

NPLs and Credit servicers: the legislative decree draft implementing (EU) directive 2021/2167

15 April 2024

Consultation on the draft Legislative Decree implementing Directive 2021/2167, which was adopted to outline a consistent approach to non-performing loans.

The Directive should have been implemented by the Member States by 29 December 2023.

The Ministry of Treasury published the document for consultation on the draft Legislative Decree on its website. Hogan Lovells also took part in the consultation, and we are currently awaiting the results.

Introduction

Directive 2021/2167 (the so-called Secondary Market Directive - "SMD", hereinafter the "**Directive**") was adopted in order to set out a comprehensive strategy on non-performing loans¹. As the Directive's "*recitals*" clearly show, the European Lawmaker's purpose is to implement measures to promote the development of a secondary market for NPLs that is transparent, competitive, efficient and capable of guaranteeing the protection of borrowers (and in particular consumers).

As set out in the summary note published by the Ministry of Finance, "the Directive aims to remove the obstacles present at a national level for the transfer of bad debts, for example by liberalising their assignment by credit institutions to so-called "credit purchasers" (natural and legal persons who purchase receivables as part of a professional activity) and by promoting the activity of due diligence by potential purchasers. The aim is to increase competition, also on a cross-border basis, in order to encourage the entry of new players by opening up single national markets (with positive effects, for instance, on bid-ask prices and the development of the secondary market)".

The Directive should have been implemented by Member States by 29 December 2023. In Italy, a legislative decree draft implementing the Directive is presently under discussion (the "LD Draft"). On 30 January 2024 the Ministry of Treasury published the document on its website for consultation, which has now closed and we await the results (the "**Consultation Document**").

The LD Draft introduces a number of provisions which, as currently drafted, would be included in the Consolidated Banking Act (hereinafter "CBA"), inter alia through the introduction of a new Section II titled "Purchase and servicing of non-performing loans and non-performing loan servicers" in Title V, dedicated to "*Entities operating in the financial sector*".

Section II of the CBA focuses on the purchase and servicing of non-performing loans and introduces the new role of intermediary as per the Directive, the "servicer of non-performing loans", authorised and supervised by the Bank of Italy. Furthermore, amendments are planned concerning Title VI regarding transparency and customer relations, as well as on the sanctions outlined in Title VIII.

Scope of application of the LD Draft

The scope of application of the provisions being reviewed is outlined in Article 114.2 of the new Section II of the CBA, whereby the provisions of Section II apply to the purchase of non-performing loans by purchasers of non-performing loans and the servicing of non-performing loans, except in cases where the servicing activity is carried out by:

- servicers, as defined in the Consolidated Banking Act, acting on behalf of collective investment undertakings;
- banks, including with regard to loans they have granted or purchased;
- financial intermediaries under Article 106 of the CBA, including with regard to loans they have granted or purchased, provided that the activity is carried out in Italy.

Moreover, these provisions shall not cover the servicing of non-performing loans carried out as part of securitisation transactions under Law No. 130 of 30 April 1999, if the purchaser of such loans is a securitisation special purpose entity as defined in Article 2(2) of (EU) Regulation 2017/2402.

Review of the key provisions of the LD Draft

Purchase of non-performing loans

As mentioned above, to encourage the growth of a secondary market for NPLs, the Directive introduced, inter alia, the concept of a "credit purchaser", which includes any natural or legal person, apart from a credit institution, engaged in purchasing the creditor's rights under a non-performing credit agreement or the non-performing credit agreement itself, while carrying out their business or professional activities.

In accordance with the provisions of the Directive, the LD Draft, notwithstanding the rules of law applicable to the purchase of credits, broadens the scope of entities eligible to purchase non-performing loans, allowing for such activity to be carried out by natural or legal persons, other than a bank, engaged in such transactions as part of their business or professional activities.

In line with the above paragraphs, Article 114(3) specifies that the purchase of non-performing loans for consideration by purchasers thereof does not qualify as granting loans as per Article 106 of the CBA.

As per the new Article 114.1 of the CBA, "non-performing loans" (*crediti in sofferenza*) means "*loans granted by banks and other entities authorised to grant loans and classified as non-performing in compliance with the implementation regulations set forth by the Bank of Italy*".

The Italian lawmaker therefore opted not to include within the scope of the LD Draft loans classified as "*unlikely to pay*" (UTP) or "*past due and/or in arrears*". Essentially, the LD Draft excludes from its scope bad debts arising from a credit agreement that has not expired, has expired less than 90 days before or has not been terminated in accordance with national civil law and in relation to which the bank considers it unlikely that the borrower will meet its contractual obligations in full, without taking measures such as enforcement of guarantees. This decision, which arose concern among initial reviewers of the LD Draft, as it notably narrows the scope of application of the regulation in question, stems from the Italian

lawmaker's intention to preserve the rules of law provided at the national level in matters of loans (since bad debts stemming from agreements still to be terminated entail active servicing thereof and consequently the potential granting of new loans).

Servicing of non-performing loans

As provided for in Article 114.3, the purchaser of non-performing loans is in any event required to appoint a non-performing loan servicer (or a bank or financial intermediary referred to in Article 106 CBA), who shall be in charge of credit servicing activities.

Pursuant to Article 114.1, letter c), the non-performing loan servicer shall be a company entered in the special register provided for by Article 114.5, whose activity consists in servicing non-performing loans on behalf of the purchasers of such loans. The rules whereby credit servicers shall be "regulated" entities are due, on the one hand, to supervisory requirements and, on the other, to the desire to ensure greater protection for the assigned debtor.

The "*non-performing loan servicing activity*" is broken down by the LD Draft into the following macro-activities:

1. collection and recovery of payments due by the borrower;
2. renegotiation;
3. handling of complaints; and
4. information to the borrower.

With regard to renegotiation activities, the LD Draft clarifies that:

- the servicer may not grant loans as part of such activities. Therefore, renegotiation should be limited to early repayments and extension of payment terms (where repayment plans have already been negotiated by the borrower with the originator);
- renegotiation activities shall be carried out "*in line with the instructions provided by the purchaser of non-performing loan*", which suggests that the servicer may not autonomously modify the loan, but shall only assess whether the instructions provided are in compliance with the law (i.e. that they do not involve the granting of loans). In any event, renegotiation activities will presumably be provided for in the servicing agreement, which must be entered into in writing between the servicer and the purchaser as provided for by Article 114.3.

As already pointed out in our comments² on the Consultation Document, based on the definition of "complaint handling activity" it is not clear whether (i) such activity also covers the handling of complaints regarding substantive issues concerning the credits and/or the related agreements or (ii) instead, as it seems to be the case, based on the definition at hand, the handling is limited to complaints regarding the conduct, within the scope of collection and recovery activities, of purchasers, servicers and entities to which corporate functions related to such handling have been outsourced.

For the purpose of registration in the special register, the Bank of Italy authorises non-performing loan servicers that meet the following requirements:

1. their legal form is that of a joint stock company, a partnership limited by shares, a limited liability company or a cooperative;
2. the registered office and headquarters are located in the territory of the Republic, where at least part of the activity is carried out;
3. the conditions to grant the authorisation provided for by Article 19 CBA are fulfilled in respect of the holders of the stakes set out therein;
4. the persons performing administrative, management and control functions are eligible, in accordance with Article 114.13, paragraph 2;
5. a programme is submitted, along with the memorandum of incorporation and articles of association, concerning the initial activity and organisational structure, corporate governance rules, administrative and accounting organisation and internal audits, policies and procedures to ensure compliance with the applicable borrower protection provisions, including those for the handling of complaints.

Pursuant to Article 114.7, non-performing loan servicers may also be authorised to receive and hold the funds paid by borrowers for the purpose of their subsequent transfer to purchasers of non-performing loans, provided that such amounts are credited to a separate account opened with a bank and kept on such account until they are transferred to the purchaser. These accounts will represent separate assets and no action will be permitted on them either by or in the interest of creditors of the non-performing loan servicer or by creditors of the bank in which such amounts are deposited.

Disclosure of non-performing loans to potential purchasers and other disclosure obligations

Based on the provisions of Article 114.4, originators will be required to provide potential purchasers of non-performing loans with the information necessary to assess the loan and the likelihood of recovery.

More specifically, information shall also be provided when the potential purchaser is a bank. According to the procedure envisaged by the above mentioned provision, the assignors shall provide the Bank of Italy and, where appropriate, the competent authority of the home State, at least every six months, with information on the non-performing loans assigned. In this regard, since the above provision imposes an obligation on the assignor to provide information on a portfolio of loans over which the assignor may no longer have control, it would be appropriate to clarify at least the nature of the information to be provided by the assignor.

In addition, the Bank of Italy may identify further cases in which the information necessary to assess the loan and the likelihood of recovering its value is provided to the potential purchaser of non-performing loans, regulating the manner and content of disclosure.

Information to assigned debtors

As provided for by Article 114.10, in the event of purchase of non-performing loans, the non-performing loan servicer, the bank or the intermediary entered in the register provided for by Article 106, appointed by the purchaser of non-performing loans to act as non-performing loan servicer under Article 114.3 paragraph 2, shall inform the assigned debtor of the assignment individually, on paper or on another durable medium after the assignment and in any event before the start of debt collection.

This obligation is considered necessary in order to ensure equal treatment and widespread protection of the assigned debtors. Moreover, the Bank of Italy has the power to establish the content and manner of disclosure and to identify additional cases in which the assigned debtor shall receive information on the assignment of a loan or agreement, regulating the manner and content of disclosure. No specific reference is made in the relevant legal provision with respect to the treatment of guarantees covering the assigned loan. .

Paragraph 7 of the provision under examination clarifies that "this article shall not affect application of the provisions of Article 58, in respect of the assignments provided for therein, as well as the provisions on effectiveness of the assignment of the agreement and the effectiveness of the assignment of claims vis-à-vis the assigned debtor and third parties as set forth by the Italian Civil Code and by special laws".

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References

1 On 24 November 2021, the European Parliament and the Council adopted Directive (EU) 2021/2167 (the so-called *Secondary Market Directive* or *SMD*) on servicers and purchasers of non-performing loans, which also amends Directives 2008/48/EC (*Credit Consumer Directive*) and 2014/17/EU (*Mortgage Consumer Directive*). The Directive is intended to encourage the growth of secondary markets for bad debts within the European Union and to strengthen the safeguards put in place to protect assigned debtors.

2 Hogan Lovells took part in the consultation launched by the Treasury Department.