EUROPEAN
COMMISSION

Brussels, 18.1.2018
COM(2018) 37 final

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

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

{SWD(2018) 33 final}

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

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

1. ADDRESSING NON-PERFORMING LOANS AS PART OF RISK REDUCTION IN THE FINANCIAL SECTOR

Following the financial crisis, the regulatory framework for banks has changed substantially. The European Union has taken the lead in implementing reforms agreed globally at the level of the G20 and in the Basel Committee with the objective of reinforcing financial stability, reducing risk in the banking sector, and avoiding that taxpayers have to contribute financially to the costs of failing banks.

In addition to significantly more stringent capital and liquidity requirements for banks, as well as the obligation for all banks to hold sufficient amounts of "bail-inable" capital for the purpose of resolution, the institutional arrangements for the supervision and resolution of banks in the Union, and notably in the euro area, have been strengthened fundamentally with the establishment of Banking Union and two of its three pillars, the Single Supervisory Mechanism and the Single Resolution Board.[1] As a result of these measures, the EU banking sector is in a much better shape than in previous years. Since 2014, banks in the euro area have increased their capital by EUR 234 billion and added EUR 813 billion of liquid assets. Euro area banks have over recent years reduced their holdings of government debt with a decrease by 17% between 2015 and 2017 and thereby also reducing their financial connection with their sovereigns. In November 2016, the Commission proposed further risk-reducing measures, including changes to the Capital Requirements Directive and Regulation [2] and a proposal dealing with business insolvency, restructuring and second chance.[3] The Commission is also pursuing work on Capital Markets Union (CMU) as one of its highest priorities.

High stocks of Non-Performing Loans (NPLs), in certain banks and Member States, are being reduced. The average ratio of NPLs has decreased by one third since 2014 and is on a steady downward trend. High stocks of NPLs can weigh on a bank's short- and longer-term

[1] The third pillar of Banking Union, the European Deposit Insurance Scheme, 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 European Deposit Insurance Scheme (EDIS).

[2] The Commission proposals will require banks to build up buffers of liabilities that can, if necessary, be bailed in, by implementing the Total Loss Absorbing Capacity standard of the Financial Stability Board and integrate it into the existing rules on the Minimum Requirement for own funds and eligible liabilities; and by providing for harmonised rules on where debt instruments eligible to meet the Total Loss Absorbing Capacity / Minimum Requirement for own funds and Eligible Liabilities buffers stand in the bank creditor hierarchy. The Commission proposals also provide for harmonised rules concerning the application of moratorium tools applied by supervisors and resolution authorities to stabilise banks, which are equally important based on recent experience.. Finally, the Banking Package proposes to implement a number of international standards, including the introduction of a leverage ratio and a Net Stable Funding Ratio (NSFR),

[3] COM/2016/0723 final - 2016/0359 (COD)

performance through two main channels. First, NPLs require higher levels of provisioning. Loan provisions reduce bank profitability and reduce the bank's regulatory capital. In the most severe cases, the necessary accounting for NPLs can put in question the viability of a bank with potential implications for financial stability. Second, 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 which rely on bank lending to a much greater extent than larger companies, thereby affecting economic growth and job creation. For these reasons, the Commission has for a long time highlighted the urgency of taking the necessary measures to address the risks related to NPLs.

Addressing high stocks of NPLs and their possible future accumulation is essential to complete Banking Union, and well developed secondary markets of NPLs are one of the building blocks for a well-functioning Capital Markets Union. Such elements form a key priority under the EU's agenda to deepen the Economic and Monetary Union, as set out in the Commission's Reflection Paper of May 2017[4] Moreover, an integrated financial system will enhance the resilience of the Economic and Monetary Union to adverse shocks by facilitating private risk-sharing across borders, while at the same time reducing the need for public risk-sharing. The Commission's EMU package of 6 December 2017 presented a roadmap and concrete proposals for the deepening of Europe's Economic and Monetary Union, which is part of a More United, Stronger and More Democratic Union.[5]

The primary responsibility for tackling high NPL ratios remains with the affected banks and Member States. The Commission has consistently mentioned this matter, for the countries concerned, in the context of the European Semester. However, there is also a clear EU dimension to reducing current NPL ratios, as well as preventing any build-up of NPLs in the future, given the interconnectedness of the banking system of the EU and particularly of the euro area. In particular, there are important 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 high level of agreement on the need to continue and extend the actions already initiated by the Commission, the Council adopted in July 2017 an "Action Plan To Tackle Non-Performing Loans in Europe". This Action Plan calls upon various institutions – including the Commission – to take appropriate measures to further address the challenges of high NPL ratios in Europe. Furthermore, the Council agreed in its Conclusions to revert to this issue regularly and initially after six months, in order to take stock of the evolution of NPLs in the Union on the basis of a stock-take from the Commission. This Communication, together with the accompanying Staff Working Document, is the first progress report on the implementation of the Action Plan. The Staff Working Document includes contributions from other EU stakeholders, who were also invited by the Council, along with the Commission, to take action to support and accelerate the resolution of NPLs in the Union.

[4] COM(2017) 291

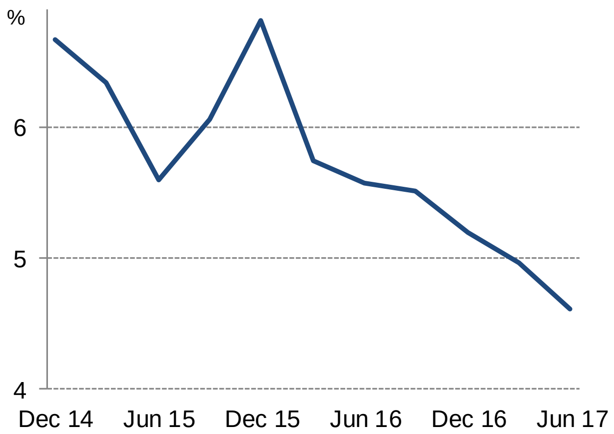
[5] COM (2017) 821

2. RECENT EVOLUTION OF NON-PERFORMING LOANS

As mentioned above, the general improvement in NPL ratios over recent years continued in 2017. The quality of banks' loans portfolios continued to improve. The latest figures confirm the downward trend of the NPL ratio, which declined to 4.6% (Q2 2017), down by roughly 1 percentage point year-on-year (cf. Figure 1). As a result, the ratio reached its lowest level since Q4 2014. The provisioning ratio [6] has also risen, amounting to 50.8% (Q2 2017).

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

NPL ratios have been recently falling in nearly all Member States, although the situation differs significantly across Member States. Several still have high NPL ratios (9 Member States had ratios above 10% at the end of the second quarter of 2017) and others have very low ratios (10 Member States have ratios below 3%). The accompanying Staff Working Document reports in detail on the evolution of NPLs and on policy measures in a selection of countries with high NPL ratios.

There is evidence of encouraging progress in reducing NPL ratios in these Member States, due to a combination of policy actions and economic growth. However, NPLs continue to pose risks to economic growth and financial stability. The total volume of NPLs across the EU is still at the level of EUR 950 billion, clearly above pre-crisis levels.[7] Structural impediments continue to hamper a faster fall in NPL stocks. Among other elements, activity on secondary markets for Non-Performing Loans is not yet sufficient to substantially contribute to NPL reduction efforts, notwithstanding the increased interest from certain investor groups and the increasing volume of NPL-related transactions. Moreover, debt restructuring, insolvency and debt recovery processes are still too slow and unpredictable in some cases.

[6] Source: ECB. Due to the unavailability of provisioning data for loans, the provisioning ratio for the EU was calculated by considering impairments and Non-Performing Loans for all debt instruments (loans and debt securities).

[7] Source: ECB.

3. TOWARDS A COMPREHENSIVE PACKAGE OF MEASURES TO ADDRESS NON-PERFORMING LOANS

The Commission has devoted significant attention to addressing the issue of NPLs since the outset of the financial crisis in 2008/9. For banks, whose viability was threatened by high NPL ratios, the Commission has assisted Member States in setting up ad-hoc and system-wide measures with the objective of reducing NPL stocks (sometimes as part of a financial assistance programme) through solutions compatible with State aid rules such as specific impaired assets measures for banks, winding down vehicles and/or market compatible structures, which entailed a substantial reduction of the stock of Non-Performing Loans present in the banking sector. In this way, it has incentivised banks to manage and reduce their NPLs via market mechanisms and thus protected tax payers from bearing the costs via adequate burden sharing and in-depth restructuring. The need to take determined action to address high NPL ratios has also been underlined in the European Semester recommendations to relevant Member States. The European Central Bank in its supervisory capacity (the Single Supervisory Mechanism), national competent authorities and the European Banking Authority have also played an important role in enhancing the supervision and reporting of NPLs in Europe, while the European Central Bank has had an integral part in safeguarding financial stability in the Union.

Moving forward, this comprehensive approach to addressing high NPL ratios must be maintained and, as set out in the Council Action Plan, it should focus on a mix of complementary policy actions in four areas: (i) supervisory actions, (ii) reform of restructuring, insolvency and debt recovery frameworks, (iii) development of secondary markets for distressed assets, and (iv) fostering restructuring of the banking system. Action in these areas should be at national level and at Union level where appropriate.

For its part, the Commission is committed to delivering on those elements of the NPL Action Plan for which it has direct responsibility. The Commission announced, in its Communication on Completing the Banking Union in October 2017, a comprehensive package for tackling high NPL ratios by spring 2018.[8] Significant progress has already been made and delivery of the package of measures – including 3 legislative proposals[9] – is on track for spring 2018.

The package will consist of the following measures:

- A Blueprint for how national Asset Management Companies (AMCs) can be set up in compliance with existing EU banking and State aid rules by building on best practices learned from past experiences in Member States. In addition to developing the blueprint for national AMCs, the Commission intends where relevant to continue analysing other proposed impaired asset relief measures which are alternatives to centralised AMCs, in full respect of the BRRD, SRMR and State Aid rules.

- Measures to further develop secondary markets for Non-Performing Loans, especially with the aim of removing undue impediments to loan servicing by third parties and the transfer of loans.

[8] COM (2017) 592

[9] The Commission has held stakeholder consultations pertaining to the three potential legislative initiatives.

- Measures to enhance the protection of secured creditors by allowing them more efficient methods of value recovery from secured loans through Accelerated Extrajudicial Collateral Enforcement (AECE). This refers to an expedited and efficient out-of-court enforcement mechanism which enables secured lenders to recover value from collateral granted solely by companies and entrepreneurs to secure loans.[10]

- Introduce statutory prudential backstops to prevent the risk of under-provisioning of NPLs. Such backstops, on newly originated loans that later turn non-performing, would amount to minimum levels of provisions and deductions from own funds that banks would be required to make to cover incurred and expected losses. In this context, the Commission will also consider introducing a common definition of non-performing exposures (NPE), in accordance with the one already used for supervisory reporting purposes.

- A way forward to foster the transparency on NPLs in Europe by improving the data availability and comparability as regards NPLs, and potentially supporting the development by market participants of NPL information platforms or credit registers.[11]

In addition to this package, and as mentioned above, the Commission presented in November 2016, in the context of the Capital Markets Union work, a proposal for a Directive on restructuring, second chance and efficiency of insolvency[12]. The key features of this proposal, in particular the availability of restructuring procedures enabling viable companies in financial difficulties to avoid insolvency as well as measures to enhance the effectiveness of restructuring and insolvency proceedings, would contribute to reducing NPLs as well as preventing their accumulation in the future. The Commission calls on the European Parliament and the Council to progress swiftly on this important proposal, following the detailed examination by the Justice and Home Affairs Council and the recent exchange of views in the Ecofin Council. The Commission also clarified in the Single Supervisory Mechanism Review Report, accompanying the Communication from October 2017, the interpretation of the relevant Articles of the Capital Requirement Directive (CRD) and the Single Supervisory Mechanism Regulation. The Commission confirmed that the supervisory powers enshrined therein allow the competent authorities to influence a bank's provisioning policy with regard to NPLs within the limits of the applicable accounting framework and to apply specific adjustments where necessary for prudential purposes.[13]

[10] Work in this area will be determined by the Impact Assessment and remain consistent with and complementary to the Commission proposal of November 2016 for a Directive on restructuring, second chance and efficiency of insolvency frameworks and would not require harmonisation of actual insolvency provisions.

[11] In addition, since the management of Non-Performing Loans would benefit from more efficient and more predictable loan enforcement and insolvency frameworks, the Commission is also undertaking a benchmarking exercise of loan enforcement regimes to establish a reliable picture of the delays and value-recovery banks experience when faced with borrowers' defaults, and invites close cooperation from Member States and supervisors to develop a sound and significant 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 which would be crucial in order to demonstrate the efficiency of the regulatory framework in Member States as regards insolvent debtors.

[12] COM/2016/0723 final - 2016/0359 (COD)

[13] COM (2017) 591

The Staff Working Document accompanying this Communication offers a detailed overview by Commission services' of the progress made in the overall implementation of the overall Council Action Plan. This includes measures under the responsibility of the Commission and measures under the responsibility of other institutions and agencies.

Overall, the progress made so far on all fronts is encouraging. These efforts should be maintained by all actors, with the purpose of completing all the measures envisaged in the Action Plan, so as to attain a sustainable solution for NPLs throughout the Union.

4. CONCLUSIONS

In line with the overall significant progress on risk reduction in the EU banking sector, the ratio of NPLs continues to decline in the Union. Despite this positive trend, high NPL ratios remain an important challenge for several Member States and for the Union as a whole. The Action Plan, agreed by the Council in July 2017, was a major step in addressing this challenge. This first assessment shows important progress is being made in the implementation of the Action Plan.

It is necessary to maintain this pace of progress in implementing the Action Plan in the 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 any future accumulation. While work needs to continue at a sustained pace at the level of individual banks and Member States concerned, continued concerted action by the Commission and other EU institutions, including the European Central Bank, is required at EU level. The Commission will present a dedicated package of measures in spring 2018 including a number of legislative proposals to facilitate the management of NPLs by banks and avoid the accumulation of new NPLs in the future.

The Commission will continue to follow this matter closely and will report again in March 2018 at the latest.