Luxembourg, 20 October 2017

Response to European Commission consultation on the development of secondary markets for non-performing loans and distressed assets and protection of secured creditors from borrowers' default

Introduction

The Association of the Luxembourg Fund Industry (ALFI) is the representative body of the Luxembourg investment fund community. Created in 1988, the Association today represents over 1300 Luxembourg domiciled investment funds, asset management companies and a wide range of service providers such as custodian banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax experts, auditors and accountants, specialist IT providers and communication companies. The Luxembourg Fund Industry is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment structures are distributed on a global basis in more than 70 countries with a particular focus on Europe, Asia, Latin America and the Middle East.

We thank the European Commission for the opportunity to participate in this consultation on non-performing loans (NPLs). We understand the consultation's main focus, in accordance with the action plan published by the Council of the European Union on 11 July 2017, is to receive information on the current state of secondary markets for NPLs in the European Union. Therefore, the questions raised in the questionnaire are more targeted to banks with the aim to identify impediments to the transfer of NPLs from banks to non-bank investors. However, when creating a new framework for NPLs, we think it is also important to bear in mind the role played by loan funds. In the context of a low interest rate environment and scarcity of bank credit, non-bank entities such as investment funds have become increasingly involved in capital markets and credit intermediation.

As recently confirmed by IOSCO[1], loan funds in the EU are allowed in almost all Member States and are predominantly located in Luxembourg and the United Kingdom. By providing credit to economic actors, loan funds play an important role in achieving economic growth which complies with the goal of the European Commission's Capital Markets Union and Investment Plan for Europe. It is worth noting in this context that in Luxembourg, loan funds were already set up long before the financial crisis of 2008 which allows the Luxembourg fund industry to rely on expert knowledge and experience in this field. Our main comment aims at preserving existing flexibility for loan funds within the framework of the Alternative Investment Fund Managers Directive (AIFMD), but also with regard to the European Venture Capital Funds (EuVECA), European Social Entrepreneurship Funds (EuSEF) and European Long-Term Investment Funds (ELTIF) Regulations.

[1] IOSCO final report "Findings of the survey on loan funds", dated February 2017

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Response to the consultation

Question 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?

Question 23:
Do you consider that a EU regulatory framework (Directive or Regulation) regulating third-party loan servicers would be useful?
- Yes
- No
- Don't know / no opinion / not relevant

* 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?

Question 29:
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?
- the sale and transfer of loans?
- 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.)?

When considering the creation of an EU framework on NPLs, ALFI is of the view that it is crucial to preserve the activity of loan funds as credit intermediators within existing legal frameworks. Neither loan origination (where an investment fund provides credit acting as a sole or primary lender) nor loan participation (where an investment fund buys all or a portion of a loan originated by another entity directly from the lender or on secondary markets) should be restricted or even negatively impacted. The European Commission's Capital Markets Union and Investment Plan for Europe aim both at finding or promoting alternative sources of financing for the European economy. Loan funds being non-bank entities, play an important role in this regard and the sector is steadily growing without posing any systemic risks. In other words, the sector's size is still limited.

Loan funds qualify as alternative investment funds and are indirectly governed by the Alternative Investment Fund Managers Directive (AIFMD) which provides a robust framework for funds primarily marketed to professional investors. The EU Regulations for European Venture Capital Funds (EuVECA), European Social Entrepreneurship Funds (EuSEF) and European Long-Term Investment Funds (ELTIF) explicitly allow for loan origination with certain restrictions. On the other hand, funds open to retail investors (namely Undertakings for Collective Investment in Transferable Securities, UCITS) are prohibited from originating loans.

These frameworks were adopted in consultation with the fund industry and strike a balance between necessary legal requirements and flexibility in terms of structuring. The flexibility of such frameworks encouraged the development of loan funds in Europe and provided new financing resources, in particular, for small and mid-size enterprises.

We do not consider that an EU regulatory framework regulating certain aspects of the transfer of loans would be useful. Furthermore, concerning a regulation of third party loan services, we tend to consider that services in this area can today be provided by various entities such as corporate services entities, administrative agents, accounting firms etc. which already are subject to certain licencing requirements. A dedicated EU regulatory framework does not appear to be useful in this context because it would regulate actors and activities which are already subject to a wider regulatory framework. Loans generally can be assigned or transferred by the creditor thereof to a new creditor without the consent of the debtor. Therefore, an EU regulation concerning the sale and transfer of loans is not likely to facilitate the resolution of NPLs.

When creating a framework for NPLs, it is in ALFI's view crucial to ensure that rules comply with what is required in particular under the AIFMD. Any kind of restrictions or additional burdens would rather create an impediment to economic growth.