EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Danièle NOUY
Chair of the Supervisory Board

Mr Antonio Tajani
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 13 October 2017

Re: Your letter of 9 October 2017

Honourable President of the European Parliament, dear Mr Tajani,

The President of the European Central Bank (ECB) forwarded to me your letter regarding the draft addendum to the ECB Guidance to banks on non-performing loans, which we published for public consultation on 4 October 2017[1] (hereinafter, "the draft addendum"). As the comments you raise relate to the ECB's supervisory tasks, I believe it would be helpful to provide you with some background on the process as well as on the rationale of the ECB for putting forward the draft addendum.

The SSM, as the first pillar of Banking Union, has been tasked to ensure the safety and soundness of the European banking system. It is thus our obligation to address key vulnerabilities in the banking sector and to guarantee the consistent application of regulations and supervisory policies by taking harmonised supervisory actions.

Given that a high level of non-performing loans (NPLs) in the banking system poses a risk to the soundness of many banks under our supervision, addressing this vulnerability has always been a key priority of the SSM. The high-level of NPLs is essentially a legacy of the financial crisis with around €865 billion NPLs still weighing on the balance sheets of significant institutions[2]. In order to address this vulnerability, a dedicated High Level Group has been established within the SSM consisting of representatives of national competent authorities and the ECB with the European Banking Authority (EBA) as an observer. The group has been tasked to establish a consistent and effective supervisory approach to addressing this problem, with the purpose of reducing the level of NPLs, building on European and international best practices.

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1 https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/npl2/ssm.npl_addendum_draft_201710.en.pdf

2 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorybankingstatistics_first_quarter_2017_201707.en.pdf

As a first step, after a successful public consultation process, in March 2017 we published the ECB's NPL Guidance setting out the ECB's expectations as to how banks should manage their NPLs. In June 2017, we published an extensive stocktake of national practices related to NPLs across 19 Member States participating in the banking union, which clearly identified the need for further joint actions by all relevant stakeholders to address existing and future NPL issues. In parallel to the work of the High Level Group, the Financial Services Committee (FSC) established a work stream – in which the ECB also participated – laying the groundwork for the Council conclusions on Action plan to tackle non-performing loans in Europe in July 2017[3]. The ECB's efforts to address the problem of NPLs are fully consistent with the Council conclusions, the FSC's NPL report[4] and the Commission's Communication on Completing the Banking Union[5] as explained below.

The rationale of the draft addendum is to foster a more timely provisioning practice for new NPLs from 2018 onwards in order to avoid a renewed increase of NPLs in the future. It sets out the ECB's supervisory policy for addressing NPLs and provides credit institutions with the ECB's supervisory expectations, aiming to provide clarity and a level playing field. As part of a periodic comply-or-explain process, credit institutions are asked to demonstrate, on the basis of acceptable evidence, if the supervisory expectations are not justified in a specific case[6]. If, after this process, the ECB still considers on a case by case basis provisioning levels to be inadequate for prudential purposes, it may adopt supervisory measures (so-called Pillar 2 measures) to ensure that credit institutions reassess and increase respective risk coverage in order to meet prudential expectations. There is therefore no automaticity.

Section 2.2 of the published draft Addendum provides full details on the related regulatory context, referencing Articles 74, 79, 88, 97 (and 104 insofar the ECB concludes that supervisory measures are warranted to address a bank's risks relating to NPLs) of Capital Requirements Directive IV[7] as well as paragraph 479 of the EBA Supervisory Review and Evaluation Process (SREP) Guidelines.[8]

The FSC's NPL report and the European Commission's Report on the Single Supervisory Mechanism published on 11 October 2017 encourage the ECB, where necessary, to apply the relevant Pillar 2 measures. The Commission's Report states in this respect that *"the ECB is encouraged to apply the whole panoply of supervisory powers to allow risks to be addressed through the most suitable supervisory tools. Existing powers include the possibility for the competent authority to influence a bank's provisioning level within the limits of the applicable accounting framework and to apply the necessary adjustments (deductions and similar treatments) in case, for example, accounting provisioning is not sufficient from a supervisory perspective"*.[9]

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[3] http://www.consilium.europa.eu/en/press/press-releases/2017/07/11-conclusions-non-performing-loans/

[4] http://data.consilium.europa.eu/doc/document/ST-9854-2017-INIT/en/pdf

[5] http://ec.europa.eu/finance/docs/law/171011-communication-banking-union_en.pdf

[6] Section 2(3) of the draft Addendum.

[7] Directive 2013/36/EU of the European Parliament and of the Council

[8] EBA/GL/2014/13

[9] https://ec.europa.eu/info/sites/info/files/171011-ssm-review-report_en.pdf

In conclusion, the draft Addendum does not establish additional obligations on banks and therefore does not go beyond the existing regulatory framework. It clarifies, in the interest of transparency at all levels and for level playing field reasons, what the ECB expects from the banks when complying with existing provisions.[10] Hence, we are of the view that the draft Addendum falls within the supervisory mandate and powers of the ECB. In fact, it is an obligation of the ECB, in line with its supervisory mandate, to address this key vulnerability in the European banking system.

Lastly, regarding the process, in the interest of transparency and to gather the input from the stakeholders, the ECB went further than strictly required by the Single Supervisory Mechanism Regulation (SSMR) and launched a public consultation on the draft addendum. This public consultation will run until 8 December 2017, and the ECB will carefully consider all comments received before finalising the draft addendum. In addition, as key stakeholders, the Members of the European Parliament's Committee on Economic and Monetary Affairs (ECON) received an advance version of the draft addendum and are invited to provide their observations and suggestions to the ECB.[11] As in past interactions with the European Parliament where we discussed the topic of NPLs[12], my ECON hearing on 9 November will provide a good opportunity to directly exchange views on the topic. In addition, on 30 November, the ECB will also conduct a public hearing on the draft Addendum which will be open to all interested stakeholders.

I hope the above addresses your concerns and I remain at your disposal for any further clarifications.

Yours sincerely,

[signed]

Danièle Nouy

[10] The draft Addendum is therefore also to be distinguished from the Commission's announced comprehensive package of further measures to tackle NPLs to be delivered in the first quarter of 2018 under Pillar I. See Commission announcement of 11 October 2017.

[11] https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/npl_addendum2.en.html

[12] For example, at the Presentation of the ECB Annual Report on supervisory activities 2016 to the European Parliament's ECON Committee on 23 March 2017: https://www.bankingsupervision.europa.eu/press/speeches/date/2017/html/se170323.en.html