EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

Public consultation on the draft addendum to the ECB guidance to banks on non-performing l

Institution/Company
EACB - European Association of Co-operative Banks

Contact person

Mr/Ms
[redacted]

First name
[redacted]

Surname
[redacted]

Email address
[redacted]

Telephone number
[redacted]

☐ Please tick here if you do not wish your personal data to be published.

General comments

Template for comments

Public consultation on the draft addendum to the ECB guidance to banks on non-performing loans

Please enter all your feedback in this list.
When entering feedback, please make sure that
- each comment deals with a single issue only
- you indicate the relevant article/chapter/paragraph, where appropriate
- you indicate whether your comment is a proposed amendment, clarification or deletion.

Deadline	8 December 2017

ID	Chapter	Paragraph	Page	Type of comment	Detailed comment	Concise statement as to why your comment should be taken on board	Name of commenter	Personal data
1	2 - General Concept	2.1, 2.2	3	Amendment	Overall, we would like to point out that existing loans that have or will in the future turn non-performing are sufficiently covered by a number of existing instruments, within the SREP dialogue and including the SSM guidance on NPL management published in March, 2017. Thus, we do not see a need to introduce an additional statutory prudential backstop regime as competent authorities in general and the ECB in particular already have sufficient tools at their disposal to identify banks with high levels of non-performing loans and recommend institution specific measures and sound risk coverage. Many provisions under current CRD IV (e g. Art. 97(3), Art. 104(1)(d), Article 104(1)(a) of CRD IV) address the adequacy of processes, arrangements, and strategies in the institutions and the possible supervisory measures. Also, Art. 16(2)(d) of the SSM Regulation gives the ECB the power to prescribe a “specific provisioning policy or treatment of assets in terms of own funds requirements”. And according to Art. 4(1)(f) of the SSM Regulation the ECB can impose further capital requirements if it finds a bank’s arrangements, strategies, processes and mechanisms, together with its regulatory capital, to be insufficient to ensure sound risk coverage. The peculiarity of all these tools is that they are institution specific, designed and meant to be so.	We strongly advise against a prudential backstop for NPLs as the one envisaged as have serious doubts regarding a one-size-fits-all approach. While legacy assets constitute an issue for certain banks and particularly in some Member States, the new rules would have to be applied by all institutions in all SSM Member States. It should rather be left at supervisors to approach high NPL banks individually to discuss the issue and decide what action to take. To this end, there are already existing, proportionate means to achieve the intended results. High NPL ratios are not necessarily a problem per se if the bank has built up sufficient (accounting) provisions or has enough collateral. Where comparatively high NPL ratios exist in retail banking, banks negotiate higher margins in this area to cover future defaults. It should be borne in mind that a restrictive squeeze would have effects on credit policies and may push out of the market customers that could then revert to grey market or to the shadow banking sector, which does not seem a preferable solution. In addition, the shadow banking sector (e.g. hedge funds), could even be placed at a competitive advantage, due to the bargaining power in purchasing NPLs/collateral from troubled banks. This would also further weaken the capital situation at the troubled banks (for example, fire sales). The ECB indicated, during the public hearing on 30th November, that given the magnitude of NPLs in the Banking Union, the one of NPLs it is in practice a “buyers market”. However, additional incentives to systematically sell at prices below the asset value would further tilt the market balance and basically leave the workout business out of the banking industry. This would also have consequential impacts on the internal estimations of LGDs, reducing the interest for banks to develop more punctual and reliable figures and rather rely on a standardized solution. Finally, high NPL ratios correlate with national economic conditions, weak institutions’ control frameworks, or mismanagement practices. New regulations/backstops would not solve such underlying problems nor would they address issues on timely accessibility of collateral, which requires reforms of national legal systems.	[redacted]	Publish

2	2 - General Concept	2.3	6	Amendment	While the ECB indicates that the addendum does not intend to substitute or supersede any accounting requirements, the expected practices seem in conflict with FRS, where “impaired” (stage 3) exposures have to be valued on the basis of their expected discounted cash flows. There is a clear trend towards extremely conservative (i e. worst case) provisioning, rather than an individual transaction based one: Banks are in fact encouraged “to close potential gaps relative to the prudential minimum expectations by booking the maximum level of provisions possible under the applicable accounting standard. If the applicable accounting treatment does not fulfil the prudential provisioning backstop, banks should adjust their Common Equity Tier 1 capital on their own initiative, applying Article 3 of the CRR on the application of stricter requirements.” It is unclear whether the accounting treatment is not considered prudent if it is not sufficient to satisfy the prudential provisioning backstop although all of the IFRS requirements are met in full. We believe that the accounting provisioning under IFRS 9 offers sufficient coverage. This addition to accounting practice (in particular the “linear path” under discussion for building up the backstop) potentially conflicts with the fundamental objectives of IFRSs, e.g. as regards the true and fair view and neutrality. Moreover, the discussion with the auditor about the appropriate level of provisioning shall also be sufficient to fulfil supervisory expectation.	A one-size-fits-all coverage without any link to the exposure and the collateral would increase the pressure to realise the collateral. This would remove the incentive for the institutions to work their way through the economic cycle so as to limit any losses from realisation. An additional prudential provisioning backstop would result in the need for additional explanation also on the capital markets, which would not necessarily be understood in all its implications. Indeed, it is unclear how users of financial statements, or market participants would benefit from a systematic upward adjustment of provisions regardless of the real economic value of the asset. In light of this, we strongly advise against the introduction of a prudential provisioning backstop. Moreover, the prudential provisioning backstop seems to limit the accounting measurement in practice.	[redacted]	Publish
3	2 - General Concept	2.3	6	Clarification	We understand that the capital deduction in accordance with Art. 3 CRR should be interpreted as an “other own funds reduction” within the meaning of Art. 159 CRR, and that it should therefore be taken into consideration in the comparison of provisioning. We would welcome a clarification in this respect.		[redacted]	Publish
4	2 - General Concept	2.3	5	Clarification	We would also welcome clarifications regarding the following elements: We would see that the “newly booked provisions” referred to under Figure 1 page 5 may be recognised immediately without them having to meet the criteria set out in Art. 26(2) CRR. Also, we understand that “all accounting provisions” mean all recognised risk provisions and valuation allowances, for example the Stage 1 and 2 loss allowances to be recognised in accordance with IFRSs in addition to specific provisions or valuation allowances and general/global provisions or valuation allowances.		[redacted]	Publish

5	2 - General Concept	2.3	5	Amendment	The higher own funds requirements for the credit risk of the relevant NPL exposures should be taken into account among the components for satisfying the expectations of the prudential provisioning backstop. In this context, the questions is whether the risk of a higher and additional loss from NPLs is not already adequately taken into account in the Pillar 1 framework through the calculation of higher own funds requirements for NPL exposures (e.g. a 150% RW for the SA under Art. 127 CRR).	If the specific and higher own funds requirement for NPL exposures is not recognised, capital will eventually be double-counted as the capital deduction (in accordance with Article 3 of the CRR) would be calculated inclusive of own funds requirements already allocated to the same end.	[redacted]	Publish
6	3 - Definitions	3.2	7	Amendment	The draft addendum creates misunderstandings of established concepts (e.g. LGD, expected loss, excess amount/shortfall calculation in accordance with Art. 158–159 CRR). Restricting collateral for NPLs' provisioning to the one defined by the CRR does not take into account that there might be economically recoverable collateral for which an LGD history or appraised mortgage lending values can be demonstrated. The recognition of collateral should therefore not be restricted to the collateral recognised by the CRR, but – in line with the use test principle – should follow the economically recoverable collateral actually used in risk management.	Restricting the recognition of collateral results in an inappropriate calculation of the backstop provisioning requirement, resulting into provisioning excesses that do not recognize the substance of transactions and the collateral at hand.	[redacted]	Publish
7	3 - Definitions	3.2	7	Clarification	The draft addendum indicates that deviations are in theory possible on a comply-or-explain basis. To enhance clarity and certainty for institutions, examples of stable value collateral or exemptions would be welcome (including treatment of state guaranteed or investment grade guarantor), without implying that such examples would constitute an exhaustive list.	Example based clarifications would help in ensuring consistent administrative and audit practices.	[redacted]	Publish

8	3 - Definitions	3.2	7	Amendment	As indicated, the criteria for the recognition of collateral to ascertain the need for the prudential provisioning for NPLs are too rigid. Physical collateral that is not immovable property collateral should also be allowed if the collateral valuations are conservative and regularly validated. It should be clarified that – at least in the EEA countries – the conditions for criteria for liquid markets and well-established, publicly available market prices are deemed to be satisfied for various types of physical collateral such as motor vehicles, ships or vehicles. This would be important as the EBA has decided not to disclose a list of types of physical collateral in accordance with Article 199(8) of the CRR for which institutions can assume that the conditions referred to in Article 199(6) points (a) and (b) of the CRR are met. Corresponding clarification is urgently required in order to give the institutions – and in particular SA institutions – the necessary legal certainty for calculating the prudential backstop provisions. This applies in particular in the event that the ECB sticks to its view that – regardless of the CRR credit risk approach applied – only physical collateral that satisfies the IRB requirements in the CRR for eligibility of credit risk mitigation may be used for the purpose of calculating the prudential provisioning backstop.	The collateral eligibility requirements places at a disadvantage credit institutions that have only implemented the credit risk SA and hence do not satisfy the IRB criteria for credit risk mitigation under the CRR. This also holds true for credit institutions for which collateral other than real estate and financial collateral plays a major role.	[redacted]	Publish

9	4 - Prudential provisioning backstop	4.1, 4.2	12	Amendment	In general, a standardised timeline (i.e. 2/7 years) to fill the prudential provisioning is not suitable to cover the huge amount of different tenors. Especially in situations where the tenor amounts to more than 10 years, these fixed rules are not appropriate. Additionally, experience shows that within the first 2 years of an ongoing restructuring of an exposure (retail and commercial as well) an expected amount to be repaid can be estimated. Thus, the proposed provision does not take into account the agreed repayment schedule, which can differ dramatically. It must also be taken into account that during a restructuring process normally no efforts are made to realise security, Therefore it cannot be assumed that the realisation of security was unsuccessfully attempted from the beginning. Therefore, we believe that after the period of two years of vintage it should be assessed whether the customer is still unlikely to pay or has already become likely to pay. In the event that the customer is unlikely to pay the unsecured part of the exposure could be subject to prudential provisioning. Any provision forcing institutions to an automated prudential provisioning is considered as excessive and therefore should be avoided.	The application of the vintage is too undifferentiated. For example, progress in NPL work-outs should be taken into consideration, and rewarded in the calculation of the vintages through resets or prolongation. Examples of meaningful progress could be certain milestones in the recovery and resolution of NPLs, such as (partial) realisation of collateral, cash recoveries or restructurings. The requirements being designed also impact banks with low levels of NPLs. Input filters/criteria which could be useful to understand the institution situation also for the bank itself, to alleviate process related efforts, bearing in mind that each action must be taken on a case by case basis and there should be no automatic triggers. An example of such a criterion could be a repeated breach of a specified average NPL ratio. Only the wait-and-see approach should be penalised. A strict NPL process also takes some time and should not lead to penalizing actions in the shape of supervisory measures according to a standardized timeline.	[redacted]	Publish
10	4 - Prudential provisioning backstop	4.1	11	Amendment	For unsecured exposures, the capital deduction full effect on year 2 from default encourages a faster reduction of the NPL exposure. In general, however, this is not a sufficient timeframe to restructure an NPL, especially a corporate loan, and it rather creates incentives to outsource problem loans, e.g. to unregulated funds. We would suggest reviewing the arbitrary two-year period for unsecured positions. A distinction by client clusters could instead be envisaged.	An undifferentiated two-year vintage for all unsecured NPL exposures is too restrictive.	[redacted]	Publish

11	4 - Prudential provisioning backstop	4.2	12	Amendment	As collateral realization is most likely to take some time, banks would already have to “set aside” 1/7 in the first year for almost all secured loan components, despite IFRS accounting. Systematic lower collateral valuation, and thus higher risk provisioning, is not justified when normal realisation periods are involved. It would appropriate to take into account a reasonable realisation period and start building up the backstop only after that period. Practical experience shows that a period of seven years is too short to build up a 100% backstop, for example in the case of public guarantees realisation that can only start once the insolvency proceedings have been completed. The progressive approach set forth in the recent consultation by the European Commission is more likely to fit with the intention of penalising wait-and-see approaches, although also in that case a longer period is appropriate. Eventually 100% backstops will thus only be applied in the most problematic cases. As also suggested by the Commission, a haircut approach to measuring collateral if it has to be realised should be considered as an alternative to the (linear) write-down of all secured NPLs over a vintage of seven or more years. Because of its more economically driven basis and the differentiated consideration of the type of collateral, that design is definitely preferable to a one-size-fits-all approach.	It is not possible to state on the basis of a one-year realisation period whether the collateral has lost value or whether a wait-and-see approach (to be penalised) is being used by the bank. The one-size-fits-all treatment of secured positions over a seven-year period also runs counter to practical and business experience. Ultimately, it can lead to excessively restrictive capital deductions and also punishes banks with appropriate NPL management.	[redacted]	Publish
12	5 - Related supervisory reporting	5	13	Amendment	With regard to the templates to be submitted to the ECB, we would urge to provide a sufficiently long lead time for the IT implementation. A reporting obligation should not take effect before 2019. This would also allow the coordinated implementation of the extended disclosure requirements expected by the ECB, which are supposed to be implemented by the end of 2018 and disclosed for the first time in 2019 in the 2018 disclosure report. Moreover, if templates were to be already submitted in 2018 they would not provide meaningful information as there should be provisions for new NPLs for at least one year in order to allow an assessment of institutions’ practices in light of the new guidance.	Without a transitional period, disproportionately high implementation effort and costs emerge in light of the achievable and intended benefits.	[redacted]	Publish