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FRENCH BANKING FEDERATION RESPONSE TO EC CONSULTATION PAPER

DEVELOPMENT OF SECONDARY MARKETS FOR NON-PERFORMING LOANS AND PROTECTION OF SECURED CREDITORS FROM BORROWERS' DEFAULT

SECTION I: SECONDARY MARKET FOR LOANS

TRANSFER OF LOANS

1. Would you consider the current size, liquidity and structure of secondary markets for NPL in the EU an obstacle to the management and resolution of NPLs in the EU? If yes, would you consider such obstacle to be significant?

Whilst it is possible for a bank to sell an NPL on a case by case basis, the current size, liquidity (see the bid-ask spread and the lack of transparency) and structure of the secondary markets for NPLs in France is most certainly an obstacle to the management and resolution of NPLs in the EU on a large scale. There are transactions of significant size but they are opportunistic, for banks as well as investors. Banks would benefit from an efficient secondary market for NPLs (i.e. providing real market prices) however it is not a necessary prerequisite to the good management of their NPLs portfolios. Indeed in this context the main issue is the pricing and there is no better way of fixing prices than an efficient market place. From this perspective an illiquid market is useless.

As things stand, the secondary market for NPLs in France would probably not be able to cope with the volumes of NPLs should banks decide to sell large portfolios of NPLs due primarily to a shortage of third party investors in NPLs as well as limited third party NPL servicing capacity.

French banks also consider that they cannot be the sole and unique source of fresh liquidity for distressed companies for a variety of reasons. The development of the secondary market would favor the participation of other liquidity providers.

In fact, NPL market is structured into 3 different segments:

- Retail (mortgage and consumer financing);
- Specialized financing (notably real estate) with a large number of investors and rather organized market;
- Corporate less liquid due to asset type (RCF) and complicated bankruptcy process.

NPL secondary market volume were roughly €100bn in 2015 and 2016, while activity seems to shrink in 2017 despite the fact that forthcoming IFRS 9 standards might push banks towards a more forward-looking approach to loss provision. Our view is that the EMEA market develops strongly, as cash is available and investors remain massively keen to put their cash at work. Nevertheless some regional constraints on loan and receivable sell down (with its list of exemptions for Insurance companies, FCT…)

can be considered as barriers to expand liquidity and NPL optimized sell down (it being noted that the French banking monopoly on the secondary market has just been alleviated upon request of the French banks).

Another important aspect is the impact of potential losses on LGD calculation. The loss is both liquidity related and credit profile related. Therefore, banks do consider the secondary market as a significant option in terms of NPLs management, an option that could be bolstered by removing some regional constraints.

2. What are the key considerations for banks in deciding whether loan sales should be a significant part of their strategy to manage its NPLs?
In answering please specify

- bank internal factors (i.e. any factors inside the bank including the type and characteristics of the NPL portfolio, management capacity etc.)

- external factors (i.e. any factors outside of the bank that are important considerations in this context.

Loan sales are just one tool available to banks to manage their NPLs, albeit one that can lower the volume of a bank's NPLs potentially more quickly than others. Therefore sales are opportunistic. The decision to sell depends on the comparison of the valuation of the claim on the bank's balance sheet (net accounting value i.e present value of the futures cash-flows expected by the bank) and the price offered to the potential selling bank on the secondary market.

The internal factors a bank would consider in deciding whether loans sales should be a significant part of their strategy to manage its NPLs would be:

- risk assessment on whether credit profile will recover or further deteriorate through the cycle;
- discrepancy between investors' perception and workout internal assessment, for instance the comparison of the valuation of the claim by the bank and the price offered to the potential selling bank on the secondary market (to be more specific, the valuation by the bank may take into account quantitative elements such as the ratio between NPLs and the bank's total assets, but also qualitative elements, such as reputational risk or the time consumption generated by the NPLs' sale process);
- ability to properly manage and negotiate the restructuring process;
- participation to a Coordination Committee or Steering Committee;
- global relationship of the bank with the Borrower.

The external factors: traded levels on other participant's piece, forthcoming IFRS 9 standards, proposed restructuring plan (debt to equity resolution), Bank's relative share in the pool and ability to have an impact on further negotiation.

A distinction must be made depending on the nature of the relationship with the debtor:

- If the contract is still alive and there is still a client relationship, selling the loan is a commercial decision which can have negative consequences. This decision will depend on the context, notably a possible restructuring (more or less complicated). In such a market transactions are name-based;
- If there is no contractual relationship anymore (recovery phase), the nature of the decision is very different and opportunism regarding the price offered is eased.

Decision to sell depends also on the following factors:

- Conditions under which clients' interest is protected in such a context, which relates to the recovery process notably (conformity to best practices);

- Conditions regarding originator's responsibility that refers back to the information provided to the investor or the servicer on the loans that have been sold.

3. What would be the best way(s) of attracting a wider investor base to secondary loan markets, especially for non-performing loans?

Loan Market Association (LMA) terms and conditions are already a good framework in terms of documentation and best practices. The best way of attracting a wider investor base would be to reduce regional regulatory constraints like banking monopoly rules on the secondary markets (it being noted that the French banking monopoly on the secondary market has just been alleviated upon request of the French banks) and simplify/make homogenous the transfer of security package for asset-backed NPL.

In France, the best way of attracting a wider investor base to secondary loan markets for NPLs would be to revise the bankruptcy law, for example with the "*European Directive on Insolvency*" currently being discussed, in order to make the working out of an NPL both faster and more predictable in its outcome. This would allow stakeholders to more easily, accurately and fairly price an NPL. As a case in point, the secondary market for loans is more liquid in some other markets, notably when investors have a better visibility of the expected outcome of the legal procedure. Countries where the absolute priority rule applies can be expected to have more efficient NPL markets. This is because actors have less uncertainty surrounding the order in which stakeholder are repaid. Cash-flows predictability is a crucial issue. It also depends on the servicers, their role and the way they perform their duties. It also refers to the need to pool loans having non-contractual cash-flows so that they generate recurring cash-flows, statistically foreseeable, and attractive enough.

It should however be stressed that changes to the existing French bankruptcy law must take into account the need to adapt legal procedures to the size of the defaulted borrower (individuals, SMEs and corporates). However, existing legal procedures, when efficient (such as the conciliation procedure or other amiable negotiations in France for smaller borrowers) should be left unchanged.

In addition, development of specialized local funds/dedicated special situation investment departments in banks could also have a positive impact on the market liquidity.

Like sellers, investors must rely on deep and liquid markets. We can expect few unitary sales, notably in the retail. It must be possible to bundle them in pools to be securitized.

4. In order to widen the investor base, please specify
- which incentive(s) should be given?
- whether certain obstacles to widening the investor base should be removed?

We do not see a need for incentives to be given in order to widen the investor base for NPLs in France. There are, however, certain obstacles that could be removed that would help to widen the investor base:

- Barriers to entry for NPL investors: in accordance with French regulation, loan servicers have to hold a licence to acquire and service French loans. Moreover, to acquire large NPL portfolios, buyers will have to acquire and potentially develop existing dedicated platforms that have sufficient trained and knowledgeable staff and the technical capacity to service large numbers of loans;
- Limitations on the transferability of loans: banks wishing to sell loans are required to remove from any loan portfolios up for sale those loans for which a clause rendering the loan non-transferable has been inserted, at the borrower's request, into the underlying contract. Such a clause continues to be in force once a loan becomes non-performing

- Disclosure limitations during certain legal proceedings: banks are not allowed to disclose to potential buyers that a mandate or conciliation procedure is underway, which complicates the sale of any NPLs affected by such a legal proceeding.

We do believe that current application of prudential capital rules discourage buying distressed loans at discount and yet the development of a healthy brokerage function could be an important element in favouring intermediation and hence the liquidity of the NPL's. This should make cross-borders transactions easier (acquisitions by foreign investors). Transparency on their NPLs portfolios is the main issue banks now have to solve. Due diligences will have to be carried out.

Incentives:

Investors buy cash-flows. Cash-flows have to be secured at most, notably by:

(a) Structuring the assets sold in order to diversify their cash-flows within portfolios (to reduce their specific risk) ;
(b) Relying on strong servicers, having good reputation.

Obstacles to be removed:

Three types of stakeholders intervene: the originator, the holder of the loan/investor and the servicer. The focus should be on these actors relationship, notably its transparency.

- Regarding public authorities, incentives can only come: In the form of tax advantages for instance (there is no reason why these incentives would come from value transfers from banks to investors);
- By contributing to increase confidence in the cash-flows generation (servicers' safety and capacity must be developed so that they can process larger volume of loans).

5. What are the specific advantages to the development of secondary markets when the acquiring investor is a bank, an investment fund or another type of entity?
In particular, would you see specific advantages for
- helping banks overcome legacy assets;
- creating investment opportunities for specialised investors?

The development of the secondary markets is by nature positive for the acquiring investors. For the vendor banks, an increase in demand of the offer from any of the above categories of players will provide access to more attractive sale prices for the NPLs and thus can constitute an important option to recovery. It also facilitates balance sheet management.
As a general comment, it is important to stress that the investment decisions of all the above types of investors will be made considerably easier if the transparency and predictability of the negotiations in the insolvency or capital restructuring discussions can be made clearer. This improves prospects to determine the value available for stakeholders. For this reason pan-European reform of insolvency law is important.

With specific regard to investment opportunities for specialist investors, in France the existing "privilege of new money" rules do not provide investors with a fully robust framework (unlike the US Debtor In Progress financing in Chapter 11) since there is no protection available in the event of a "safeguard".
A bank trading desk might be very useful to provide liquidity and market color

The following advantages:

- Advantages when the acquiring investor is a bank: reassure the counterparty as a bank is supposed to provide better settlement capabilities and facilitate borrower consent so the transfer process should be smoother for the counterparty;

- Advantages when the acquiring investor is a fund: may operate on trickery deals or on portfolios deals, usually they have more liquidity available as they have a commitment to invest;
- Aiming to banks or investment funds also depends on marketing strategy: asset by asset sale process or portfolio sale (especially for non-core assets, legacy book or run-off portfolio).

Moreover, it is possible to identify four different types of distressed debt buyers:

i) Those seeking to act as broker or to resell in a relatively short time-frame;
ii) Buy and Hold investors looking to generate an attractive internal rate of return through a search for yield or an objective of securing a capital gain via a refinancing or repayment at par;
iii) Loan to own investors seeking to use an investment in the debt as a route to own the business or assuming ownership of key assets;
iv) Specialist provider of fresh liquidity (in the US for example, Debtor in Possession finance providers).

6. What are the main concerns linked to each of these investor types?

Main concerns if you sell to a Bank Trading desk:

- Are they buying and holding this asset for/on their own trading book?
- Are they book-building a position for an end-Buyer, including a potential of debt buy-back by the Borrower while you're selling the paper with a huge discount?

Main concerns if you sell to a non-bank investor end buyer:

- Borrower consent issue for a non-bank investors especially if buyer is widely considered as tough on the Restructuring process optimizing the debt to equity;
- Commercial risk for the seller, on further performing transactions if the NPL is sponsor-driven and the asset is sold to a non-friendly buyer.

In the case of collateralized loans, the investors are exposed to the risk that if investment funds buy massively collateralized assets and then sell the collateral, this could lead to a drop of the value of the collateral.

7. What are potential benefits and risks from a public policy point of view when considering the appropriate legal framework for secondary markets for loans, and especially NPLs?

Regarding the legal framework, French banks consider that the following issue must be re-considered:

- In France, when a contentious debt claim has been sold, the debtor becomes liable for an amount equal to the sale price only in certain circumstances ("retrait litigieux"). The pro-borrower provisions in art 1699 of the civil code for example enable a debtor to discharge his debt claim in the amount of its secondary market transfer price in circumstances where the legal validity of the claim itself is open to contest. This risk is borne by the buyer of the loan.
- Art 1343-5 of the civil code allows a debtor to obtain from a competent court a payment stay for up to 2 years in the event of dispute with a creditor. This right contributes to lengthen the time taken in France to achieve a successful outcome to a negotiation and hence can be expected to place a downward pressure on secondary market bids for NPL's

The single most important public policy issue in considering the legal framework for secondary loan activity in distressed debt is the critical role played by the applicable insolvency framework or indeed other statutory provisions which can limit creditor rights.

French banks consider that there is no need for urgent changes to French laws or regulations concerning the secondary market for loans because they have not suffered the same balance sheet constraints as other European players.

Besides, as afore mentioned (see our answer on question 2), the management by the bank of its own loan work-out (i.e. negotiation with its debtor) can often remain a pertinent approach for a lending bank depending on its view of the economic value of the NPL's compared to the price available in the secondary markets.

Please rank the following dimensions (in order of importance):
- debtor protection,
- privacy,
- data secrecy,
- promoting increased market size and depth and equal treatment of investors

Firsty, privacy and data secrecy are crucial as they represent key factors to avoid any risk of wide disclosure of information on the financial situation of the distressed companies, which may result in a risk of cut-off of credit lines for the debtor or otherwise destabilize a company finding itself in financial distress. This duty care that lenders owe to the borrower needs to be balanced against the clear benefit that all stakeholders can often derive from the presence of non-bank lenders in the deleveraging process. Data secrecy and privacy is an even greater consideration for retail borrowers given the strong personal data protection laws in France (CNIL).

Secondly, a transparent, predictable and fair treatment of investors is key which is the purpose of a properly functioning insolvency law. As the first three dimensions are genuinely linked, and considering the stakes of an efficient market, the four dimensions stand out as equally important. Debtor protection is a critical issue. It refers to servicers notably. Indeed the value of NPL portfolios rely on their professionalism. Furthermore servicers must respect best practices towards debtors.

8. How can one best strike the balance between such dimensions?

We would suggest that the legislator consider how other markets resolve this thorny issue (for example the USA and UK). A key element could be the existence of a statutory obligation to behave with a duty of care not only to the borrower but also other stakeholders.

Sale of pools of loans protects debtors' confidentiality and mitigates investor's risks. It has also the advantage of allowing the price to be based on statistics while offering a level of cash-flows high enough to remunerate the different securitization tranches.

9. Do differences in these benefits and risks across Member States justify national differences in the framework for secondary markets for loans? If yes, in which way?

No. Liquidity and efficiency of the NPL secondary market will be increased by homogenous legal framework as legal framework is a strong barrier to new potential buyers.

10. Would you consider current rules applicable in Member States pertaining to secondary markets for NPL in the EU a significant obstacle to the further development of these markets?

In France, the legal confidentiality constraints inherent to some pre-insolvency procedures (such as the "*conciliation*" or the "*ad hoc mandate*") and the subsequent requirement for the potential purchaser of the loan to execute a "*non-disclosure agreement*" is an impediment to an efficient secondary market for NPLs. It is not unknown for court action to be taken against a creditor for knowingly disclosing to a third party the existence of an ad hoc mandatory or a conciliation procedure. Whilst the law has been diluted (it is no longer a criminal offense) banks can remain liable to damages as well as reputation risk if disclosure of such "out of court" settlement processes are disclosed.

However, in certain insolvency proceedings (such as conciliation) confidentiality is essential and should be preserved. Generally, if these procedures are doing well it is mainly because they are confidential (borrower's feeling of trust).

Exceptions could be considered in the case of assignments of loans where the assignee is subject to confidentiality obligation.

11. What is the most suitable manner to protect a debtor in the case of transfer of a loan and/or collateral by the creditor to a third party?

The most suitable manner to protect a debtor, in addition to the protection already provided by French law (i.e banking monopoly / prohibition of unmatured debt assignment), would be to use contractual protections.

The answer will depend on the risks against which the debtor wishes to be protected:

a. Against the disclosure of information / confidentiality

Concerning a non performing debtor, the main risk is the knowledge by third parties of debtor's financial difficulties (with the risk of contagion, impediment of the restructuration of the debt, loss of credit resources, risk of reputation …). In France the debtor is protected by the banking secrecy policy, the confidentiality of mandat ad hoc and conciliation procedures and all debtor protection measures, but nevertheless he might require that any creditor should sign with the third party a "Strong" Non-Disclosure Agreement – NDA - (i.e an agreement containing obligations of reinforced confidentiality).

b. Against the quality/ status of the potential third party

The debtor's best interest is to obtain contractually different levels of protection.

For example : Strong protection for the debtor will be included in the legal documentation that no transfer of a loan should occur without its prior consent, except if the loan is transferred to an Existing Lender ; or, Borrower can also negotiate for no transfer to occur in favor of non-Existing Lenders who are located outside the EU or in a sanctioned country……or in favor of non-financial institutions (such as hedge funds…)

In this respect a distinction should be made between retail loans which need a strong level of protection and corporate loans where the protection can be loosened to support market liquidity.

In any case, the debtor should request previous information when a creditor intends to transfer its loan.

Moreover, originators must not be exempted from their responsibility as originators (see what happened in the US regarding subprime origination) and servicers must implement debtors' protection rules.

12. What are the (potential) advantages from specialisation across jurisdictions or asset classes?

Potential advantages from specialisation across jurisdictions or asset classes include more efficient due diligence activity and faster trades as well as better valuations of NPL portfolios.

There could, however, also be pitfalls from the specialisation across jurisdictions or asset classes. Indeed, such specialisation may entail or accelerate a market fragmentation, which would be detrimental to the functioning of the secondary markets for loans (and notably, for NPLs).

We do not see a need to distinguish greatly between distressed and in bonis names. However in a restructuring scenario it can be helpful to all stakeholders if new parties with specialist sectoral knowledge or competencies are able to come to the negotiating table. The existence of liquid and distressed market would minimise the loss consequences for historical lenders to these companies by maximising the secondary market price of the distressed loans.

13. Are you aware of obstacles to operating in secondary markets across national jurisdictions? Would you consider these obstacles to be significant, and/or influence your geographical scope of business operations?

Although the FBF does not support a complete harmonization at EU level of the insolvency laws (considering that some efficient French legal rules must be preserved), the distortions in the various EU insolvency laws and regulations are probably an obstacle to operating in secondary markets across national jurisdictions.

Besides, it is likely that confidentiality constraints imposed on market actors as well as distortions in confidentiality requirements between the EU Member States may hinder the development of secondary markets transactions across national jurisdictions.

However, in certain insolvency proceedings (such as conciliation) confidentiality is essential and should be preserved.

"Bank Monopolies" on the secondary market is one significant national jurisdiction obstacle (it being noted that the French banking monopoly on the secondary market has just been alleviated upon request of the French banks). Another obstacle to deeper liquidity is the fact that regulation requires the use of local language for any legal documentation or local procedure. Security-package re-registration after a transfer and third parties recognition of the right and obligations of the transferee should also be facilitated.

We think that withholding tax exemptions shall be extended to SPV, eg. a French SPV buying a Spanish loan will not benefit from the tax Treaty between France and Spain. Investors, that can be foreigners, must clearly be distinguished from servicers that are necessarily domestic.

The fact the servicers are necessarily domestic is not an obstacle to cross-border investments which have the advantage of diversifying cash-flows.
Future cash-flows expectations rely on the servicer performance which depends on regulation and best practices.

14. Do you consider that an EU regulatory framework (Directive or Regulation) regulating certain aspects of the transfer of loans would be useful? What are in your view the key elements that should be addressed in such a framework?

Pursuant to our answer to question 13, a harmonized policy on confidentiality rules (that must not be too stringent to avoid hindering loans sales) and on bankruptcy/insolvency laws and regulation would be essential.

However, in certain insolvency proceedings (such as conciliation) confidentiality is essential and should be preserved.

EU regulatory framework could be very useful to increase new lenders' security-package legal recognition by third parties and also to have regulatory exemptions recognized at European level, not only at local level (for example banks monopoly exemptions for FCT in France or law 130 SPV in Italy…)

Cross border loan sales are lengthy and complex. Unlike securities, loans are difficult to transfer. This should result in priority being given to securitizations. NPLs securitizations should be facilitated.

15. Please provide any other comments that you find useful in relation to this section.

We do not consider that the liquidity of the secondary market is the real issue jeopardizing a bank's lending capacity. The key issue is the adequacy of the bank's level of provisions for some specific banks only. We consider that there are currently no specific problems for European corporates to find financing. Indeed, the financing offer is currently substantial as evidenced by monetary data.

We don't think that it would be necessary or beneficial that the European Commission, the European Central Bank or the European Banking Authority impose new general constraints on holders of NPLs whatever their individual situation such as:

- a standardized procedure to register NPL provisions on both the stock and new NPLs;
- a maximum rate of NPLs in banks' balance sheets;
- an obligation to sell NPLs on the secondary market after a regulated number of years.

It is noteworthy that specialist distressed players can regard portfolio sales as great investment opportunities in part because the underlying value (as opposed to book value) is often not fully recognized. The over-riding consideration should be the discount rate used to value the NPL portfolio depending on its risk profile. NPLs can be a source of capital on occasions where banks are able to avoid transferring an excessively high IRR to the potential investors.

The management of NPLs is the first and key activity of banks. We are strongly against any measure of standardization either direct (new regulation) or indirect (SSM guidance), against this management activity. On the contrary, we fully acknowledge that the SSM has the power, since 2014, to impose individual prudential obligation for specific individual bank deficiencies that should be used.

We are afraid that all these contemplated measures within the addendum are only supporting NPL buyers and "shadow banking activities" through the standardization and the structuration of a decommissioning process of NPL. As such, we already observe evolutions on the secondary market, for the benefit of buyers.

In the case of collateralized loans, the sudden asset sale by distressed investors could potentially have an adverse effect on the overall market price of similar assets with a detrimental impact on the value of other collateral held by banks.

Two side issues need to be considered carefully:

1) Tax treatment for selling banks;
2) Buyers financing (investment funds or servicers turned into investors).

Cash-flows from NPLs portfolios do not rely on their owners but on the debtors' capacity and servicers' operational effectiveness. Improvement of the recovery process is crucial. Larger volumes processing suppose servicers increased capacities.

THIRD PARTY SERVICERS

16. What are the advantages of having access to third-party loan servicers in terms of secondary loan market efficiency?
In particular, do you see specific advantages for
- helping banks overcome legacy assets;
- creating investment opportunities for specialised investors?

From a buyers point of view, secondary loan markets cannot develop and become more liquid without strong independent third party servicers across Europe. Large NPL portfolios cannot be sold without servicers having large platforms of expert staff and IT capacities. Small investors in particular are reliant on third-party loan servicers to enter a new market. In France, only large banks (and Crédit Logement for retail loans) have sufficient staff to cope with large NPL portfolios.

Servicers which collect non-contractual cash-flows are not part of banks core businesses. Quite naturally banks already call upon such services. However in some cases banks can be the best servicers (see some specific cases where bank's responsibility is questioned). The fact that the bank may be both judge and judged (selling the loan and partly controlling its futures cash-flows) may be a limiting factor for banks collection activities.

From a bank's point of view, on the back of our large experience there is no advantage of having access to third-party loan servicers for Corporate loans or Specialized financings. They are usually less responsive. One tiny advantage that could be raised is neutrality of third-party loan servicers, but Chinese wall between work-out/Agency and execution desk are really strong.

17. Are there any obstacles for banks and non-bank investors to have access to third-party loan servicers?
In accordance with French regulation, loan servicers have to hold a license to acquire and service French loans.
To the best of our knowledge, there are no regulatory or legal obstacles for banks and non-bank investors to have access to third-party loan servicers.

If yes, please specify the nature of these obstacles, i.e.
- regulatory,
- legal, or
- other

For corporate loans, banks' internal departments like work-out and/or Agency teams are more able to deal with NPL servicing than any third party servicer.

18. What are the advantages and risks of outsourcing specific activities to third-party loan servicers compared to internal workout of loans? Please be concrete as to the activities that have been outsourced and why this has proved to be beneficial or not.

The advantages and risks of outsourcing specific activities to third-party loan servicers compared to internal workout of loans depend on the servicing capacities of each bank.

The advantages to some banks include economies of scale and the speed of the recovery process. For example, Crédit Logement, as guarantor of a large portion of French home loans, has an active role in the recovery business for non-performing loans. Crédit Logement has a strong track record in the French market because it has developed its expertise on a large volume of loans over many years.

Workout Department have a long knowledge of the deals and extended relationships with the business lines in order to develop synergies and facilitate the highest level of recovery. A third party would have no such knowledge of the commercial history of our deals / clients and would not have such level of trust from the business lines.

Moreover banks have Middle-Offices and Back-Offices which are in charge of most of the tasks a third party service would provide and which take care of those tasks in a very satisfactory way.

When banks chose to outsource their loan servicing is not due to a lack of expertise at the bank.

19. What are the main risks for debtor protection, in particular for the households in financial difficulties, which are linked (directly or indirectly) with the practices of the third-party loan servicers?

Regarding corporate loans, one of the risks we could see is that the third party loan servicers will probably have no knowledge of the sometimes very long history/relationship of the debtor with the bank and will perhaps not embrace all aspects (including commercials) of the signed deals.

Inappropriate behavior towards borrowers could be prevented thanks to a strict policy imposed by the regulator. As loan servicers are regulated, such a policy could be put in place in France.

20. In the markets and jurisdictions that are relevant to you, is third-party loan servicing mainly focused on management of performing loans, non-performing loans, or both? Please describe the advantages and drawbacks of both situations.

Performing loans recovery and non-performing loans recovery are not the same activities. They rely on two different information systems. In general they are performed by two different legal entities.
Third-party loan servicing is mainly focused on management of plain vanilla performing loans, because plain vanilla performing loans servicing is straight-forward (no waiver, only interests or contractual repayments).

Focusing solely on one of the two activities would be more useful to banks/investors given that a specialized servicer provides better follow-up and expertise (in either credit management or recovery). However, separating the two activities could result in reduced economies of scale, a loss of data or a deterioration in the relationship with the debtor when outsourcing a non performing loan to a new servicer.

21. Do, in your experience, third-party loan servicers concentrate on a specific asset class or does their asset mix tend to be more diverse? Please describe the advantages and drawbacks of both.

In France, third party servicers usually concentrate on specific asset classes. They have thus been able to develop very high levels of expertise and efficiency in servicing their particular asset classes.

22. What specific services are offered by third-party loan servicers, in the markets and jurisdictions that are relevant to you? Which services do you consider to be most instrumental in terms of market efficiency? Please be as concrete as possible.

Services offered by third-party loan servicers are mainly:

- Interests and contractual principal payments;
- Waiver circularization;
- Security-package management;
- Secondary Transfers management;
- Public/Private information management.

The specific services offered by third-party loan servicers are:

- Administrative services:
  1) fast decision process through an extranet used for simulation, uploading documents and online consultation;
  2) dedicated hotline for partner banks.
- Recovery services, reliant on their legal expertise, which are provided at competitive costs thanks to economies of scale.

The basic condition is a mandatory reporting to the originator on recovered cash-flows (the originator is still responsible for the loans that have been sold).

23. Do you consider that a EU regulatory framework (Directive or Regulation) regulating third-party loan servicers would be useful?
If yes, should such legal framework include rules on
- the licensing requirements for such servicers;
- the supervision of such servicers?
Are there any other elements that should be covered by such a legal framework?

Pursuant to our answer to question 16 here above, in our opinion a EU legal or regulatory initiative regarding loan servicers should not be a priority, as third-party loan servicers already exist in France and as the market can find its solutions on its own thanks to the capacity of investors to manage their loan servicing, directly and/or via the assistance of said third-party loan servicers.
However sharing data on NPL could be useful, creating a public supranational data bank.

24. Please provide any other comments that you find useful in relation to this section.

No additional comment

REMOVING POSSIBLE CONSTRAINTS TO THE DEVELOPMENT OF SECONDARY MARKETS FOR LOANS

25. Are you aware of significant differences in business practices in different markets and jurisdictions, for example through voluntary codes of conducts, industry standards, etc.? If yes, does this, and how, constitute an obstacle to your business?

Industry standards provided by LMA are widely shared by market participants. LMA provides one set of market practices by big geographic region. Differences are related to:

- interests treatment: delay compensation do not apply in Asia though they go to the Buyer from T+7 business days in the US and T+10 business days in EMEA;
- Breakage costs apply in Asia, not in the US or in EMEA, unless otherwise agreed by parties of course;
- Transfer and recordation fees are paid by the Buyer in Asia while they are equally split in the US and EMEA.

There are further market practices differences for Distress market vs performing market, but they do not depend on jurisdictions. We are not aware of any difference according to country, within EMEA. As most participants on EMEA NPL secondary market are UK-based, Brexit impact on practices and standards is still unclear.

26. As a market participant, are you actively partaking in several national markets? If so, do you encounter obstacles to operate internationally in an efficient manner? Please specify.

We confirm that several French banks take part in the secondary markets as loan sellers. French banks do act in several national markets (the European trading desk covers mainly Asia and EMEA while the US trading desk manages US NPL book on its own) and always respect the market rules related to the region (EMEA/US/Asia) where the asset is booked.

For international operations, distortions in the various EU bankruptcy laws are perceived as an obstacle. In addition, in certain countries, the majority rule or the court of justice can impose the prolongation of the maturity of the loan, a minority lender cannot do anything about the decision or the court of justice is not required to decide the sale be made at the best market price. All these obstacles make the loans' secondary market less attractive to investors.

27. In the markets and jurisdictions that are relevant to you, are there unduly onerous legal restrictions in place:

a. on the sale of loan portfolios, including to non-bank entities? Please specify these restrictions and their impact.

b. on banks that want to outsource some or all loan servicing functions to third-parties, including to non-bank entities. Please specify those restrictions and their impact.

Such undue restrictions could for example concern the areas of debtor protection, privacy, data secrecy, equal treatment of investors.

If yes, could the removal of such undue requirements be considered? Please specify where such an approach could be contemplated and describe the advantages and drawbacks thereof.

As mentioned in our answer to the question 13, in France, the banking monopoly rules on the secondary market (which has just been partially lightened by a new French regulation upon request of the French banks) and the confidentiality obligations imposed represent potential legal restrictions.
However, in certain insolvency proceedings (such as conciliation) confidentiality is essential and should be preserved.

Furthermore, if the judiciary system and insolvency regime is slow and imposes less predictable decisions on the creditor, it does not encourage the development of the loan secondary market. As mentioned in our answer to the question 26.
France currently suffers from an insolvency regime which causes longer work out periods than in some other countries with more creditor friendly jurisdictions. This can result in a longer period of financial distress with both higher uncertainty and higher relapse rates. It is notable for example that in a French liquidation there is no legal obligation for the insolvency court to accept the highest bid for the company's assets.

28. What specific aspects could be improved, in order to facilitate existing cross-border activities and/or entry into new markets? Going beyond mere facilitating, what would accelerate the resolution of NPLs?
In our view, tax harmonization (notably the tax treatment of some specific transactions) and the reduction of tax uncertainty would be helpful for the development of cross-border activities.
Fostering NPLs securitization would help. As already stressed, securities issued are better suited for cross-border transactions than loans.
See also our answer to question 29.

29. Do you consider that the development of a common EU approach would have an added value in the areas of:

a. the sale and transfer of loans?

b. loan servicing by third parties?

If yes, which areas so far regulated under national law should be the focus of such harmonisation efforts? Potential focal points could include third party servicers' licensing regimes, capital requirements, trade secrecy and consumer protection.
Are there other actions that could be taken at EU level that would yield significant benefits for market efficiency (for example EU guidance or recommendations, the creation of a central register of loan servicers, etc.)?
In our view, the most useful initiative for the development of the secondary market of loans would be the harmonization of the various EU bankruptcy laws and regulations (with exception of some efficient French legal rules to be preserved, as mentioned in our answer to the question 13), and of laws regarding collateral enforcement, the transfer of loans and loan servicing.
As answered above, we consider that the development of a common EU approach would have an added value in the areas of security package transfer and third party recognition for asset-backed NPL. Creating a public supranational data bank for NPL would also have a positive impact.

30. Please provide any other comments that you find useful on this section.
No additional comment

SECTION II: POTENTIAL MECHANISM TO BETTER PROTECT SECURED CREDITORS FROM BORROWER DEFAULT

THE RATIONALE FOR A POSSIBLE EU ACCELERATED LOAN SECURITY

31. Do similar forms of out-of-court enforcement allowing banks to enforce secured loans exist in your country?.
If yes,

- please describe these.

- what are the benefits of these provisions for banks in terms of enforcement and value recovery from NPLs?

- what are the main risks and challenges arising from these forms of out-of-court enforcement tool?

In France there is a similar solution called “pacte commissoire”. However, its functioning is not optimal as it is frozen by insolvency proceedings. There would be room for progress in this field, but any evolutions should be well articulated with insolvency law. Furthermore, if a corporate borrower is still in activity it should be ensured that the collateral is not enforced if the assets are vital to the borrower’s operations.

Most often banks do not wish to encumber their balance sheet with real estate collateral and banks do not necessarily have qualified resources available to manage physical assets. They prefer that the collateral be sold rather than to take possession of it. Shipping and aircraft collateral are an exception because banks are usually well equipped to sell these assets.
The threat of a possible collateral enforcement can in itself be persuasive. Therefore banks do not automatically wish to enforce the collateral, they wish to keep the freedom of choosing to enforce the collateral or not.

The main risks in such cases will be:

- a potential acceleration of the debtor’s difficulties resulting in the opening of an insolvency proceeding;
- a risk linked to the contestation/challenges of the value of the assets on the basis of which the enforcement is made;
- a risk of timing / length and costs of the procedure;
- a risk of proceeding based on the creditor’s liability / right to enforce the security

Other similar forms of out-of-court enforcement allowing banks to enforce secured loans exist in France, such as the securities implicating a transfer of property as securities (i.e Dailly law assignments (Art.L313-23 and following of the French Monetary and Financial Code), trust (fiducie – art.2011 and following of the Civil Code), cash pledge…) at inception of the security or in case of default. In these cases, if an event of default occurs, there is no need to take the case in front of court to enforce the security as the lender or a third party (on behalf of the lender) is already the owner of the asset.

32. Do you see benefits in ensuring that every Member State makes available an instrument along the lines of the 'accelerated loan security' facility?

The value of such an instrument is questionable in Member States where there is a similar instrument, such as in France with the “pacte commissoire”.

We do not necessarily see a strong benefit from the accelerated loan security for the work-out of loans, but perhaps for market liquidity. The accelerated loan security facility can, however, be useful in some circumstances to accelerate recovery process.

We don't expect banks to make an extensive usage of the accelerated loan facility, as it is not a bank's core business to manage and sell the assets that constitute the collateral. Furthermore, the foreclosed collateral would weigh on the bank's balance sheet, which is contrary to the current balance sheet reduction targets. Finally, the existence of an instrument which could be enforced rapidly appears to run counter the proposed widespread implementation in insolvency or pre-insolvency of a "stay of execution" to enable viable but distressed companies to find a solution to preserve value for all stakeholders.

Whatever the class of assets involved (key or non-key assets), the main point is that the new procedure must remain an option: the creditor must be free to enforce it or not, without any risk of liability or financial consequence on its right to recover its non-performing loan.

We would need to have a very clear and precise view of the structure of such accelerated loan security and of its implementation to be able to answer such question.

33. Do you see the accelerated loan security as a valuable instrument to avoid future accumulation of NPLs in banks' balance sheets?

We would need to have a very clear and precise view of the structure of such accelerated loan security and of its implementation to be able to answer such question. At this stage, the concept is too vague to provide a definitive answer but on principle anything that could help accelerating the repossession of the collateral should be seen as "valuable" by any bank. However in some cases, selling on the secondary market may prove to be a more valuable option to get rid of an NPL loan than exercising securities.

FUNCTIONING OF A POSSIBLE ACCELERATED LOAN SECURITY INSTRUMENT

34. Do you agree with the possible main features of an accelerated loan security as described above? If not, what are the features that you do not agree with and why?

We do not agree with the debtors' full discharge from further repayment obligations, when the recovered value from the sale of assets is lower than the value of the outstanding loan.
Such a principle would be an incentive for debtors not to act responsibly. The lender's position would be worse than without the security… In France, before a bank originates a mortgage loan, it gives an estimate of the capacity of the borrower to pay back based on his/her future incomes and not on the value of the collateral.

An accelerated recovery means that an accelerated loan security will not be possible without an efficient judicial system: judicial controls and the possibility for legal protection of both the debtors and the guarantors should be integrated in the proposal.

Banks would have to consolidate newly acquired assets on their balance sheets. Regarding mortgage loans, the transfer of property raises a number of concerns, among them:

- The fact that the transfer implies charges and taxes (transfer rights) for the bank;
- If the asset is used by operating companies for their business, then the ownership will change but the related operating contracts (management contract, employment contract, etc.) will stay with the previous owner;
- What will happen in case of the recovery of a syndicated loan? If the asset is jointly owned by the syndicate members, then many legal questions are raised…

35. What are the (additional) features that an accelerated loan security should have in order to enhance its effectiveness in avoiding the encumbrance of bank balance sheets with further NPLs in terms of functioning of the mechanisms?

The accelerated loan security should be transparent for other creditors of the client. The effects on unsecured debt and debt financing rules need to be addressed. Banks should be free to choose to activate the traditional enforcement procedure even if the accelerated loan security clause was agreed with the borrower.

As it is planned for mortgages, the accelerated loan security should be publicly registered.

36. Do you agree with the proposed restriction on the scope of a possible accelerated loan security instrument to loans to businesses and corporates, and on the exclusion of primary residence of borrower even in the case of these loans? Please explain the reasons for your answer.

We agree with the exclusion of the borrower's primary residence. The French "pacte commissoire" excludes the debtor's residence. In France, 80% of residential loans are guaranteed by Crédit Logement. Hence they are not mortgage loans.

37. In what ways could an accelerated loan security be rendered potentially advantageous to borrowers to ensure its willing take-up by debtors (e.g. possible discharge of debtors in case the value of the assets becomes less than the debt)?

We do not support the idea to discharge debtors in a bilateral negotiation or when they are in bonis. In our view, discharge of the debtor should only occur in a collective insolvency proceeding. If the discharge of debtors were applied to the accelerated loan security, the lenders would ask for additional guarantees, which could lead to credit restrictions.

RELATIONSHIP WITH RESTRUCTURING AND INSOLVENCY FRAMEWORKS

38. How should an accelerated loan security instrument be designed in order to be consistent with the preventive restructuring framework and the insolvency law of your country (e.g. stay on enforcement actions, cram-down on minority creditors, avoidance actions, ranking of creditors)? In your view, what would be the main obstacles to ensure such consistency?

To ensure the consistency of the accelerated loan security instrument, the following French legal features of insolvency/pre-insolvency law should be adjusted accordingly:

- the cases in which the enforcement of securities is stayed in the framework of the French preventive restructuring and insolvency law should be drastically reduced/harmonized ;
- the cases in which, according to the claw back legal dispositions, the enforcement of securities can be cancelled, should be reduced ;
- the terms of the article 1343-5 of French civil Code (allowing the Court to enforce a stay/moratorium of debt repayment and a freeze of enforcement measures in case a creditor formally seeks repayment of its claim whereas a preventive restructuring proceeding has been opened) should be applied with caution.

Moreover, it could be appropriate, in order to avoid any challenges, to include contractually or legally, the possibility to enforce the securities out of court specifically in the framework of insolvency proceedings, but exclusively in case certain conditions are met (*to be defined*) and corresponding protections to the creditor are offered.

39. How should an accelerated loan security instrument be designed in order to be consistent with the public and private law rules and principles (including for instance property law, public and private law) of your country? In your view, what would be the main obstacles to ensure such consistency?

To ensure the consistency of the accelerated loan security instrument, we should prevent the applicable law (its effects) related to this security instrument from being neutralized by various applicable French laws, such as the French Property Law, the French Insolvency Law, the various rules on liabilities etc.

40. How should an accelerated loan security instrument be designed in order to be consistent with the existing national collateral legal framework?

We do not want the solution of an accelerated loan security to be exclusive. It should remain an option among others for banks.