



Tackling the NPL mountain

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In brief...

The draft Directive on credit servicers, credit purchasers and the recovery of collateral (NPL Directive) from 2018 proposed two principal measures in relation to the reduction of NPLs: a framework for the secondary market for NPLs, and an accelerated extrajudicial collateral enforcement (AECE) procedure. Subsequently, the Council of the EU decided to split it into two parts, each concerning one of the mechanisms of the original NPL Directive.

Under the revised mechanism for the AECE procedure, creditors should be, under certain circumstances authorized, in an enforcement event, to either appropriate collateral or sell it through public auction or private sale. If both possibilities are made available by Member States, credit institutions may have an improved possibility to maximize the economic potential of the collateral, however, due to the quite broad implementation discretion for national regulators, the true impact of the AECE procedures remains for the time being questionable.

As part of a package of measures aimed at improving the high ratios of NPLs, the European Commission proposed the NPL Directive in 2018. However, as reaching agreement on the entirety of the directive proved to be more difficult than expected, the Council of the EU decided to split the NPL Directive into two parts, each dealing with one of the mechanisms. The Permanent Representatives Committee (COREPER) approved the Council's mandate for negotiations with the European Parliament on the secondary markets part in March 2019 and they approved the mandate in relation to the AECE procedure in November 2019. This article focuses on the AECE procedure contained in Directive COM/2018/0135 final – 2018/063 (COD) (the AECE Directive).

Proposed next steps

The proposed new mechanism for the AECE procedure needs to be agreed between a credit institution and a business borrower up front in a written agreement, or in a notarized format where national law so provides. Where the borrower defaults on the loan, the creditor would have to notify the borrower of its intention to begin the AECE procedure and give the borrower a predetermined amount of time to settle the outstanding debt. An independent valuer would have to carry out a valuation of the collateral specifically for the purposes of the enforcement event.

Depending on the method of enforcement selected, the creditor would either sell the collateral by private sale or public auction, or appropriate it by a transfer of ownership. It is up to each Member State to decide whether to adopt one or both of these methods of enforcement. In an acknowledgment of the rules governing the secondary market in NPLs, the proposal prescribes that where a secured credit agreement with a clause providing for the AECE procedure is transferred, the transferee will be able to also make use of the AECE procedure.

The provisions of the AECE Directive would be without prejudice to the national legal protection offered to the

parties involved in enforcement proceedings and to the regulations regarding insolvency proceedings and accordingly should be considered to be an additional enforcement tool, but appropriate measures against abusive challenges by business borrowers should be put in place by Member States.

Considerations

While Member States of the EU have diverging views on forfeiture agreements and many – based on Roman law traditions even restrict such forfeitures to a large extent (*lex commissoria*), i.e. where the secured creditor may keep the collateral in place of the secured liabilities, in general, they are much less restrictive when it comes to business borrowers. Thus, the AECE Directive would not drastically change the substantive position of business borrowers laid down by many existing national laws.

It is important to note that because the proposal requires the agreement in writing or a notarized format, the AECE procedure will most likely, potentially impact future NPLs, as it is difficult to imagine that the existing debtors, with the exception of a voluntary restructuring scenario, will be willing to renegotiate the terms of enforcement of the collateral to their detriment.

Because Member States are free to choose one method of enforcement under the AECE directive and there are certain specifics that apply to each method, such as with the valuation requirement, the combination of existing national laws and the choice of the enforcement method will determine, the extent of advantage emanating from the AECE procedure.

In addition, the varying national laws regarding the right to challenge the AECE procedure may result in significantly different length of proceedings across various Member States. For insolvent debtors, a stay of enforcement proceedings imposed by the start of insolvency proceedings may even prevent AECE procedures even completely.

Moreover, if the choice of the enforcement method and other specifics vary among Member States, the effectiveness of the transfer of credit agreements subject to the AECE procedure may also be impaired. In view of this, it is difficult to assess the extent of harmonization and the true efficiency of the AECE procedure in advance, however it will most likely impact only Member States with currently less efficient national enforcement procedures.

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