



EUROPEAN CENTRAL BANK

EUROSYSTEM

EN

ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 5 July 2018

on the regulation of the business of owning credit agreements

(CON/2018/31)

Introduction and legal basis

On 8 June 2018 the European Central Bank (ECB) received a request from the Chairman of the Oireachtas (the Irish National Parliament) Joint Committee on Finance, Public Expenditure and Reform and Taoiseach (the Irish Prime Minister), for an opinion on the Consumer Protection (Regulation of Credit Servicing Firms (Amendment)) Bill (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC¹, as the draft law relates to the Central Bank of Ireland (CBI), rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets and the tasks conferred upon the ECB concerning the prudential supervision of credit institutions pursuant to Articles 127(6) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

- 1.1 The draft law intends to regulate the owners of credit agreements entered into with natural persons and with micro, small or medium-sized enterprises. For that purpose, the draft law aims to extend the requirements introduced by the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 (hereinafter 'the 2015 Act') to 'credit agreement owners'. The draft law defines 'credit agreement owners' as persons who – in respect of a credit agreement or portfolio of credit agreements – hold legal title to the credit, determine the overall strategy for management and administration of the credit, determine the interest rate, maintain control over key decisions, or take such steps as may be necessary for the purpose of enabling the undertaking of credit servicing by another person or enforcing a credit agreement.
- 1.2 The draft law seeks to regulate credit agreement owners by extending existing provisions of Irish law to these entities, in particular the Central Bank Act 1997, which regulates the activities of retail credit firms and credit servicing firms. First, the draft law amends the definition of a 'regulated business' to also include credit agreement owners². This means that credit agreement owners are

¹ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

² See section 2 of the draft law. See also Part V (Supervision of Regulated Businesses) of the Central Bank Act 1997, as amended.

required to hold an authorisation issued by the CBI. The CBI may also impose a condition or requirement for a credit agreement owner to effect a policy of professional indemnity insurance³. In addition, the draft law provides that a credit agreement owner is prohibited from taking or failing to take an action, if this would otherwise be a contravention of Irish legislation or Irish statutory instruments, of CBI codes or directions, or of conditions, requirements or obligations imposed by the CBI in accordance with those acts⁴.

- 1.3 Second, the draft law explicitly sets out that the CBI may impose requirements on debt management firms, credit servicing firms, and credit agreement owners to be subject to the CBI's Code of Conduct on Mortgage Arrears 2013 (CCMA), and the Consumer Protection Code (CPC)⁵. The CBI is also empowered to require such entities to provide certain information to customers, within 30 days of their credit agreement being sold, including information on the terms on which the credit agreement was sold, any material change to the terms under which the credit agreement is serviced (including the interest rate), whether the loan was sold at a discount, and details of their rights under the CCMA and in respect of the Financial Services and Pensions Ombudsman (FSPO).
- 1.4 Third, similar to the 2015 Act, the draft law amends the definition of 'customer'⁶ to include a relevant borrower in a case where a regulated financial service provider undertakes the role of credit agreement owner. The draft law also amends the definition of 'relevant default' by a regulated financial service provider to include the actions of a credit agreement owner, such as: taking steps to cause a breach of the terms of a credit agreement; enforcing security when the customer is not in financial difficulties; and altering the fixed duration of a credit agreement without the consumer's written consent⁷. These changes aim to ensure that the CBI's existing supervision and enforcement powers in relation to protecting customers are extended to relevant borrowers in their interactions with credit agreement owners. In this respect, the draft law also clarifies the respective roles of the CBI and the FSPO.
- 1.5 Fourth, similarly to the 2015 Act, the draft law extends the provisions regarding the FSPO, including the complaints mechanism, to consumers and any person engaging with a credit agreement owner⁸.
- 1.6 Fifth, the draft law obliges the CBI to publish statistics on a quarterly basis, on loans held by micro, small or medium-sized enterprises, including information on the number and values of loans held by such enterprises, the total number of loans of such enterprises held by credit agreement owners, the total number of loans in arrears, and the total number of loans held by credit agreement owners that have been restructured.
- 1.7 Finally, the draft law provides that a regulated financial service provider, which is authorised to provide credit in the Republic of Ireland, is deemed to be authorised to carry on the business of a

3 See section 4 of the draft law.

4 See section 9 of the draft law.

5 See section 8 of the draft law.

6 See section 6 of the draft law.

7 See section 10 of the draft law.

8 See sections 7 and 11 of the draft law.

credit agreement owner⁹. Moreover, the draft law includes transitional provisions applicable to existing credit agreement owners that are not yet regulated financial service providers¹⁰. These provisions set out that credit agreement owners can be taken to be authorised to carry on the business of a credit agreement owner until the CBI has granted or refused authorisation, on condition that an application for authorisation has been submitted by that credit agreement owner. During the transitional period, the CBI may: impose conditions or requirements relating to the proper and orderly regulation and supervision of credit agreements; direct that the person should not carry on the business of credit agreement owner for a period; or direct that a purchaser of a credit agreement will be subject to the provisions of the Act, except where such purchase is made by way of securitisation. Moreover, the transitional provisions prescribe that a credit agreement owner that possesses a portfolio of credit agreements within the same competing commercial sector, or is involved in the management and administration of a commercial enterprise in the same sector, may not instruct a credit servicing firm to take action in such a manner as to jeopardise the interests of customers to benefit these competing interests. The CBI is empowered to investigate complaints into such competing interests. The draft law also amends the transitional provisions applicable to existing retail credit firms and credit servicing firms, by empowering the CBI to direct that a purchaser of a credit agreement is subject to the provisions regarding regulated business, except where such purchase is made by way of securitisation¹¹.

2. Observations

2.1 *Tasks of the CBI*

The draft law complements the CBI's existing tasks, in particular in the field of supervision of regulated financial service providers and regulated businesses. However, it does not confer genuinely new tasks on the CBI in this area. For example, in respect of retail credit firms and credit servicing firms, the CBI already has powers to authorise and supervise such entities, to make them subject to CBI codes or directions, and to take enforcement measures against them, including for the purposes of protecting natural persons and micro, small or medium-sized enterprises that have entered into credit agreements¹². Moreover, the CBI also already has the function to collect statistics in the field of micro, small, and medium-sized enterprises¹³. Consequently, the issue of assessing the conferral of new tasks on a national central bank from the perspective of the prohibition of monetary financing does not arise¹⁴.

2.2 *Impact on secondary markets for credit institution assets*

2.2.1 The ECB has been a strong proponent of the development of secondary markets for bank assets, particularly non-performing loans (NPLs), as reflected in the EU Council's action plan to tackle

⁹ See section 3 of the draft law.

¹⁰ See section 5 of the draft law.

¹¹ See section 9 of the draft law.

¹² See sections 28 to 36N of the Central Bank Act 1997, as amended.

¹³ Section 5A(1)(g) of the Central Bank Act 1942.

¹⁴ See paragraph 3.1 of Opinion CON/2018/27. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

NPLs in Europe¹⁵. In the context of the large stocks of NPLs that remain on the balance sheet of some European credit institutions, and as part of a comprehensive solution to NPL resolution¹⁶, the development of secondary markets may contribute to reducing NPLs. Looking ahead, well-functioning secondary markets may also prevent stocks of NPLs building-up in the future.

2.2.2 Moreover, a well-functioning secondary market may have a positive effect on financial stability to the extent that it could facilitate the transfer of the risks of NPLs off credit institutions' balance sheets. The presence of significant volumes of NPLs on credit institutions' balance sheets reduces their ability to fulfil their function as providers of credit to the real economy and hampers the operational flexibility and overall profitability that are essential to a well-functioning banking sector. It is essential that the legal framework applicable to secondary markets enables the efficient transfer of NPLs off the balance sheet of credit institutions.

2.2.3 In this context, the draft law must carefully balance the benefits of creating well-functioning secondary markets against the impetus to protect debtors. Provisions within the draft law may create a burden of costs for investors, which could impede their participation in secondary markets, thereby reducing overall participation and reducing price competition in the market place. Even if the provisions of the draft law do not result in reduced participation by investors, investors may simply pass the costs associated with meeting these provisions onto the credit institutions selling the assets. As such, risks to financial stability may emerge either as a result of a failure to develop secondary markets or because prices in those markets are subdued by regulatory costs.

2.2.4 While risk transfer through asset sales, securitisation and other measures may be effective in reducing NPLs, risk reduction measures remain, nevertheless, an important channel, particularly in a context where NPL stocks are high. In that regard, and in the context of a comprehensive solution to NPL resolution, the originating credit institutions' internal procedures for handling the work-out of NPLs themselves will always remain important.

2.3 *Impact on securitisation*

2.3.1 The ECB has a strong interest in the sustainable revival of the European securitisation market. As a form of asset-based financing with the capacity both to channel flows of credit to the real economy and to transfer risk, securitisation has particular significance for the transmission of monetary policy. A healthy European securitisation market is important to ensure well-functioning capital markets in the Union. Particularly where credit institutions' capacity to lend to the real economy is constrained, securitisation can act as a fresh source of funding and free up capital for lending¹⁷. Securitisation may also have a positive effect on financial stability to the extent that it can facilitate the transfer of the risks of NPLs off credit institutions' balance sheets. Securitisation is one of a variety of options that banks may apply alone or in combination with other measures, such as borrower-creditor engagement¹⁸, to address the issues posed by NPLs¹⁸.

15 See the EU Council's press release of 11 July 2017 on the 'Council conclusions on Action plan to tackle non-performing loans in Europe', available at: <http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/>.

16 See, for example, Section B of the ECB's November 2016 Financial Stability Review, available at: <https://www.ecb.europa.eu/pub/pdf/other/sbfinancialstabilityreview201611.en.pdf>.

17 See paragraph 3.1.1 of Opinion CON/2018/16.

18 See paragraph 3.1.2 of Opinion CON/2018/16.

2.3.2 The ECB understands that the draft law intends to exempt securitisation from the scope of the draft law. The ECB welcomes this intention, as this will ensure that the draft law does not discourage securitisation activity. However, this exemption is not fully clear from the current text of the draft law¹⁹. Therefore, it is suggested that the drafting be further reviewed, in order to ensure full legal certainty in this respect.

2.4 *Interaction with existing Irish statutory provisions and prospective Union legislative measures*

2.4.1 The ECB recalls that the 2015 Act set out that credit servicing firms would be regulated financial services providers and thus subject to the authorisation and supervision of the CBI, including, *inter alia*, the application of the CCMA and the CPC. The ECB was consulted on the draft 2015 Act, and welcomed the measures, which aimed, *inter alia*, to contribute to preserving confidence in the marketplace²⁰. In that respect, the ECB welcomes the intention of the draft law.

2.4.2 However, the current text of the draft law may raise issues of legal certainty. The draft law amends a number of existing provisions of Irish law. In some cases, it is unclear how these amendments interact with the existing provisions, and with the existing powers of the CBI. In particular, it is unclear what the relationship will be between the draft law and the existing rules applicable to credit servicing firms. Credit servicing firms are responsible for managing or administering credit agreements and interacting directly with the relevant borrower on behalf of credit agreement owners. The application of identical provisions to credit servicing firms and credit agreement owners could result in uncertainty as regards the responsibility and liability of the respective entities. In this respect it is worth noting that under the 2015 Act, persons who hold legal title to credit are already directly subject to the rules applicable to credit servicing firms, if they do not engage an authorised credit servicing firm to carry out credit servicing²¹. Moreover, it is a criminal offence for persons holding legal title to credit to take action, or fail to take action, which would lead to a contravention of the applicable rules²².

2.4.3 To the extent that the draft law aims to address elements of credit agreement ownership and servicing that are not currently subject to regulation, and that go beyond the protections already in place in respect of credit servicing firms, the impact of the draft law, and the role of the CBI, are not clear. These new elements include the credit agreement owners' capacity to determine the overall strategy for the management and administration of credit agreements, to determine the interest rate, or to maintain control over key decisions. The CBI does not currently regulate these activities in relation to regulated lenders, namely credit institutions and retail credit firms, and, in this context, caution should be exercised when purporting to regulate commercial decisions of market actors. Such administrative control should only be undertaken where it is clear what purpose the controls seek to achieve and that they are likely to achieve this purpose²³. Otherwise, the introduction of such measures could lead to unintended side effects. If the Irish market for investment in credit

19 The definition of 'credit agreement owner' in section 2 of the draft law refers to persons who hold title to a portfolio of credit agreements. This would appear to include persons who hold such title by way of securitisation. However, sections 5 and 9 of the draft law include provisions that refer to purchasers of credit agreements being subject to the provisions of the draft law 'except where such purchase is made by way of securitisation'.

20 See paragraph 2 of Opinion CON/2014/69.

21 See the definition of 'credit servicing firm' under section 28 of the Central Bank Act 1997, as amended.

22 See section 34G of the Central Bank Act 1997, as amended.

23 See paragraphs 3.1, 3.1.2 and 3.1.4 of Opinion CON/2016/54.

agreements is rendered significantly less attractive in general, this could limit the ability of Irish credit institutions to diversify their sources of finance for any type of credit agreement, not just those in arrears or which are non-performing. This could in turn increase pressure on Irish credit institutions to adjust their own strategy for managing and administering existing credit agreements and determining interest rates, which might not ultimately benefit borrowers. In addition, it could detrimentally affect Irish credit institutions' ability to engage in new lending and the terms on which they would provide new credit, also to the potential detriment of borrowers.

2.4.4 The draft law is being introduced without the benefit of a thorough impact assessment. It is only by making such a prior assessment that it may be possible both to determine whether the draft law could achieve its aims, and to mitigate any negative implications. In the absence of an impact assessment, however, it is difficult to ascertain whether the objectives set by the draft law will be achieved²⁴.

2.4.5 Finally, the ECB notes that on 3 March 2018, the Commission published its proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral²⁵. This proposal seeks to set out a common Union framework and requirements for credit servicers, credit purchasers, and for the recovery of collateral in respect of credit agreements concluded with business borrowers, with a view to ensuring a high level of consumer protection and a level playing field across the Union. If this proposed Directive is adopted by the European Parliament and the Council, its provisions will be transposed into Irish law, requiring further amendment of the rules applicable to credit servicing and credit ownership.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 5 July 2018.

[signed]

The President of the ECB

Mario DRAGHI

²⁴ See paragraph 2.2.2 of Opinion CON/2018/13, paragraph 2.3 of Opinion CON/2012/40, paragraph 2.3 of Opinion CON/2012/70, and paragraph 2.2 of Opinion CON/2010/34.

²⁵ COM(2018) 135 final.