Minimum loss coverage for non performing exposures

2018/0060(COD) - 14/03/2018 - Legislative proposal

PURPOSE: to complement existing legislation to ensure that banks can adequately cover the losses they may incur on future non-performing loans (NPLs).

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure on an equal footing with the Council.

BACKGROUND: **non-performing loans (NPLs) are one of the main risks** that still threaten the European banking system. Non-performing loans are 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 a "non-performing loan".

Addressing the high stock of NPLs and their possible future accumulation is essential to complete Banking Union, as well as to ensure competition in the banking sector, preserve financial stability and encourage lending activity to create employment and growth in the Union.

High levels of NPLs must be addressed by a comprehensive approach. While the primary responsibility for tackling high levels of NPLs remains with banks and Member States, there is also a clear EU dimension to reduce current stocks of NPLs, as well as preventing any excessive build-up of NPLs in the future given the interconnectedness of the EU’s banking system and in particular that of the euro area.

The need for decisive and comprehensive action was recognised in the action plan to tackle non-performing loans in Europe, endorsed by the ECOFIN Council on 11 July 2017.

The Commission proposed, in its communication of October 2017, to make NPL reduction measures **an essential part of the process of completing Banking Union** by sharing and reducing risk in parallel. The European Parliament and Council welcomed this.

IMPACT ASSESSMENT: among the four options considered, two options were designed as a prudential deduction from own funds in case of insufficient provisioning, using either an end-of-period approach or a gradual path (which could be linear or progressive). The preferred option is a **gradual deduction approach following a progressive path**. As shown in the impact assessment, the costs to be expected from the introduction of a prudential backstop for under-provisioned NPEs can be considered manageable.

CONTENT: this proposal for the amendment of Regulation (EU) No 575/2013 on capital requirements (CRR) provides for a **statutory prudential backstop** against any excessive future build up of NPLs without sufficient loss coverage on banks' balance sheets.

The prudential backstop consists of two main elements:

(i) a requirement for institutions to cover up **to common minimum levels** the incurred and expected losses on newly originated loans once such loans become non-performing ('minimum coverage requirement'), and

(ii) where the minimum coverage requirement is not met**, a deduction of the difference between the level of the actual coverage and the minimum coverage from Common Equity Tier 1** (CET1) items.

The longer an exposure has been nonperforming, the lower is the probability to recover the amounts due. Accordingly**, the minimum coverage requirement increases gradually** depending on how long an exposure has been classified as non-performing, in accordance with a prescribed timetable.

The proposal sets out the items that would be eligible for compliance with the minimum coverage requirements. It also establishes:

- **a distinction between secured and unsecured non-performing exposures (NPE):** given the higher risk of unsecured loans, it is proposed to apply a stricter timetable. An exposure that is only partially covered by collateral would be considered as secured for the covered part, and as unsecured for the part which is not covered by collateral;
- **a distinction between NPEs where the obligor is past due more than 90 days and other NPEs:** a different schedule would apply depending on whether the exposure is non-performing because the debtor's arrears are greater than 90 days or for other reasons. In the first case, the minimum coverage requirement should be higher, since the institution has not received any payment from the debtor for a long time. In the second case, there should be no total coverage requirement, as some repayments still occur or the probability of repayment is higher.

The prudential backstop would apply only to exposures originated after 14 March 2018.

In order to help banks to better manage NPLs, the Commission also issues a separate proposal that (i) enhances the protection of secured creditors by allowing them more efficient methods of recovering their money from secured loans to business borrowers, out of court, and (ii) removes undue impediments to credit servicing by third parties and to the transfer of credits in order to further develop secondary markets for NPLs.