
NPL Guidelines in Peru

Lima office

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As a consequence of the current COVID - 19 situation, the level of corporate and personal debt will continue to grow in Peru and Latam. We expect major activity in the non-performing loan (NPL) and real estate owned (Reoco) market.

Here we explain some of the major aspects involved in the acquisition of distressed debt portfolios and the main risks and legal considerations under Peruvian regulations.



Regulatory issues for portfolio acquisition

Restrictions for non-Peruvian residents and foreign exchange

Currently, there are no restrictions on the export or import of capital, including foreign exchange controls or restrictions on the remittance of dividends, interest or other payments to non-resident investors.

Banking regulations

No license or authorization is required for money-lending activities or for the acquisition of loans granted by third parties, including financial institutions.

Transfer of portfolios to a non-financial institution in Peru:

- Entering into financing agreements with foreign or Peruvian resident entities that are not financial institutions in Peru is not subject to any restriction and does not require any prior authorization or registration with the Central Reserve Bank of Peru or any other authority. Payment of debt abroad under such agreements is also free of authorizations or restrictions, provided that applicable income tax withholdings on any interest paid are made.
- However, the transfer of a portfolio from a financial entity to a third party is subject to the provisions of SBS Resolution 1308-2013. According to it, the seller can transfer a portfolio through sale, assignment of rights, assignment of contractual position or other contractual modalities. The resolution prohibits the repurchase, exchange or use of any mechanism through which, directly or indirectly, the seller assumes all or part of the credit risk of the portfolio transferred, except for the operations previously authorized by the SBS. Likewise, the seller will require prior authorization from the SBS to transfer the portfolio, except in the following cases:
 - Written-off loans;
 - Loans that are not written-off but classified as lost and provisioned 100%; and
 - Cash transfers through cash payments, as long as they are at least at net book value of specific provisions required.



Consumer protection regulation

The Peruvian Consumer Protection and Defense Code (the "**Consumer Code**") applies to portfolios made up of loans granted to individuals for the provision of financial products by entities supervised and not supervised by the SBS.

Legislation on consumer protection seeks to protect the rights of consumers, as they are presumed to be at a disadvantage with respect to loan providers regarding the quantity and quality of information about products and services offered in the market.

Servicing activities in Peru

No special registration or licensing requirements apply to companies rendering loan services, including debt collection. Except for the provisions of the Consumer Code for the collection of loans, there are no applicable best-practice principles regarding the servicing of loan portfolios.

Portfolio transfer

Under Peruvian Law, there are two types of assignments to transfer a portfolio: (i) assignment of contractual position, under which the buyer acquires the rights and obligations with respect to the credits, provided the borrowers accept the assignment before, simultaneously or after the assignment (otherwise, the assignment agreement is not enforceable); and (ii) the assignment of rights, under which the buyer acquires the collection rights and flows arising from these rights with respect to the credits. In this case, the borrowers do not need to provide their authorization.

The assignment of a credit right generates the transfer of all collateral and security interest related to such credit right. By default, the assignment of credit rights is done on a "true sale" basis. Indeed, under the Peruvian Civil Code, if the parties do not agree to the contrary, the assignor only assumes liability for the existence and enforceability of the assigned credit right but not for the debtor's solvency.

Tax matters

No stamp duty applies to the transfer of a credit.

The assignment of credits consists of the transfer of the collection right by an initial creditor (transferor) to an assignee that becomes the new creditor. The assignment can be done as a factoring or a discount operation, depending on who assumes the debtor's default risk being assigned.

In a credit transfer without recourse (factoring), the assignee assumes the debtor's credit risk, i.e., in the event of default, the assignee is not entitled to demand the collection of the debt from the transferor.



For income tax purposes, if the buyer of the credit is a tax resident in Peru, taxable income (deemed as service revenue) must be reported when collected for the difference between the nominal value of the credit and its transfer value, taxed at a 29.5% rate.

If the buyer is not a tax resident in Peru, the applicable income tax rate will be 30%.

The credit transferor will report an expense for services for the difference between the nominal value and the transfer value of the credit.

In a credit transfer with recourse (discount), if the debtor fails to cancel the debt, the assignee will be entitled to demand reimbursement of the appropriate amount from the transferor. Usually, this is not applicable to NPLs, which are subject to the true sale principle (transfer of assets). In a discount operation, the income generated by the buyer is considered interest income, equal to the difference between the credit's nominal value and the price at which it was transferred.

If the buyer is domiciled in Peru for tax purposes, the income tax rate will be 29.5%. On the other hand, if the buyer of the credit is a foreign entity, then the tax rate at collection will be 4.99%, provided certain conditions are fulfilled.

The transfer of a NPL will not be subject to VAT. Only in the case of a discount operation will VAT (at a rate of 18%) be charged if the transferor repurchases the credit. The assignment of bank credits will not, as a rule, be subject to VAT in any circumstances.

Insolvency procedure

Introduction

Peruvian Law provides that all insolvency, bankruptcy and restructuring procedures involving companies or individuals that are Peruvian residents and do business in Peru are ruled by the Insolvency System Act (*Ley General del Sistema Concursal*). INDECOPI is the government agency with exclusive and mandatory jurisdiction over insolvency matters. Banks, insurance companies and governmental institutions (ministries, the tax authorities, local governments, municipalities and the like) are not subject to this Act.

The insolvency procedure seeks to protect the debtor's estate and to provide an orderly scenario for creditors to decide whether to restructure or liquidate the debtor. Unlike other insolvency legal frameworks, there is no court participation in the insolvency procedure, which is between debtor and creditors, i.e., highly private at its core.



Insolvency steps and timing

An insolvency procedure can be initiated by creditors or by the debtor itself: **(i)** insolvency at the request of debtor (which is not confidential), when it has losses in excess of one third of its paid-in capital or past due obligations for more than 30 days in excess of one third of the total liabilities; or **(ii)** insolvency initiated by the creditors, when their credits exceed 50 Tax Units¹ and are overdue for more than 30 days. Procedures initiated by creditors are confidential until approved by INDECOPi and published.

Repossession steps

Once insolvency has been declared, (i) the enforceability of all the borrower's payable debts will be suspended until a liquidation agreement or a restructuring plan is approved; and (ii) the private enforcement of security on the borrower's is no longer allowed, unless these assets secured are third-party obligations.

If the liquidation and dissolution of the borrower is decided, payment will follow this order:

- a) Remuneration and social security credits
- b) Alimony credits
- c) Secured credits
- d) Tax credits
- e) Credits not included above

In addition, preferential payments or fraudulent conveyances, apart from eventual criminal sanctions, can be pursued through a specific civil action when: (i) those acts were committed within one year prior to the start of the insolvency procedure; and (ii) they have negatively affected the debtor's estate.

¹ One Tax Unit is currently equivalent to S/ 4,400 Soles, approximately USD 1,200.



Mortgage foreclosure

Types of enforcement

Under the Peruvian Civil Procedure Code, the enforceability of mortgages, provided that the mortgage has been incorporated according to law (i.e., by means of a public deed and registered in the Peruvian public records) and the guaranteed obligation is contained in an enforceable title, is done by civil proceeding.

Enforceable titles in Peru include (i) securities (i.e., promissory notes) and (ii) public deeds, provided that the obligation contained in the title is true, express, enforceable and liquid or able to be liquid through an arithmetic operation.

Because of their characteristics, promissory notes are usually the title banks choose to enforce mortgages.

Auction procedure

Appraisal: Once foreclosure has begun, the judge orders the appraisal of the property, if the parties have not expressly agreed on its value. The appraisal, if required, will be made by the experts appointed by the judge and within the term established in the court order.

The appraisal is made known to the interested parties for three days, during which time they can file observations. Once the term for observations has elapsed, the judge will approve or reject the appraisal. If rejected by the judge, a new appraisal will be ordered. The rejected appraisal cannot be challenged.

Once the value of the property has been approved, the judge will make the first call for auction.

Auction price: The base price on the first auction call will be two thirds of the value of the property (either judicial or conventional appraisal). As a requirement for validity, the judicial auction call must be published in the Official Public Gazette (*El Peruano*) for six days. If no bids are submitted in the first auction call, a second call is issued, in which the judge will reduce the base price by 15%.

If no bids are submitted in the second call, the judge will issue a third one, reducing the base price again by 15%.

If there are no bidders in the third call, the creditor can request the award of the property. In this case, if the value of the awarded property exceeds the due amount, the creditor must reimburse or pay the excess to the debtor.



For further information, please contact our Finance team in Peru.

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