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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL AND THE EUROPEAN CENTRAL BANK

Second Progress Report on the Reduction of Non-Performing Loans in Europe

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1. INTRODUCTION

As the European Union and its economy are visibly regaining strength, the EU must continue to seize the momentum to reinforce its Economic and Monetary Union (EMU). Within the context of the roadmap set out by the Commission on 6 December 2017 for the deepening of Europe's Economic and Monetary Union[1], and in line with the Leaders' Agenda[2], one of the most immediate priorities is to complete the Banking Union and put in place all building blocks for a Capital Markets Union.[3] An integrated financial system will enhance the EMU's resilience to adverse shocks by enabling private risk-sharing across borders, while reducing the need for public risk-sharing.

In parallel, the Commission's Communication of 11 October 2017[4] sets out a way forward to complete the Banking Union by promoting risk reduction and risk sharing in parallel, based on the Council Roadmap of June 2016.[5]

Risk reduction measures taken since the financial crisis have resulted in a significant improvement in banks' solvency, leverage and liquidity positions, as mentioned in the Commission's First Progress Report on the Reduction of Non-Performing Loans (NPLs) in Europe, published on 18 January 2018.[6] In addition to the progress on these key risk metrics in virtually all Member States, greater convergence towards an improving average of these indicators can be observed across Member States. This development is driven in particular by marked improvements in those national banking systems most affected by the crisis and ensuing economic recession. The Tier 1 capital ratios of euro area banks have improved across the sample of the European Central Bank (ECB) from 14.6% in Q3 2016 to 15.3% in Q3 2017. The strengthening in capital positions of euro area banks is also visible in their strengthened leverage ratios. The average leverage ratio[7] increased further from 5% in Q3 2016 to 5.2% in Q3 2017. Euro area banks also improved their resilience to liquidity shocks, as the liquidity coverage ratio increased from 138% in Q3 2016 to 140% in Q3 2017. As a result of determined action on risk reduction, remaining risks have been more effectively and evenly addressed in the euro area today than three years ago.

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[1] COM(2017) 821.

[2] http://www.consilium.europa.eu/media/21594/leaders-agenda.pdf.

[3] The Commission issued a Communication [COM(2018)] on 7 March entitled "Completing the Capital Markets Union by 2019 – Time to accelerate delivery".

[4] https://ec.europa.eu/info/publications/171011-communication-banking-union_en.

[5] http://www.consilium.europa.eu/en/press/press-releases/2016/06/17/conclusions-on-banking-union/.

[6] COM(2018) 37.

[7] I.e. the fully loaded leverage ratio that is calculated in a more stringent manner and presented before 2019, when the transitional phase ends. The softening effect of the transitional implementation period is ignored.

The Commission has also put forward several further substantial measures in order to reduce risks and enhance resilience of the EU banking sector. For example, in November 2016, the Commission proposed a significant legislative package to review the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR), the Capital Requirements Directive IV (CRDIV) and Capital Requirements Regulation (CRR) with the objective of further reducing risks in the banking sector.[8] The same year, the Commission also adopted a proposal for a Directive on preventive restructuring procedures, second chance for entrepreneurs, and the efficiency of insolvency frameworks.[9] Effective restructuring and insolvency rules are essential for the prevention or reduction of NPLs and for a well-functioning Capital Markets Union. The Commission calls on the European Parliament and the Council to show determination on these important files in order to facilitate their swift adoption.

Addressing the high stock of NPLs[10] and their possible future accumulation is essential to complete Banking Union. NPLs are loans where the borrower has difficulties to make the scheduled payments to cover interest and/or capital reimbursements. When the payments are more than 90 days past due, or the loan is assessed as unlikely to be repaid by the borrower, it is classified as an NPL. The financial crisis and subsequent recessions led to a more widespread inability of borrowers to pay back their loans, as more companies and people faced continued payment difficulties, or even bankruptcy. This was particularly so in Member States that faced long or deep recessions. Consequently, many banks saw a build-up of NPLs on their books.

High stocks of NPLs can weigh on bank performance through two main channels:

1. NPLs generate less income for a bank than performing loans and thus reduce its profitability, and may cause losses that reduce the bank's capital. In the most severe cases, these effects can put in question the viability of a bank, with potential implications for financial stability.
2. NPLs tie up significant amounts of a bank's resources, both human and financial. This reduces the bank's capacity to lend, including to small and medium-sized enterprises.

The primary responsibility for tackling high levels of NPLs remains with the affected banks and Member States. The Commission has consistently raised this matter, for the countries concerned, in the context of the European Semester. At the same time, there is also a clear EU dimension to reducing current NPL ratios, as well as preventing any excessive future build-up of NPLs, given the interconnectedness of the EU's banking system in general and that of the euro area in particular. There are important potential spillover effects from Member States with high NPL ratios to the EU economy as a whole, both in terms of economic growth and financial stability.

Reflecting this EU dimension and building on the shared agreement on the need to continue and extend the actions already initiated by the Commission, the Council adopted in July

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[8] http://europa.eu/rapid/press-release_IP-16-3731_en.htm

[9] COM/2016/0723 - 2016/0359 (COD).

[10] NPLs denote loans where the borrower is unable to make the scheduled payments to cover interest or capital reimbursements. When the payments are more than 90 days past due, or the loan is assessed as unlikely to be repaid by the borrower, it is classified as an NPL (Commission Implementing Regulation (EU) 2015/227).

2017 an "Action Plan To Tackle Non-Performing Loans in Europe" that calls upon various institutions – including the Commission – to take appropriate measures to further address the challenges of high NPLs in Europe. In the First Progress Report on the Reduction of NPLs, the Commission committed to report back in March on the progress made in the implementation of those actions.

As a result of combined efforts and the current economic recovery, the high stocks of NPLs, particularly in certain banks and Member States, are being reduced. The average ratio of NPLs is on a steady downward trend and has decreased by more than one third since 2014.[11] As explained below, progress in reduction of NPLs has also continued over the last couple of months.

It is now essential to reinforce efforts to decisively address the remaining stock of NPLs and the possibility of future build-ups of NPLs.

Together with this Progress Report, and building on a solid foundation of risk-reducing measures already taken by the Union, the Commission is putting forward a comprehensive package to accelerate the resolution of NPLs in Europe and to prevent their build-up in the future. The package consists of two legislative proposals aimed to create a Union wide legal framework to encourage the resolution of NPLs and a staff working document providing non-binding technical guidance (a so-called “blueprint”) for how national asset management companies (AMCs) can be set up. Together, these proposals will:

- enhance the prudential tools needed to effectively address NPLs;
- encourage the development of secondary markets for NPLs;
- facilitate debt recovery by enhancing the protection of secured creditors in an extrajudicial proceeding, in a manner complementary to the proposal on preventive restructuring procedures, second chance for entrepreneurs, and the efficiency of insolvency frameworks put forward in November 2016; and
- provide guidance to Member States – that so wish – for the restructuring of their banks by establishing AMCs or other measures dealing with NPLs.

2. PROGRESS MADE IN RELATION TO NPLS

The Commission has devoted significant attention to addressing the issue of NPLs since the outset of the financial crisis in 2008-2009. For banks whose viability was threatened by high NPLs, the Commission has assisted Member States in setting up ad hoc and system-wide measures to reduce NPL stocks, compatible with State aid rules.[12] This has resulted in a substantial reduction of the aggregate stock of NPLs in the banking sector. It has incentivised banks to manage and reduce their NPLs via market mechanisms and thus protected taxpayers from bearing the costs through adequate burden sharing and in-depth restructuring. Furthermore, as part of the requirements applicable under State aid rules, banks have been required to restructure their business in order to guarantee their long-term viability. Where viability could not be ensured, banks were put in liquidation or were taken over by viable banks. These actions have contributed to a more resilient and sound banking

[11] See Section 2 for an overview.
[12] In some cases as part of a financial assistance programme.

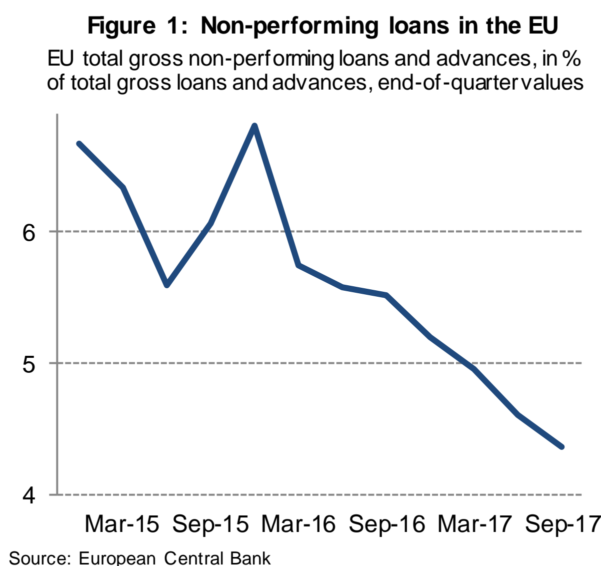
system. Similarly, going forward, failing banks will, in order to be eligible to benefit from State aid, either be restructured or liquidated, thereby strengthening the banking system.

The institutional arrangements for the supervision and resolution of EU banks, and notably in the euro area, have also been strengthened fundamentally with the establishment of the Banking Union and two of its three pillars, the Single Supervisory Mechanism and the Single Resolution Board.[13] Moreover, the European Semester recommendations, which are addressed to Member States concerned, have underlined the need to take determined action to address high NPL ratios. Furthermore, the Commission's Structural Reform Support Service gives technical assistance to Member States on NPL-related projects.[14] The ECB in its supervisory capacity, the Single Supervisory Mechanism, national competent authorities and the European Banking Authority (EBA) have also played an important role in enhancing the supervision and reporting of NPLs in Europe, while the ECB has played an integral role in safeguarding the financial stability in the EU. As a result of these combined efforts, there has been significant progress over recent years in reducing the volumes and ratios of NPLs in EU banks.

In particular, the latest figures, for the end of Q3 2017, confirm the downward trend of the NPL ratio in the EU. It declined to 4.4%, down by roughly 1 percentage point year-on-year (see Figure 1), and down by 0.2% or EUR 40 billion quarter-on-quarter. As a result, the ratio reached its lowest level since Q4 2014. This is the outcome of a decrease in the volume of NPLs, as well as a rise of the volume of loans in the EU. The provisioning ratio[15] remained stable, amounting to 50.7%. Despite these positive developments, decisive action must continue and be accelerated.

Figure 1: Non-performing loans in the EU

EU total gross non-performing loans and advances, in % of total gross loans and advances, end-of-quarter values



Source: European Central Bank

[13] The third pillar of Banking Union, the European Deposit Insurance Scheme (EDIS), was proposed by the Commission in November 2015. In October 2017 the Commission, in its Communication on Completing the Banking Union [COM(2017) 592], gave new impetus to the negotiations on the EDIS.

[14] (EU) 2017/825.

[15] Source: ECB. Due to the unavailability of provisioning data for loans, the provisioning ratio for the EU is based on impairments and NPLs for all debt instruments (loans and debt securities).

NPL ratios have been recently falling in nearly all Member States, although the situation among them[16] differs significantly (see Table 1). Yet, there is encouraging progress in Member States with still high NPL ratios, due to a combination of policy actions and economic growth.

Table 1: Non-performing loans and provisions by Member State [17]

	Gross NPLs and advances (% of total gross loans and advances)		**Private sector NPLs*** (% of private-sector loans)		**Total loss provisions (loans)**** (% of total doubtful and non-performing loans)	
	2017Q3	2016Q3	2017Q3	2016Q3	2017Q3	2016Q3
Belgium	2.7	3.4	3.9	4.4	50.1	48.9
Bulgaria	11.5	13.7	18.6	22.0	56.6	55.1
Czech Republic	2.6	4.3	5.0	6.3	54.2	50.9
Denmark	2.7	3.4	3.0	3.9	39.6	38.7
Germany	2.1	2.7	4.0	4.9	42.6	43.2
Estonia	2.0	1.9	2.7	2.6	42.9	51.3
Ireland	11.2	14.4	15.4	18.6	37.2	41.8
Greece	46.7	47.4	50.4	50.3	49.1	49.8
Spain	4.7	5.8	6.3	7.5	59.2	59.5
France	3.2	3.9	4.5	4.9	60.3	60.3
Croatia	10.8	11.3	15.8	16.7	69.0	74.6
Italy	12.1	16.1	15.7	19.9	53.6	50.0
Cyprus	32.1	36.8	51.3	55.5	47.3	39.5
Latvia	6.0	6.2	9.0	10.1	44.1	44.6
Lithuania	3.7	4.4	4.9	5.9	34.4	38.7
Luxembourg	0.7	1.0	1.7	2.3	52.4	39.2
Hungary	9.6	13.7	14.1	21.7	67.1	63.9
Malta	3.4	4.4	5.7	6.8	44.7	40.7
Netherlands	2.2	2.4	2.9	3.1	37.2	41.3
Austria	3.8	5.8	5.3	7.2	63.8	59.2
Poland	6.6	6.6	7.2	7.3	57.9	60.6
Portugal	14.6	17.7	14.6	17.7	50.2	47.3
Romania	8.1	10.2	10.3	13.5	70.1	62.9
Slovenia	10.8	14.4	13.9	18.8	70.9	71.7
Slovakia	4.1	4.9	4.6	5.4	70.4	64.5
Finland	1.2	1.4	2.1	2.1	31.8	34.0
Sweden	1.2	1.2	1.4	1.4	34.5	36.1
United Kingdom	1.6	2.1	1.6	2.1	41.2	38.5
European Union	**4.4**	**5.5**	**4.4**	**5.5**	**50.7**	**47.7**

Source: ECB, Consolidated Banking Data. Calculations by Commission services (DG FISMA).

[16] At the end of Q3 2017, several Member States had low NPL ratios (10 Member States had ratios below 3%). Others had high ratios (8 Member States had ratios above 10%).

[17] *Notes:* Figures correspond to domestic credit institutions and foreign-controlled subsidiaries and branches.

* Sector-specific data for Portugal and the EU are not available. Figures correspond to loans and advances to all sectors. Sector-specific data (i.e. total exposure to households and non-financial corporations) for Bulgaria, Germany, Spain and Hungary are only available in carrying amount.

** Data for the provisioning of loans are unavailable for Bulgaria, Germany, Spain, Hungary and the EU. In these cases, figures are based on impairments and NPLs for all debt instruments (i.e. loans and debt securities). Aggregate data for the EU were not available for Q2 and Q3 2016. The figure in the table for 2016 corresponds to Q1 2016.

Despite this significant progress, NPLs continue to pose risks to economic growth and financial stability. The total volume of NPLs across the EU is still at around EUR 910 billion, well above pre-crisis levels.[18] Structural impediments continue to hamper a faster fall in NPL stocks. Provisioning is often too slow and insufficient to allow for effectively resolving and preventing any critical accumulation of NPLs in the future. Activity on secondary markets for NPLs is not yet sufficient to substantially support NPL reduction efforts, despite the increased interest from certain investor groups and the increasing volume of NPL-related transactions. Moreover, debt restructuring, insolvency and debt recovery processes – in the absence of progress on proposals already put forward by the Commission – are still too slow and lack legal certainty in some cases.

3. A COMPREHENSIVE PACKAGE TO ADDRESS REMAINING AND FUTURE NPLS

Despite good progress, further legislative measures appear necessary to address the remaining issues linked to high levels of NPLs. In this context, a comprehensive approach is needed and should focus on a mix of complementary policy actions in four areas: (i) bank supervision and regulation, (ii) further reforms of national restructuring, insolvency and debt recovery frameworks, (iii) developing secondary markets for distressed assets, and (iv) fostering, as appropriate and necessary, restructuring of banks. Action in these four areas should be taken at national level and at EU level where necessary. The Commission is committed to deliver on those elements of the NPL Action Plan that are under its direct responsibility.

Today, the Commission adopts a comprehensive package addressing the four areas described above, thereby fostering financial stability in the EU (see Figure 2 on how the Commission's package of measures fits into the general Action Plan). The proposed action will enable banks and Member States to address NPLs in an even more determined way than before and avoid excessive build-up of NPLs in the future.

Banks will be required to put aside sufficient resources when new loans become non-performing, creating appropriate incentives to work out NPLs at an early stage and avoid too large accumulations of NPLs.

If loans, nevertheless, become non-performing, more efficient enforcement mechanisms for secured loans will allow banks to work out NPLs, subject to appropriate safeguards for debtors and with the exception of loans granted to consumers.

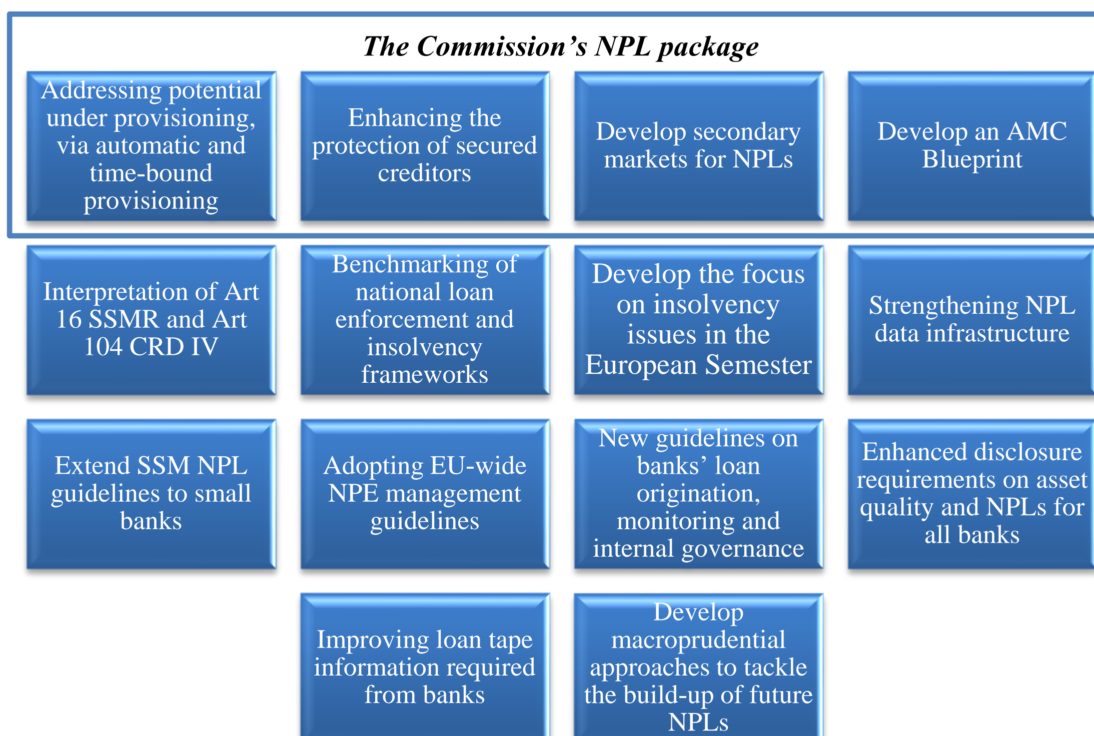
If despite the measures above, NPL stocks become too high – as is currently the case for some banks in certain Member States – banks will be able to sell NPLs to other operators on efficient, competitive and transparent secondary markets. Supervisory authorities will guide banks in these endeavours, based on their existing bank-specific – so-called Pillar 2 – powers under the Capital Requirement Regulation.[19]

Where NPLs have become a significant and broad-based problem, Member States that so wish may set up national AMCs or other measures under current State aid and bank resolution rules.

[18] Source: ECB.

[19] Regulation (EU) No 575/2013 (Capital Requirements Regulation)

Figure 2: Elements of the Council "Action Plan to Tackle Non-Performing Loans in Europe" [20]



4. Sufficient Loan Loss coverage by banks for future NPLs

A Regulation amending the Capital Requirements Regulation[21] will require banks to have sufficient loan loss coverage for newly originated loans if these become non-performing exposures. The amendment introduces a 'statutory prudential backstop' in order to prevent the risk of under-provisioning of future NPLs. Such a backstop amounts to minimum coverage levels of provisions and deductions from own funds that banks will be required to have for incurred and expected losses on newly originated loans that later turn non-performing. In case a bank does not meet the applicable minimum level, deductions from own funds would apply.

To ensure consistency in the prudential framework, the Commission also introduces a common definition of non-performing exposures (NPE), in line with the one already used for supervisory reporting purposes. The prudential backstop will reduce financial stability risks arising from high levels of insufficiently covered NPEs, by avoiding the build-up or increase of such NPEs with spillover potential in stressed market conditions. It will also ensure that institutions have sufficient loss coverage for NPEs, therefore protecting their profitability, capital and funding costs in stressed times. In turn, this would ensure that stable, less pro-cyclical financing is available to households and businesses.

[20] Note on abbreviations: AMC (Asset management company), SSMR (Single Supervisory Mechanism Regulation) CRD IV (Capital Requirements Directive IV).

[21] Regulation (EU) No 575/2013.

5. A DIRECTIVE ON CREDIT SERVICERS, CREDIT PURCHASERS AND THE RECOVERY OF COLLATERAL

The Directive enables banks to deal in a more efficient way with loans once these become non-performing by improving conditions to either enforce the collateral used to secure the credit or to sell the credit to third parties. Accelerated extrajudicial collateral enforcement as a swift mechanism for recovery of value would reduce the costs for resolving NPLs and would hence support banks in recovering value. In cases where banks face a large build-up of NPLs and lack the staff or expertise to properly service them, the Directive facilitates the outsourcing of the servicing of these loans to a specialised credit servicer or the sale of the credit agreements to a credit purchaser that has the necessary risk appetite and expertise to manage it.

The two avenues for banks to deal with NPLs facilitated by this Directive reinforce each other. Shorter time of resolution and increased recovery, as expected with accelerated extrajudicial collateral enforcement, increases the value of the NPLs as well as bid prices in possible NPL transactions. It is also easier to price a collateralised NPL than an unsecured one in secondary markets because the value of the collateral sets a minimum value of a NPL. Hence, credit purchasers will prefer NPLs with the accelerated extrajudicial collateral enforcement feature. This, in turn, would give additional incentives for credit institutions to use this feature at the origination of new loans. Moreover, the harmonisation achieved by accelerated extrajudicial collateral enforcement would foster the emergence of pan-European NPL investors, which would further improve market liquidity.

5.1. Further develop secondary markets for NPLs

The Directive will contribute to the development of secondary markets for NPLs by removing undue impediments to loan servicing by third parties and to the transfer of loans to loan purchasers, while fully respecting the existing Union civil law acquis and Member States' consumer protection rules.

Currently, banks are not always able to manage their NPLs in an effective or efficient manner. In such cases, banks will recover less from their portfolio than would otherwise be possible. This may occur, for example, when banks face a large volume of NPLs and are unable to properly service their NPLs. Banks may also find themselves with a portfolio of NPLs where the nature of the loans falls outside of the banks' core expertise to recover. In these instances, the best option may be to either outsource the servicing of these loans to a specialised loan servicer or sell the credit agreement.

For these reasons, the proposal creates a common set of rules that credit servicers need to abide by to operate cross-border within the Union. The proposal sets common standards to ensure proper conduct by and supervision of loan purchasers and credit servicers across the Union, while allowing more competition by harmonising market access rules across Member States. This will lower the cost of entry for potential loan purchasers by increasing the accessibility of credit servicing and by reducing the costs of credit servicing. A higher number of purchasers on the market means a more competitive market, leading to higher demand and transaction prices.

In order to have a sound secondary market for NPLs and a solid framework for credit servicers, clear rules are proposed to protect consumers' rights and interests. The proposal

includes legal safeguards and transparency rules, making sure that the level of consumer protection is not impacted by the transfer of the debt. Particular attention is paid to the most vulnerable and over-indebted consumers. For example, credit servicers should have appropriate policies in place for dealing with borrowers and, where needed, should refer the consumer to debt-advice or social services.

To prevent possible new NPLs in the context of consumer loans, Member States are also invited to put in place rules for the assessment of consumer affordability. The preparatory work on creditworthiness assessment envisaged in the Consumer Financial Services Action Plan [22] is ongoing, and the Commission will continue the work with Member States to define best practices and guiding principles for credit institutions when assessing the creditworthiness of consumers.

5.2. More efficient value recovery from secured loans

The Directive will also provide secured creditors with a more efficient method of value recovery from secured loans through an accelerated extrajudicial collateral enforcement. This refers to an expedited and efficient out-of-court enforcement mechanism that enables secured lenders to recover value from collateral granted solely by companies and entrepreneurs to secure loans. Such mechanisms already exist in 25 Member States (yet in half of these, the scope of such mechanisms is limited to either movable or immovable assets).

The proposal will help banks to improve their current workout processes, and manage NPLs by increasing the efficiency of debt recovery procedures through an accelerated extrajudicial collateral enforcement. In the majority of cases, banks address their NPLs themselves by recovering value through workout. A large share of loans that become NPLs are loans secured by collateral. While banks are able to enforce collateral under national insolvency and debt recovery frameworks, the process can often be slow and lack legal certainty. In the meantime, NPLs remain on banks' balance sheets, keeping the bank exposed to prolonged uncertainty and tying up its resources. This prevents the bank from focusing on new lending to viable customers. Therefore, the proposal includes an efficient method for banks and other undertakings authorised to grant loans, in order to allow them to recover their funds from secured loans to business borrowers, in an out-of-court procedure. This efficient extrajudicial procedure would be accessible when agreed upon in advance by both lender and borrower, in the loan agreement. It will not be available for consumer credits, and is designed to not affect early restructuring or insolvency proceedings. It will not impact the insolvency laws of the Member States on issues such as the hierarchy of creditors in insolvency.

Restructuring and insolvency proceedings prevail over the accelerated extrajudicial collateral enforcement procedure set out in this proposal. In order to ensure full consistency and complementarity with the Restructuring Proposal, the following principle will apply: the extrajudicial enforcement of collateral would be possible only as long as a stay of individual enforcement actions, in accordance with applicable national laws, is not applicable. The Restructuring Proposal already foresees that creditors, including secured creditors of a company or an entrepreneur that is undergoing restructuring proceedings, are

[22] COM(2017) 139.

subject to a stay of individual enforcement actions. In this case, the debtor in difficulty can negotiate a restructuring plan with creditors and avoid insolvency.

6. A TECHNICAL BLUEPRINT FOR HOW NATIONAL ASSET MANAGEMENT COMPANIES (AMCS) CAN BE SET UP

As part of the package, Member States are also provided with non-binding guidance on how they can set up, if they so wish, national AMCs in full compliance with EU banking and State aid rules. The AMC Blueprint provides practical guidance for the design and set-up of AMCs at the national level, building upon best practices from past experiences in Member States, to the extent applicable. AMCs can be private or (partly) publicly supported with no need for State aid, if the State can be considered to act as any other economic agent. The option of an AMC involving State aid should not be seen as the default solution. That said, considering AMCs with a State aid element as an exceptional solution, the Blueprint aims to clarify the permissible design for such AMCs, fully consistent with the EU legal framework, particularly the BRRD, the SRMR and State aid rules.

The Blueprint suggests a number of common principles, such as the relevant asset perimeter, the participation perimeter, considerations on the asset-size threshold, asset valuation rules, the appropriate capital structure, and the governance and operations of the AMC. In addition, the Blueprint describes certain alternative impaired asset relief measures that do not constitute State aid, such as market-conform State guarantees enabling the securitisation of NPLs. The Commission has in the past years also assessed other measures proposed by Member States to deal with legacy NPLs and will continue to do so in individual cases, in order to ensure that these measures fully respect the BRRD, SRMR and State aid rules.

7. A STRONG PACKAGE WITH MUTUALLY REINFORCING MEASURES

The proposals in this package mutually reinforce each other and would not be as effective if implemented in isolation. The statutory prudential backstop will ensure that credit losses on future NPLs are sufficiently covered, making their resolution or sale easier. These effects are complemented by the push to further develop secondary markets for NPLs as these would make demand for NPLs more competitive and raise their market value. Furthermore, accelerated extrajudicial collateral enforcement as a swift mechanism for recovery of collateral value reduces the costs for resolving NPLs.

The package covers a major part of the Council Action Plan. In combining several elements, the package as a whole creates the appropriate environment for dealing with NPLs on banks' balance sheets, and to reduce the risk of future NPL accumulation. Their impact is expected to be different across Member States and institutions concerned. Some will have a stronger impact on banks' *ex-ante* risk assessment at loan origination, some will foster swift recognition and better management of NPLs, and others will enhance the market value of such NPLs.

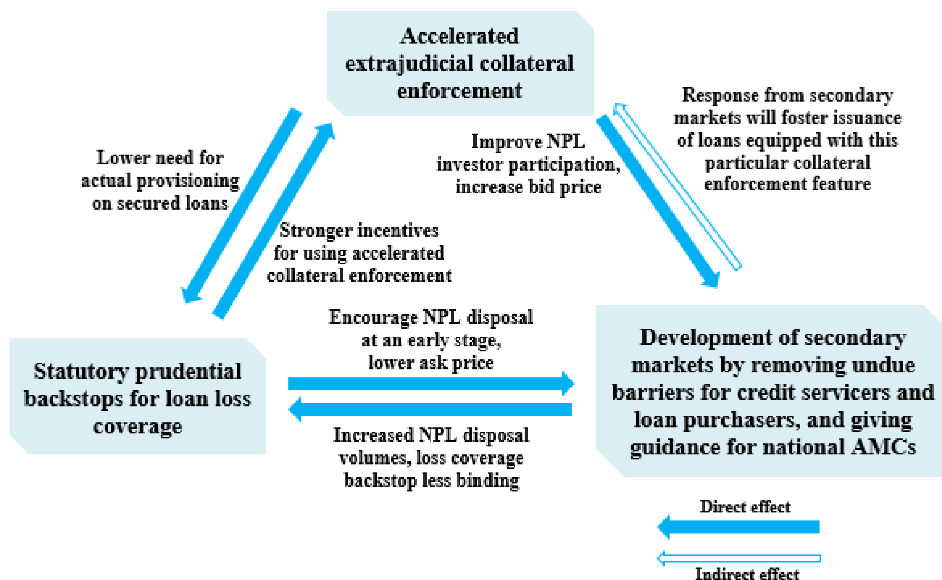
In particular:

- The proposal on prudential backstops will ensure that credit losses on future NPLs are sufficiently provisioned for, making their resolution and/or disposal easier. These effects would be complemented by more developed secondary markets for NPLs as

these would strengthen demand for NPLs and raise their market value. This will allow banks to sell NPLs more easily in light of more stringent provisioning rules.

- AMCs have historically proven to be a useful tool under the right pre-conditions and they remain a useful part of the toolkit, even if the relevant EU legal framework has evolved in recent years. However, the usefulness of AMCs is diminished if secondary markets for NPLs are undeveloped, as one important tool of an AMC is the sale of its loans to third-party investors. The AMC and many other potential credit purchasers are highly dependent on the availability of independent companies to service and manage the loans on their behalf. Therefore, AMCs will be more effective if supported by the legal proposals that the Commission puts forward in this package. Conversely, without improvement in the functioning of secondary markets for NPLs, an AMC may experience more difficulties in fulfilling its purpose.
- Furthermore, accelerated extrajudicial collateral enforcement as a swift mechanism for recovery of collateral value would reduce the costs for resolving NPLs and would therefore support banks and purchasers of NPLs in recovering value. Such a mechanism available outside the context of preventive restructuring or insolvency proceedings would complement the proposal for a Directive on restructuring, second chance, and the efficiency of insolvency frameworks of November 2016.

Figure 3: NPL Package: Reinforcing effects between actions



Furthermore, the Commission is exploring, together with the ECB and the EBA, how to foster further transparency of NPLs and markets for NPLs. To achieve this, the availability and comparability of data on NPLs will need to be enhanced. One idea being explored in this context is to support the development of NPL information platforms or credit registers by market participants. The exploratory work is close to being finalised and a dedicated technical note will present the joint work by the Commission, ECB and EBA. [23]

[23] The management of NPLs would benefit from more efficient and predictable loan enforcement and insolvency frameworks. The Commission is therefore undertaking a benchmarking exercise of such regimes in order to establish a reliable picture of the delays and value recovery that banks experience when faced with borrowers'

Finally, the initiatives put forward by the Commission today are also highly complementary to the other elements of the Council Action Plan, including the proposed measures to be taken by Member States, supervisory authorities and other EU institutions. More specifically, the following measures will complement those proposed by the Commission today:

- general guidelines on NPL management to all EU banks;
- detailed guidelines on banks' loan origination, monitoring and internal governance, addressing in particular transparency and borrower affordability assessment;
- macro-prudential approaches to prevent the emergence of system-wide NPL problems, taking into account potential pro-cyclicality and implications on financial stability of NPL policy measures; and
- disclosure requirements with regard to banks' asset quality and NPLs.

The actions by the Commission, the ECB, the EBA and the European Systemic Risk Board will create important synergies. The proposed statutory minimum coverage requirements would provide strong incentives for banks' management to prevent the accumulation of future NPLs through better NPL management and stronger loan origination practices. This will reinforce the expected effects of the ongoing work by the ECB and the EBA on banks' loan origination, NPL management, monitoring and internal governance practices. Work on NPL information and market infrastructure would further enhance the functioning of secondary markets for NPLs.

8. CONCLUSIONS

In line with the overall significant progress on risk reduction in the EU banking sector, the stock of NPLs continues to decline. Despite this positive trend, high NPLs remain a challenge for several Member States and for the EU as a whole.

Accelerating the current trends of NPL reduction and preventing new NPLs from building up is an important step towards completing the Banking Union. While the ECB's supervision of large and systemic banks (Single Supervisory Mechanism) and the Single Resolution Board are now operational, the Banking Union remains incomplete. The key building blocks of the post-crisis prudential and resolution frameworks are in place or nearing completion, and risks in the euro area banking sector are being reduced significantly. This means that the time has come to put in place the two missing elements of the Banking Union: a common fiscal backstop to the Single Resolution Fund and the European Deposit Insurance System. Within an incomplete Banking Union, the banking sector will remain fragmented along national lines and will consequently not provide the economic benefits and increased stability of a more integrated sector.

The comprehensive package launched today is a major step in addressing this challenge. It is necessary to maintain this pace of progress in implementing all envisaged measures in the

defaults. It invites close cooperation from Member States and supervisors to develop a sound benchmarking methodology. In this context, the Commission proposal for a Directive on business insolvency, restructuring and second chance lays down obligations on Member States to collect comparable data on insolvency and restructuring proceedings and communicate it to the Commission. This is crucial to demonstrate the efficiency of the regulatory framework in Member States as regards insolvent debtors.

coming months and years, if the challenge of high NPLs is to be addressed both in terms of reducing existing stocks to sustainable levels and preventing future accumulation.

While individual banks and Member States concerned need to maintain their efforts at a sustained pace, concerted action by the Commission and other EU institutions, including the ECB, must also continue. The package of legislative and non-legislative measures presented today, alongside this Communication, constitutes a critical part of this work. The Commission therefore calls on the European Parliament and the Council to progress swiftly on this important matter, in order to support the ongoing joint efforts to reduce risk in the European banking sector. At the same time, the pending legislative measures on risk reduction – the November 2016 Banking Package[24] – and business restructuring and insolvency law must be given utmost political priority and agreed upon as rapidly as possible. The Commission stands ready to engage with the co-legislators to this effect.

[24] http://europa.eu/rapid/press-release_IP-16-3731_en.htm.