



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 12 July 2018

on a proposal for a regulation on minimum loss coverage for non-performing exposures
(CON/2018/32)

Introduction and legal basis

On 20 and 24 April 2018 the European Central Bank (ECB) received requests from the European Parliament and the Council of the European Union, respectively, for an opinion on a proposal for a regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures¹ (hereinafter the 'proposed regulation').

The ECB's competence to deliver an opinion is based on the first indent of Article 127(4) and Article 282(5) of the Treaty on the Functioning of the European Union since the proposed regulation contains provisions falling within the ECB's fields of competence, including the tasks of the European System of Central Banks to contribute to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system, as referred to in Article 127(5) of the Treaty and the tasks conferred upon the ECB pursuant to Article 127(6) of the Treaty concerning policies relating to the prudential supervision of credit institutions. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. General observations

The ECB supports the proposed regulation, which is part of the European Commission's package of measures to deal with non-performing exposures (NPEs) in the Union. These measures came about following the adoption of the comprehensive 'Action Plan To Tackle Non-Performing Loans in Europe'², endorsed by the Council on 11 July 2017. The proposed regulation is expected to address the possible risks arising from the build-up of insufficiently provisioned NPEs in the future. The proposed regulation is also an important part of the Union's efforts to further reduce risks in the banking system. For a number of reasons, addressing high levels of NPEs has been one of the ECB's supervisory priorities from the inception of the Single Supervisory Mechanism³. First, NPEs weigh on the balance sheets of banks, curbing their profits. Second, NPEs are distracting for banks, and represent a drain on banks' resources. Third, NPEs undermine investors' confidence in banks. In addition, internal ECB analysis shows that, over recent years, banks with high stocks of NPEs have consistently lent less than banks with better

1 COM(2018) 134 final.

2 Available on the Council's website at www.consilium.europa.eu.

3 See the speech by Danièle Nouy, Chair of the Supervisory Board of the ECB, and Sharon Donnery, Chair of the ECB's High Level Group on non-performing loans, 'Introductory remarks to the public hearing on the draft addendum to the ECB guidance to banks on non-performing loans', Frankfurt am Main, 30 November 2017, available on the ECB's Banking Supervision website at www.bankingsupervision.europa.eu.

credit quality, therefore providing less support to firms and households and the economy generally⁴. Further, high stocks of NPEs are a macroprudential issue and often affect entire economies.

It is noted that the proposed regulation will not affect NPEs originated by credit institutions before 14 March 2018 and therefore, consistent with the European Council conclusions on the Action plan to tackle NPLs in Europe, it does not address existing stocks of NPEs.

The ECB welcomes the clarification in the proposed regulation that the prudential backstop for NPEs, which is established by the proposed regulation, does not prevent competent authorities from exercising their supervisory powers in accordance with applicable law. More specifically, despite the application of this prudential backstop, the ECB may, on a case-by-case basis, determine that the NPEs of a specific credit institution are not sufficiently covered and use its supervisory powers under the Pillar 2 framework⁵.

2. Specific observations

2.1 *Definition of an NPE*

For the purposes of the minimum loss coverage, the proposed regulation introduces the definition of an NPE into Regulation (EU) No 575/2013 of the European Parliament and of the Council⁶. This definition is based on the concept of an NPE set out in Commission Implementing Regulation (EU) No 680/2014⁷, which is applied for supervisory reporting purposes. In this respect, the ECB welcomes the fact that this definition of an NPE includes all types of NPEs, in particular retail exposures.

2.2 *Calculation of the minimum coverage requirement*

The ECB welcomes the simplicity of the minimum coverage requirement which, in principle, is based on the number of years that have passed since an exposure was classified as non-performing and whether it was a secured exposure. Such simplicity will keep the compliance efforts for banks and supervisors manageable, while still firmly addressing the issue of uncovered NPEs in a fair and balanced manner.

In order to determine the applicable amount of insufficient coverage for NPEs to be deducted from Common Equity Tier 1 items, institutions are required to multiply their NPEs by the applicable factor specified in the proposed regulation. The ECB supports the calibration of the applicable

⁴ See 'European banking supervision three years on,' Welcome remarks by Mario Draghi, President of the ECB, at the second ECB Forum on Banking Supervision, Frankfurt am Main, 7 November 2017, available on the ECB's website at www.ecb.europa.eu.

⁵ Article 9(1) of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63) states that: 'For the exclusive purpose of carrying out the tasks conferred on it by Articles 4(1), 4(2) and 5(2), the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by the relevant Union law.' In this context, see Articles 97 and 104 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338) and Article 16 of Regulation (EU) No 1024/2013.

⁶ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

⁷ Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council (OJ L 191, 28.6.2014, p. 1).

factors under the proposed regulation. In particular, there is 100% percent coverage for an unsecured NPE to be applied from the first day of the second (presumably intended to refer to the third) year. For a secured NPE, there is 100% coverage from the first day of the eighth (presumably intended to refer to the ninth) year following a non-performing classification, where the obligor is past due more than 90 days.

Regarding secured exposures, credit institutions should be able to realise their credit protection in a 'timely manner'⁸. If collateral has not been realised after a period of several years from the date when the underlying exposure was classified as non-performing, it is reasonable to consider the collateral ineffective and treat the exposure as unsecured from a prudential perspective.

2.3 *Supervisory reporting requirements*

The ECB understands that the relevant supervisory reporting requirements specified under Implementing Regulation (EU) No 680/2014 will be amended to the effect that competent authorities will be able to monitor institutions' compliance with the proposed regulation. Furthermore, the ECB invites the Commission to consider whether a disclosure requirement with regard to institutions' compliance with the minimum coverage requirement should be introduced in Regulation (EU) No 575/2013.

2.4 *Consultation of the ECB*

The ECB would like to remind the Parliament and the Council that another consultation will be necessary if the proposed regulation is substantially amended during the legislative procedure, as compared to the version on which the ECB was consulted⁹.

Where the ECB recommends that the proposed regulation is amended, specific drafting proposals are set out in a separate technical working document accompanied by an explanatory text to this effect. The technical working document is available in English on the ECB's website.

Done at Frankfurt am Main, 12 July 2018.

[signed]

The President of the ECB

Mario DRAGHI

⁸ See, for example, Article 194(4) of Regulation (EU) No 575/2013.

⁹ See, e.g. Judgment of the Court of Justice of 15 July 1970, *ACF Chemiefarma v Commission*, C-41/69, ECLI:EU:C:1970:71, paragraph 3; Judgment of the Court of Justice of 4 February 1982, *Buyl v. Commission*, C-817/79, ECLI:EU:C:1982:36, paragraph 1; Opinion of Advocate General Fennelly of 20 March 1997, *Parliament v Council*, C-392/95, ECLI:EU:C:1997:172, paragraph 15; Judgment of the Court of Justice of 11 November 1997, *Eurotunnel SA and Others v Seafrance*, C-408/95, ECLI:EU:C:1997:532, paragraph 46; Judgment of the Court of Justice of 25 September 2003, *Océ van der Grinten*, C-58/01, ECLI:EU:C:2003:495, paragraphs 100 and 102.



Technical working document
produced in connection with ECB Opinion (CON/2018/32)
on a proposal for a regulation of the European Parliament and of the Council on amending
Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures
Drafting proposals

Text proposed by the Commission	Amendments proposed by the ECB ¹
<p>Amendment 1</p> <p>Article 1(2) of the proposed regulation</p> <p>(Article 47c(2) of Regulation (EU) No 575/2013)</p>	
<p>‘(c) 1 for the unsecured part of a non-performing exposure to be applied as of the first day of the second year following its classification as non-performing, where the obligor is past due more than 90 days;</p> <p>(d) 0.8 for the unsecured part of a non-performing exposure to be applied as of the first day of the second year following its classification as non-performing, where the obligor is not past due more than 90 days;’</p>	<p>‘(c) 1 for the unsecured part of a non-performing exposure to be applied as of the first day of the second third year following its classification as non-performing, where the obligor is past due more than 90 days;</p> <p>(d) 0.8 for the unsecured part of a non-performing exposure to be applied as of the first day of the second third year following its classification as non-performing, where the obligor is not past due more than 90 days;’</p>
<p><u>Explanation</u></p> <p><i>The proposed amendments aim to ensure that the applicable factors would be applied by institutions after two years have passed since an exposure has been classified as non-performing.</i></p>	

¹ Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text.

Text proposed by the Commission	Amendments proposed by the ECB ¹
<p>Amendment 2</p> <p>Article 1(2) of the proposed regulation</p> <p>(Article 47c(3) of Regulation (EU) No 575/2013)</p>	
<p>'(o) 1 for the secured part of a non-performing exposure to be applied as of the first day of the eighth year following its classification as non-performing, where the obligor is past due more than 90 days;</p> <p>(p) 0.8 for the secured part of a non-performing exposure to be applied as of the first day of the eighth year following its classification as non-performing, where the obligor is not past due more than 90 days.'</p>	<p>'(o) 1 for the secured part of a non-performing exposure to be applied as of the first day of the eighth ninth year following its classification as non-performing, where the obligor is past due more than 90 days;</p> <p>(p) 0.8 for the secured part of a non-performing exposure to be applied as of the first day of the eighth ninth year following its classification as non-performing, where the obligor is not past due more than 90 days.'</p>
<p><u>Explanation</u></p> <p><i>The proposed amendments aim to ensure that the applicable factors would be applied by institutions after eight years have passed since an exposure has been classified as non-performing.</i></p>	