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THE SALE OF NON-PERFORMING LOANS AFTER GEO 52/2016

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Starting with 2014, after the entry into force of new prudential rules imposed by the Basel III international standards, as well as by Directive 2013/36/EU and Regulation no. 575/2013, the transactions of sale of non-performing loans have gained even more the attention of investors. Romania ranked first in Central and Eastern Europe in respect of sales of non-performing loans with transactions valued at EUR 3.5 billion in 2015 and 2016. Considering that there still are important Romanian banks with a rate of non-performing loans exceeding 10%, the market is expecting that the transactions of sale of non-performing loan portfolios will continue in the next period.

Recent legislative amendments brought by the entry into force of the Government Emergency Ordinance no. 52/2016 regarding loan agreements granted to consumers for immovable property and on amending and supplementing the Government Emergency Ordinance no. 50/2010 on consumer loan agreements (**GEO 52/2016**) could influence the structure of these transactions in the future.

Although the purpose of GEO 52/2016 was, among others, to ensure discipline of the debt recovery activity in the context of the boom of the sales of non-performing loans, certain changes brought by it triggered uncertainties on the market. Therefore, following these legislative amendments, the transfer of non-performing loans will be treated differently depending on the type of debtor (loans offer to corporate clients or consumers), on the purpose of the loan (whether they were granted in relation to immovable property or not), the moment of execution of the agreement (loans concluded before or after the entry into force of GEO 52/2016).

1. **Sale of non-performing corporate loans versus sale of non-performing consumer loans**

1.1. *Corporate loans*

Although GEO 52/2016 aimed to regulate only consumer loans, it also brought amendments to Law no. 93/2009 regarding non-banking financial institutions (**Law 93/2009**) with consequences in respect of the assignment of corporate loan portfolios.

According to Law 93/2009, lending activities on a professional basis can be carried out only regulated entities (such as credit institutions and non-banking financial institutions). Before the entry into force of GEO 52/2016, Law 93/2009 also provided that only such regulated entities can purchase loan portfolios and the main exception to this rule was that loan portfolios classified as loss, according to the provisions regarding the classification of loans, could also be transferred to unregulated entities. GEO 52/2016 repealed these provisions regarding the acquisition of loan portfolios, while regulating only the transfer of consumer loan portfolios.

This amendment raised questions in relation to the possibility for unregulated entities to continue to purchase loan portfolios which were classified as loss (commonly known as non-performing loans). Given the rule that lending activities can only be undertaken on a professional basis by

regulated entities, the question being raised is whether purchasing portfolios of loans classified as loss constitutes professional lending or not. In this respect, the National Bank of Romania (**NBR**) is the only competent authority to decide if a certain activity could be qualified as professional lending.

In January 2017, the NBR issued a press release offering its interpretation in relation to this legislative amendment. According to the NBR's opinion, despite the provisions regarding the transfer of loan portfolios having been repealed, the acquisition of loans classified as loss according to the provisions regarding the classification of loans, as well as carrying out operations in view of recovering the amounts owed, do not qualify as professional lending and, therefore, can be undertaken by entities other than professional lenders.

This intervention of the NBR offers some comfort to unregulated entities by establishing a general interpretation regarding the acquisition of portfolios of loans classified as loss. However, the NBR's press release seems to suggest that the activity carried out by the purchaser in relation to the purchased loans must still be analysed on a case by case basis in order to determine if it presents the characteristics of professional lending.

In light of the NBR's interpretation, we consider that the acceleration of the loan or the initiation of enforcement procedures after the purchase of the loans would fall outside the scope of the professional lending activity. The same interpretation would not apply for continuing to collect the principal, interest or fees and commissions after the purchase, at their due dates, in accordance with the initial contractual terms of the loan, with respect to which it could be argued that they represent professional lending activities that could be carried out only by regulated entities.

1.2. Consumer loans

With respect to consumer loans, GEO 52/2016 establishes the rule that only credit institutions or non-banking financial institutions authorized to offer that specific type of loan, or alternatively entities authorized to issue securitized debt instruments in accordance with Law no. 31/2006 regarding debt securitization, will be able to purchase the consumer loans.

As an exception, receivables deriving from non-performing loans, which have been accelerated by the creditor or in relation to which the creditor has initiated enforcement proceedings, can be purchased by debt recovery entities registered with the National Authority for Consumer Protection, under the condition they have their registered headquarters, a branch or a representative in Romania.

2. The sale of consumer loans contracted in relation to immovable property versus those contracted for other purposes

GEO 52/2016 applies to consumer loan agreements regarding the sale, respectively, purchase of immovable property, loan agreements secured by an immovable mortgage or such agreements involving a right related to an immovable asset (**Consumer Loan Agreements for Immovable Property**). However, GEO 52/2016 also amended GEO 50/2010 on consumer loan agreements (**GEO 50/2010**), narrowing its scope of application only to consumer loan agreements other than the Consumer Loan Agreements for Immovable Property (**Classic Consumer Loan Agreements**).

Although the legal regime applicable to the transfer of loans granted under the two types of contracts should have been the same, there is a notable difference. In particular, GEO 52/2016 defines non-performing loans only in relation to Consumer Loan Agreements for Immovable Property as those for which there is a delay in payment of at least 90 days but does not provide a similar definition for non-performing loans in relation to Classic Consumer Loan Agreements, regulated under GEO 50/2010. Consequently, when purchasing receivables deriving from Classic Consumer Loan Agreements, we raise the question how those loans will be classified as non-

performing. Considering that the scope of GEO 52/2016 is narrower than that of GEO 50/2010, we could not extend the definition provided for non-performing loans deriving from Consumer Loan Agreements for Immovable Property to those deriving from Classic Consumer Loan Agreements.

One approach could be to classify loans deriving from Classic Consumer Loan Agreements as non-performing by using the notion of loans classified as loss which, according to and within the limits of the NBR's interpretation, could be transferred to unregulated entities. As opposed to the qualification of non-performing loans according to GEO 52/2016 (which uses as a criterion only the number of days of delay in payment), for classifying a loan as the financial performance of the debtors is also used as a criterion (according to which a loan may be classified as loss even in case of fewer days of delay in payment), as well as the initiation of judicial procedures against the debtor (enforcement or bankruptcy). Furthermore, when classifying loans as loss, all loans granted to one debtor are classified as loss if at least one of them fulfils the relevant criteria, even if the rest of them may not meet the requirements. This is known as declassification by contamination (in Romanian, *declasare prin contaminare*).

3. The sale of non-performing loans depending on the date of the loan agreement

The new provisions regarding the Consumer Loan Agreements for Immovable Property, including those regarding their transfer, do not apply to agreements which were already in force at the moment when GEO 52/2016 was adopted (*i.e.* 30 September 2016). This means that, in principle, the general regime applicable to the assignment of loans will also apply to the transfer of such loans, meaning the NBR's interpretation of Law 93/2009 presented above. Therefore, these loans can be purchased by any regulated entity and also by any unregulated entity, not only by debt recovery entities.

In relation to Classic Consumer Loan Agreements, however, the applicability of the new rules is not limited to agreements concluded after the entry into force of the legislative amendments. Therefore, the transfer of such loans, even when such were granted before the entry into force of the new provisions, is possible only by complying with the applicable rules in force at the date of the transfer, meaning only towards regulated entities or unregulated debt recovery entities.

Therefore, depending on the criteria presented above, the following aspects could vary in the context of a transaction of sale of a non-performing loan portfolio: the entity which can purchase those loans, the conditions under which the acquisition can be performed and even the definition of the non-performing loan. These aspects will lead to additional efforts for structuring the transaction if it envisages the acquisition of a complex loan portfolio.

Nevertheless, despite these legislative amendments, the Romanian market continues to have potential for further transactions of sale of non-performing loans. Considering the recommendation that the NBR made to banks to diminish their rate of non-performing loans, we expect to witness more transactions of sale of non-performing loans in the following period.

