EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Danièle NOUY
Chair of the Supervisory Board

Mr Matt Carthy
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 21 March 2018

Re.: Your letter (QZ013-QZ014)

Honourable Member of the European Parliament, dear Mr Carthy,

Thank you for your letters on NPL sales by Irish banks, which were passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 6 March 2018.

Banks struggle with various challenges, including high non-performing loan (NPL) levels, which weigh on banks' performance and profitability. It is important that these banks address their NPLs to facilitate lending activities and regain investors' trust.

To address this matter, the ECB published its Guidance to banks on non-performing loans[1] in March 2017, setting out the manner in which it expects banks to manage their NPLs. The objective of the Guidance is to establish a consistent, best-practice approach to managing NPLs in individual banks across the euro area. This Guidance should help banks to significantly and continuously reduce high levels of NPLs, thereby benefitting the individual banks, the banking sector in general and the economy as a whole.

Following the completion and publication of the Guidance in March 2017, the ECB asked significant institutions with high NPL ratios to submit strategies to address their NPL issues and define their portfolio-level reduction targets over the medium term. The Guidance states that each bank with elevated levels of NPLs is expected to develop portfolio-level reduction targets with a view to reducing the level of non-performing exposures on its balance sheet in a timely manner.

Chapter 2 of the Guidance outlines best practices for the formulation of NPL reduction strategies and lists the possible tools for implementing these strategies, including forbearance, active portfolio reductions, change of exposure type and legal options.

[1] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf

The Guidance highlights that banks should ensure that their NPL strategies include "not just a single strategic option, but rather combinations of strategies/options to best achieve their objectives over the short, medium and long term". The optimum combination of such tools depends on the characteristics of each credit institution's portfolio as well as the market and legal environment in which it operates.

The Joint Supervisory Teams engage with banks and monitor them on an ongoing basis, including in the area of their NPL reduction strategies. The relevant team is therefore aware of the components of a specific bank's strategy.

It is important to note that, as stated in the Guidance, the combination of tools or strategy reduction drivers for a given bank is the responsibility of, and chosen at the discretion of, its management.

The ECB has not expressed a preference for certain NPL reduction tools over others. In addition, while the ECB expects banks to implement ambitious yet credible strategies in order to solve their NPL issues, the ECB has not imposed specific reduction targets.

Also following up on a question you had raised in another letter in November 2017 relating to the definition of NPLs or non-performing exposure (NPE), the definition of a NPE for regulatory purposes is laid down in the European Banking Authority (EBA) technical standards[2]. These technical standards provide criteria regarding the classification and the curing of non-performing exposures as well as forbearance. This criterion is further explained in Chapter 5 of the Guidance to banks on NPLs to ensure that banks consistently implement the definition in line with supervisory expectations.

The definition generally considers a loan to be non-performing when the borrower is in arrears for more than 90 days or the debtor is assessed as being unlikely to pay its credit obligations in full without the realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due.

The EBA technical standards also define forbearance and set out common criteria for the classification and curing of loans under forbearance. Forbearance measures are defined as concessions to a debtor facing or about to face difficulties in meeting financial commitments.

With regard to your question about the classification of restructured mortgages (forborne loans), this matter is also dealt with in the EBA technical standards. Under regulatory requirements, in order for a restructured loan to exit the non-performing stage, there are a number of key criteria which must be fulfilled: the borrower's repayments are expected to be fully sustainable by repaying regular principal and interest repayments for a minimum period of 12 months and there can be no "unlikely to pay" indicators present, including no reliance on the underlying collateral to repay the exposure to the bank. In addition, no part of the debtor's exposure can be impaired or defaulted and there can be no arrears on the exposure.

In order to reclassify restructured loans as performing, banks must also be satisfied that the borrower has demonstrated the ability to meet the post-forbearance criteria and have performed an assessment to ensure that they have no concerns regarding the sustainability of the debtor's ability to meet the ongoing repayments over time.

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[2] Final Report on final draft implementing technical standards amending Commission Implementing Regulation (EU) 680/2014 (EBA/ITS/2016/07)

These are the criteria under which the curing of a non-performing forborne loan is allowed for regulatory purposes. If these criteria are not met, a loan remains classified as non-performing. The regulatory standards therefore provide for a consistent definition of non-performing loans and forbearance and promote a level playing field for all European banks.

As regards your question on high mortgage interest rates resulting from a lack of competition, please note that the European Commission, together with the national competition authorities, is in charge of enforcing EU competition rules. As to consumer protection issues, they are a national competence.

Yours sincerely,

Danièle Nouy