns will be generated by adopting aggressive/unfair collection practices against socially and/or financially vulnerable borrowers.

Our concerns are threefold:

- The Commission does not appear to have considered, in any real depth, alternatives to this market-based solution for clearing bank's balance sheets of NPLs. We will return to the issue of alternatives to this market-based solution at a later stage. We think there are better and/or complementary ways of achieving the Commission's overall objectives without exposing socially and/or financially vulnerable borrowers to new risks and unfair practices.
- The Commission is not doing enough to reduce the risk of NPLs arising in the first place by ensuring that lenders support borrowers who are showing signs of financial difficulty.
- But, our priority now is to communicate our concerns about the way the Commission is trying to promote greater volumes of sales of NPLs without first ensuring there is a fair, robust, comprehensive, and consistently enforced consumer/social protection regime in place (also ensuring that lenders retain a proper degree of liability for their past lending behaviour). A decent consumer protection regime is needed to protect NPL borrowers whose loans are about to be sold to third party buyers. But, it is important to also protect borrowers whose loans have *already* been sold on. In the aftermath of the financial crisis, significant volumes of NPL sales have already been

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<sup>3</sup> Banking, money transmission, payments and settlement; asset allocation and management; financial intermediation and credit creation; and insurance and risk management

<sup>4</sup> See Shifting momentum, Regulation driving change in European loan portfolio markets, Deleveraging Europe H1 2017, Deloitte

allowed to take place without first establishing a robust consumer protection regime. Encouraging further sales of NPLs without improving consumer protection will just exacerbate the situation.

The Commission must acknowledge that socially and/or financially vulnerable borrowers deserve adequate protection. These borrowers:

- are effectively ‘captive consumers’ with few realistic options to improve their financial position by obtaining a better deal with another lender;
- are discouraged from proactively seeking to better their situation given that any and all extra revenue will be seized to service their loan;
- may be dependent on social security and other government welfare programmes, living on the bare minimum to survive;
- are up against powerful financial institutions with huge financial and legal resources at their disposal;
- may find that their loan is now ultimately owned by third party financial institutions based outside the EU – these overseas institutions are not very well known to the public and media and, as a result, will not face the same reputational constraints on their behaviours as domestic lenders; and
- are often unaware of their rights, are unable to exercise those rights, and in many Member States, have to rely on weak legal and regulatory systems and poorly resourced third sector organisations to defend their interests.

### **FSUG recommendations**

Therefore, the Commission, relevant European Supervisory Authorities (ESAs), and national regulatory authorities (NRAs) have a duty to protect the interests of these vulnerable borrowers. There are six main areas for improvement.

1. **Regulatory standards:** regulatory standards which apply to debt sellers, debt buyers and debt servicing/ collections firms must be improved. Note that these regulatory standards should apply to loans which have already been sold on, and loans which have yet to be sold on. These improvements should include:
  - i. Improved standards for authorising firms (debt buyers, and debt collectors/ servicers) who wish to transact in this market.
  - ii. Enhanced requirements for proper due diligence to be undertaken by lenders before selling on NPLs to ensure that prospective debt buyers are fit and proper persons and have systems in place to treat borrowers fairly.
  - iii. New guidance on the definition of a NPL.
  - iv. More robust conduct of business and consumer protection standards which buyers and debt collection/ servicing firms must comply with when collecting debt. Critically, new measures are needed with regards to the levels of fees and expenses associated with the sale and collection of NPLs.
  - v. New requirements relating to communication and engagement with borrowers at each stage of the process. These new requirements should apply to loans that are: being considered for categorisation as a NPL, being actively considered or sale, and in the process of being sold; and to the ongoing post sale relationship.

- vi. Enhanced requirements for lenders, debt buyers and collection/ servicing firms to treat vulnerable borrowers fairly, stop chasing borrowers who are showing signs of financial stress and refer them to debt advice services for support.
  - vii. Improved access to well-resourced complaints and redress schemes.
2. **Enhancement of borrowers' rights:** as FSUG's comprehensive analysis has shown previously<sup>5</sup> the level of legal and regulatory protection given to vulnerable borrowers across the EU is inconsistent and often poorly enforced. It is not clear what work has taken place to improve the level of protection and rights available to borrowers and ensure consistent enforcement of these rights across the EU. It is important the Commission and relevant ESAs assess whether the legal and regulatory protection available is fit for purpose with regards to vulnerable borrowers. This assessment should have been done anyway to protect vulnerable borrowers whose NPLs have already been sold on. The fact that the Commission is actively trying to grow the market for selling NPLs, means this assessment is even more critical.
  3. **Consistent supervision and enforcement:** it is one thing have robust regulatory standards but without consistent supervision and enforcement, these standards have minimal effect. To protect vulnerable borrowers from aggressive practices, it is important that relevant ESAs and NRAs monitor the market to ensure debt sellers, debt buyers and debt collectors/ servicers comply with regulatory standards and enforce against breaches.
  4. **Regulatory coverage:** 'retail' borrowers are protected by the provisions in the mortgage credit directives and consumer credit directives which continue to apply after a loan has been sold on. But, SMEs do not get the same level of protection across all Member States. It is important that SMEs (particularly micro-enterprises) receive the same protections as retail borrowers and that this is consistently applied across the EU.
  5. **Governance and reporting:** the Commission, ESAs, and NRAs should review and enhance the governance and reporting requirements relating to the selling of NPLs and collection practices. Lenders should report to stakeholders in a more transparent way the amount of NPLs being sold and the policy and criteria used when deciding to sell off loans. Debt buyers and debt collectors/ servicers should be required to publish their policies on treating customers fairly, their policies for collecting debts, and produce transparent reports on performance against treating customers fairly criteria. Critically, we need greater transparency on the fees and expenses involved in the sale, and collection of NPLs. ESAs and NRAs should also publish regular reports on the market containing detailed analysis of how well the market is complying with the standards outlined above.
  6. **Widening the alternatives for over-indebted borrowers:** for over-indebted borrowers who do not have the means to repay, and in all likelihood will not have the capacity to repay in the foreseeable future, an array of alternative solutions need to be made available. Examples include improving personal insolvency laws, but also offering

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<sup>5</sup> See FSUG Position Paper on the "Study on means to protect consumers in financial difficulty: personal bankruptcy, *datio in solutum* of mortgages, and restrictions on debt collection abusive practices".

borrowers similar debt reduction as those offered to ‘investors’ on secondary markets for NPLs. Policy makers need to keep in mind that in the end, given the dire situation that over-indebted borrowers are in, in certain Member States, most of the money collected from these borrowers by debt collectors, once all their assets and salaries have been seized, will be public money (from social security or other government welfare programmes, and therefore, the tax payer’s money).

### **Conclusion**

To summarise and conclude, the FSUG believes it is not sensible for the Commission to actively promote growth in this market without first:

- considering alternatives to this market-based solution;
- ensuring there is a comprehensive body of legislation, regulation and consumer protection standards in place to protect vulnerable borrowers whose loans are categorised as being NPLs and may be sold off to third party buyers (including those borrowers whose loans have already been sold off);
- ensuring this body of legislation, regulation and consumer protection standards is consistently and robustly enforced by relevant ESAs and NRAs in all Member States;
- reducing the risk of NPLs arising in the first place by ensuring measures are introduced to require lenders to support borrowers who are showing signs of financial difficulty; and
- ensuring that administrative consumer protection recourse and remedies are in place in all MS as opposed to judicial ones as the latter are too costly and ineffective for small/retail borrowers;

We would be happy to provide the Commission and ESAs with further information about our specific concerns including examples from Member States. We look forward to working with the Commission and ESAs to develop a set of measures to protect vulnerable borrowers.

Yours sincerely,



Anne-Sophie Parent  
FSUG Chair

Copie: FSUG members, Ralf Jacob (DG FISMA), Malgorzata Feluch (DG FISMA), Francesco Pontiroli Gobbi (DG JUST), Mario Nava (DG FISMA), Peter Grasmann (DG FISMA), Michael Thiel (DG FISMA), Francisco Fonseca Morillo (DG JUST), Renatas Mazeika (DG JUST), Dirk Haubrich (EBA)