EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

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Call for Advice to the EBA
**for the purposes of a benchmarking of national loan enforcement frameworks
(including insolvency frameworks) from a bank creditor perspective**

Context

As announced in the Communication on completing the Banking Union[1], and as a follow-up to the Council's request in the context of its action plan to tackle non-performing loans (NPLs) in Europe[2], the Commission services are undertaking a benchmarking of national loan enforcement frameworks (including insolvency frameworks) from a bank creditor perspective (hereinafter "the benchmarking"). The purpose of the benchmarking is to understand the efficiency of enforcement procedures in terms of recovery rates and times to recovery. The data gathered should give insights as regards formal (largely in-court) enforcement procedures, both by creditors individually and in the context of a collective proceeding in insolvency. Informal procedures leading to a renegotiation of debt through agreements between the creditor and the debtor should be excluded since they do not contribute to the picture of how well the judicial regime works where creditors need to resort to it in order to recover value. Similarly, preventive restructuring should be excluded from the benchmarking also where it involves the courts, since preventive restructuring implies a certain amount of cooperation between the creditors and the debtor and the benchmarking serves to analyse the creditors' chances at recovery in situations where the chance for agreement are limited. The Eurogroup in its report to Leaders of 4 December 2018 on the deepening of the European and Monetary Union underlined the need for progress regarding insolvency regimes, in particular, inter alia, the benchmarking exercise.

Scope of the EBA's work

General considerations

The Commission services would like to invite the EBA to provide all information considered relevant to inform the Commission services' benchmarking exercise. The Commission services would therefore like to address to the EBA a Call for Advice, the completion of which would involve an ad-hoc data collection and analysis. This should

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[1]   COM, Communication on completing the Banking Union (2017),
       http://ec.europa.eu/finance/docs/law/171011-communication-banking-union_en.pdf .

[2]   ECOFIN, Action Plan to tackle non-performing loans in Europe (2017),
       http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/pdf.

gather data of the highest quality, granular and representative of recovery processes across all EU Member States. Such data will allow the development of a comprehensive benchmarking exercise, as well as contribute to possible impact assessments of EBA Guidelines on similar topics. The main steps are the following:

    (i)   devise parameters and develop templates;

    (ii)   collect data from banks and from other data sources; and

    (iii)   analyse the data collected.

Specific considerations

1. **Scope of the requested work**

The EBA should provide country-by-country estimates, differentiated by type of loan and by type of enforcement, based on loan-by-loan data covering banks' NPLs where enforcement has been completed in the recent period (to be defined uniformly, e.g. past three years).

The objective is to identify and quantify recovery outcomes in each Member State, in order to enable the Commission to identify, at a later stage, the factors of national loan enforcement regimes (including insolvency) that drive such differences.

The starting point to devise relevant parameters for the benchmarking should be the template developed with Member States in the context of the Financial Services Committee. The Commission started the qualitative survey based on this template in 2018 and is handing over to the EBA, along with this Call for Advice, the responses received so far from Member States' authorities, which, along with input from the remaining Member States which the EBA might seek, could be an additional basis to finesse the parameters. However, these parameters, in particular where they are qualitative in nature are not to limit the criteria used by the EBA in any way.

The EBA should deploy the variables it considers best suited to identify the key loan enforcement regime outcomes as regards:

   -   the **recovery rate**; and

   -   the **time to recovery**.

It is important to quantify these two outcome variables, to the extent possible, for both types of enforcement mechanisms (individual and collective). It is also important to collect information complementary to the recovery rates (in particular as regards the costs of the enforcement procedures).

It is useful to recall that the EBA NPL Transactions templates[3] provide several data fields at loan level (borrower, loan characteristics, collateral, as well as information regarding the defaulted status and the recovery process, namely costs and dates). These data fields could help to characterise the enforcement procedures (business or non-business nature of the borrower; type of insolvency or restructuring process; stage reached in insolvency/restructuring procedure), and inform about their overall outcome, costs and length. The use of these existing templates could possibly be an efficient way of ensuring consistency of the data fields and comparability across banks and respective jurisdictions.

These NPL templates (which are based on mandatory supervisory reporting templates) may also mitigate the problem that not all banks currently record detailed recovery

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[3] https://www.eba.europa.eu/risk-analysis-and-data/eba-work-on-npls

outcomes in a specific and uniform way. The use of these templates would therefore likely reduce the time that banks will need to gather and prepare such data request.

The Commission services may also choose to convoke a group of independent experts on insolvency law for the purpose of helping in the elaboration of the data request and for ensuring plausibility checks regarding the data collection elements and data recovery statistics, and possibly also including the explanatory variables for explaining differentials in outcomes. The EBA will be given the possibility to interact with the group as it sees fit.

2. **Data collection**

The EBA is requested to collect all data and information that it deems necessary to respond to the Call for Advice. The coverage of entities and types of loans should acknowledge the methodological difficulties and current data infrastructure limitations, while ensuring the representativeness of the data collected for the purposes of the benchmarking.

2.1 Asset class breakdown and types of loans

The data collection should cover a subset of non-financial companies (NFCs), as further described below, and households. The EBA NPL transaction templates provide a granular and extensive level of data fields that could be used as definitions for data collection. In order to match banks' usual terminology and the EBA "Instructions for the usage of the EBA NPL transaction templates", the asset classes to be covered are to be broken down as follows:

  o Unsecured Retail loans (e.g. receivables from credit cards; consumer loans)
  o Residential Real Estate loans;
  o Commercial Real Estate loans;
  o Other secured and unsecured loans to small and medium-sized enterprises (SMEs; according to the Commission Recommendation 2003/361/EC) (i.e. to the extent not covered above);
  o Other secured and unsecured loans to intermediate NFCs, i.e. companies larger than SMEs but below a defined size threshold to be elaborated between the EBA and Commission services, in order to exclude large NFCs (the feasibility of covering this asset class is to be confirmed) (i.e. to the extent not covered above);

For secured loans, in principle, all types of collateral would have to be considered.The category of large NFCs would be excluded from the scope of the exercise. Firstly, the significance of the client relationship for the bank might mean that banks apply additional considerations, in order to keep the client, on top of their usual cost/benefit assessment before triggering enforcement.

Secondly, even where enforcement is triggered, other types of considerations may enter into the process (e.g. social, political). Lastly, the lower number of cases per Member State may reduce comparability, as the average values per jurisdiction would to a large extent reflect the specificities of the individual cases rather than merely reflect the quality of debt enforcement frameworks. It remains to be determined whether it is feasible to cover the intermediate-sized NFCs, i.e. which are not SMEs, with a predefined size threshold, based on experience from previous data collection exercises by the EBA.

Financial institutions as debtors, specialised loans (e.g. project finance loans; infrastructure loans; and public sector loans), leasing or asset-backed finance loans

(e.g. loans granted to corporates to purchase non-property collateral, loans for asset-backed finance such as marine and aviation) are excluded from the exercise, since different mechanisms and specific regimes apply.

For SMEs and intermediate-sized NFCs (if covered), both property collateral and non-property collateral would be included in the estimates.

As for Unsecured Retail loans, this category is relevant as the business is in general rather homogeneous and could render data of relatively good comparability. It could include, for instance, receivables for credit cards, as well as other unsecured consumer loans (identified using the template item "Loan Purposes").

2.2 Types of enforcement mechanisms

The data collection should cover and present results separately for these two categories:
- individual enforcement (e.g. asset seizure, foreclosure, court judgements in relation to enforcement of unsecured claims); and
- collective enforcement (e.g. insolvency proceedings).

No distinction in the data collected seems feasible between different types of collateral (transfer of security right, transfer of ownership, etc.).

A distinction along the lines of "Predominant Borrower Country of Cohort" would be useful, in order to be able to distinguish the effects of the insolvency framework in the borrowers' country of residence.

2.3 Time to recovery (length of the enforcement procedures)

The data collected on the time to recovery should inform about the effectiveness of the enforcement procedures across Member States. In order to be relevant for that purpose, one should be able to control for the effects of idiosyncratic elements, such as banks' internal decision-making procedures and NPL management strategy (in addition to the quality of debtor assets and the loan characteristics). Therefore, it is useful to split the overall time to recovery in two sub-periods that use uniformly-defined starting and ending points.

The point of first contact with the judicial authorities, setting the enforcement procedure in motion, could be used as a reference point to guide thus split.

The variables to be collected are:
- Average time from date of default to the initiation of judicial proceedings (months);
- Average time from the initiation of judicial proceedings to:
  - The ultimate or the latest recovery (months); and
  - The end of the legal proceedings (months).

2.4 Recovery rate (collections from the enforcement procedures and their costs)

The weighted[4] average recovery rates should be calculated before (gross recovery rate) and after (net recovery rate) deduction of costs associated with recovery, using the following input variables:

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[4] Weighting recovery rates by volumes of notional outstanding is necessary to ensure that the estimated average gives a representative picture of the overall share of value that is obtained at the end of

- Gross recovery (amounts recovered before deduction of the costs associated with the recovery procedure);
- Notional outstanding (amounts);
- The total of costs associated with the recovery procedure, legal costs and other relevant costs (amounts);

2.5 Banks and loans sampling

The information should be collected from a representative sample of institutions, covering all EU Member States. The time constraints for the exercise and the desire to avoid excessive burden on banks will require a reasonable bank sampling, at least in a first round of the exercise. This sampling would be the result of EBA's judgement on the trade-off between resource intensity and representativeness. EBA would be required to propose a sample for review by Commission services by 30 April 2019 and to adjust based on mutual understanding.

The EBA is invited to propose a suitable sample of banks by Member State that hold sufficient historical data on loan enforcement, while ensuring their anonymity. The sample of banks needs to ensure representativeness in each Member State for important aspects, such as the following: size, location and business model, asset classes; asset quality; types of enforcement proceedings (as described above). To the extent possible, this should use the regular Basel III monitoring exercise (around 200 banks).

As regards loan sampling, all individual loans that entered in formal (judicial) enforcement proceeding and completed it in the recent period (to be defined uniformly, e.g. past three years) should be covered, in order to avoid selection bias. A stratified random sample could be used by separating the population into mutually exclusive sets, or strata, and then drawing simple random samples from each stratum (current EBA data infrastructure limitations will cap the number of loan-by-loan observations for each bank per stratum). Due to possible data limitations and feasibility of the exercise, aggregation of data (e.g. weighted averages) for some data fields may be also necessary.

A point-in-time snapshot of several data fields of the EBA NPL templates (e.g. December 2018, with the respective historical information) could allow a time series of recovery outcome observations that can be used to track the evolution of enforcements over time and also inform about the costs and length of the enforcement procedures. The time-series could possibly also serve for the impact analysis of changes in enforcement regimes of the Member States on recovery outcomes over time, with the caveat that in some cases the length of the enforcement proceedings may exceed the length of the time series of outcomes that will be produced.

Plausibility checks with supervisory reports FINREP/COREP data and with Supervisory Benchmarking data[5] (e.g. Recovery Rates per bank at sub-portfolios level) are envisaged.

Final considerations

The Commission services are aware that time and resource constraints may restrict the range of analysis in terms of the breadth of the sample of banks for which data can be

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enforcement processes. A simple average would likely be excessively driven by more numerous smaller cases.

[5] https://www.eba.europa.eu/-/eba-consults-on-amended-technical-standards-on-benchmarking-of-internal-models

gathered and analysed. Should this be the case, the EBA should highlight these limitations in its final report.

It is recalled that the analysis provided will not prejudge the Commission's final decision on what type of results to use and publish in the benchmarking. In accordance with established practice, the Commission services will continue to consult, where appropriate, the Member States' and independent experts in the preparation of the benchmarking.

In order for the Commission services to be able to complete the Benchmarking over a reasonable horizon, I would ask the EBA to deliver its analysis to the Commission services by 31 December 2019. By 30 June 2019, EBA shall be required to deliver a preliminary analysis of the data gathered for a representative sample.