



CREDIT SERVICING
DIRECTIVE



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A political agreement has been reached on the Credit Servicing Directive


Establishing of a strategy for dealing with non-performing loans (NPLs) has been on the European Union's list of priorities for many years. Back in July 2017, the Council of EU presented its *Action plan to tackle non-performing loans in Europe*, inviting various institutions to participate in the formation of a strategy aimed at introducing measures that will apply to a large number of already existing NPLs, as well as preventing their accumulation in the future. In October of the same year, the EU Commission announced a similar intention in its *Communication on completing the Banking Union*. The next step was made in March 2018, when the Commission presented a *Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral*, in order to create a secondary market for NPLs.

Although the issue of NPLs is largely active, the COVID-19 virus pandemic has accelerated the whole process. As it was initially defined in the 2005 *Treatment of non-performing loans* of the International Monetary Fund (IMF), the loan becomes *non-performing* when the borrower is more than 90 days past due, or when the borrower is less than 90 days past due but the bank has assessed that the borrower's ability to repay the debt has deteriorated, and is justifiably questioned. The pandemic has brought a sharp economic decline in the EU, as well as globally. The ability of borrowers to repay their loans is increasingly questionable, the ultimate consequences of the pandemic are uncertain, and the accumulation of NPLs is expected. The situation is particularly difficult in member states that have gone through long periods of recession.

After initiating negotiations at the beginning of 2021, the European Parliament, EU Commission and the EU Council finally reached a political agreement on the scope of the proposed Directive on 28 June. The initial draft from March 2018 referred to all loans issued by credit institutions, however, the new compromise draft relates only to **NPLs issued by a credit institution established in the EU**, and especially to servicing and purchasing of such loans.

The initial draft also included a proposal for an accelerated extrajudicial collateral enforcement procedure (AECE) that would help banks in better managing of non-performing loans by increasing the effectiveness of the collection procedure. However, the AECE is not in the compromise draft as concerns were raised regarding the time scope needed to establish such procedure.

What the Directive focuses on is the establishment of new standards and rules when it comes to servicing and purchasing NPLs across the EU, which facilitates the sale of bad loans by creating a secondary market that will extend beyond the national borders of the member states, and all this with respect to the borrowers' rights.





Credit Servicing

The Directive includes following activities regarding credit servicing:

- collection from the borrower;
- negotiations with the borrower;
- dealing with all kinds of borrower's complain s;t
- informing borrower about changes of interest rates, charges or payments due;

However, in order to carry out servicing activities, legal entities must obtain **authorization** from their home country – EU member state. Obtaining the authorization implies a number of conditions that a legal entity must meet (reputation, knowledge, experience, expertise of the managing team, etc.) The competent authorities of EU member states responsible for issuing the authorization are obliged to notify the applicant within 90 days whether he meets the criteria.

The possibility of transferring authorization to other EU member states ("**passporting**") is a new feature of great significance. This means that if one legal entity obtains authorization for credit servicing activities in its home country, it may also provide credit servicing activities in another EU member state without the need to obtain a new authorization.

Of course, the authorization process requires EU member states to appoint a competent national authority to be responsible for this part of the work, which also means keeping national registers of legal entities authorized to provide credit servicing activities.

Credit Purchasing

Purchasing NPLs does not imply authorization. This is because the credit purchasers who decide to take on an already existing NPL do so at their own risk. As before, the only conditions that must be met are those regulated by the national laws of each member state. Of course, since the borrowers' rights play a big factor, they must be informed about the change of creditor.

EU banks are required to provide potential purchasers with all information relevant to a particular NPL and its collateral. The reason for this is to give potential purchasers the opportunity to assess themselves whether a particular NPL is profitable or not. The European Banking Authority (**EBA**) will set the standards by which banks will provide said information. The informing will refer to loans issued after July 1, 2018 that become problematic after the Directive enters into force. Standardization of customer information will contribute to the establishment of legal security in the operations of banks and investors.

If the new creditor wants to hire a legal entity that will provide credit servicing activities, it is necessary to document this with a formal contract that will contain the minimum elements provided by the Directive. In case the credit purchaser decides to provide servicing activities, he will have to pass the authorization phase.

It is also important to mention that the credit purchaser with headquarters out of the EU will have to hire his representative based in the EU, as well as an EU based authorized credit servicer.



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Borrower Rights Protection

The general principle of the Directive is that no borrower should find themselves in a more difficult position after the transfer of their credit agreement to a new creditor. For example, when the borrower is a natural person, micro, small or medium-sized entrepreneur (SME businesses), special rules are prescribed if the purchaser is a person from the outside of EU. The Directive also leaves room for member states to apply stricter measures when it comes to the borrower's protection at their discretion.

As we mentioned at the beginning, the goal of the Directive is to implement a strategy to combat NPLs and their future accumulation in the European Union. Gradual relief from this issue would lead to easier functioning of European banks, including clean balance sheets, capital inflows, lack of risk, operation with more resources - both human and financial, and finally, easier access to finance individuals and entrepreneurs, while protecting borrower's, that is, consumer's rights.

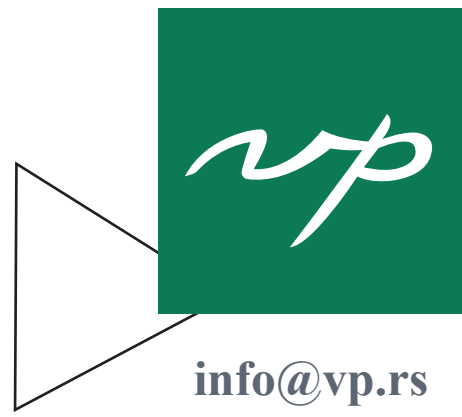
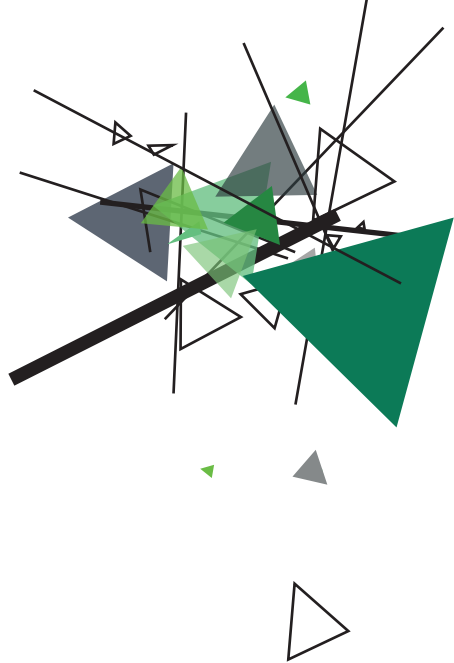
Of course, all aforementioned would contribute to the realization of another goal of the European Union - greater uniformity and integration of all member states, strengthening of all financial institutions, and achieving a complete Banking Union. The interconnectedness of banking systems through different legal systems can be overcome precisely through a Directive that addresses the problems of all member states and leads through economic recovery.

After the European Parliament and the EU Council conduct a legal-linguistic revision, it is expected that the Directive will be published later this year in the Official Journal of the European Union. The day of entry into force will be the day of publication and signing, after which the member states will have 24 months to implement the Directive into their national law.

The Credit Servicing Directive is a great step towards increasing legal certainty of all participants in the economic market. A large number of active NPLs in Serbia and planning various strategies to deal with the problem indicate that our country should follow the new EU model. This will be even more obvious after the EU members start implementing the Directive in practice



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