Valdis DOMBROVSKIS
Commissioner DG FISMA
European Commission
[redacted]

Roberto GUALTIERI
Chair ECON Committee
European Parliament
[redacted]

Danièle NOUY
Chair SSM Supervisory Board
European Central Bank
[redacted]

Toomas TÕNISTE
Minister of Finance Estonia and EU Presidency
[redacted]

Brussels, 6 November 2017

[redacted]

SUBJECT: **ECB addendum[1] and regulatory certainty**

Dear legislators and supervisors,

The European Banking Federation (EBF) has been closely following the recent exchanges concerning the "Addendum to the ECB Guidance to banks on non-performing loans: Prudential provisioning backstop for non-performing exposures" (the addendum). The EBF welcomes the ECB consultation and is preparing a response that will address the technical proposals laid out therein. The EBF notes that the Non-Performing Loans (NPL) ratio of the EU banking system has been significantly reduced via banks' internal efforts, from 7.3% in 2015 to 6.1% in 2017; far from complacency, the EBF generally supports the EU Council action plan to further reduce the NPL ratio after assessing the impact on EU economies. Nevertheless, the EBF would like to highlight an issue of concern for EU banks regarding the increase of regulatory uncertainty involved in the addendum.

The rationale behind the addendum is well understood, however we would recommend the method to be reconsidered. This because as it appears, the addendum could alter, in practice, certain quantitative metrics that constitute the core of the Pillar 1 banking international standards and EU regulation. Furthermore, while outlining the scope of risk exposures whose requirements would change, namely the new non-performing exposures from 1 January 2018, it is not clear whether the addendum could in the end also be applied to existing exposures, thus leaving an ill-defined scope that would be, and in fact already is, subject to speculation by stakeholders. Moreover, the stricter requirements put European banks with exposures in non-Eurozone Area at a competitive disadvantage *vis-*

[1] Addendum to the ECB Guidance to banks on non-performing loans: Prudential provisioning backstop for non-performing exposures (ECB - October 2017)

a-vis local banks. Finally, it announces the entry into force of those fundamental changes in a very short time period. This would all be done without a prior impact assessment, notably on credit to SMEs and economic growth across Member States.

During the years following the financial crisis, international standard setters and EU legislators have determined, on the one hand, the capital deductions that were necessary to significantly increase the quantity and quality of capital requirements, in the Pillar 1 of the Basel III agreement and in the EU Capital Requirements Regulation (CRR). On the other hand, the International Financial Reporting Standard (IFRS) number 9 will enter into force in the EU on 1 January 2018, incorporating a more conservative provisioning method that includes, *inter alia*, lifetime expected loss provisioning for exposures with significant increase of credit risk. Banks, investors, businesses and stakeholders in the wider economy have assimilated the new rules adopted by proper legislative process in the EU. The addendum proposes *de facto* to increase the provisions above and beyond the accounting regime and to deduct from capital the difference between supervisory expectations and applicable rules. The perceived impact of supervisory practices on the spirit of the underlying rules in relation to the treatment of non-performing loans, almost seems to put the idea of a predictable Single Rulebook at risk if we consider the possibility that the same method might subsequently be applied to any other element of a bank’s portfolio.

Legislators, supervisors and banks together have made enormous joint efforts to overcome the difficulties posed by the financial crisis. Today, the EU banking system is on a much stronger footing thanks to the sounder legislative framework, the impressive accomplishment of the ECB to implement the Single Supervisory Mechanism and the improved capacity of banks to thrive despite the adverse economic conditions. There remain some weaknesses in the banking system, including the high NPL ratio. The comprehensive action plan recently launched by the Council to amend this situation should be followed by all institutions in order to allow for the desired harmonisation.

In conclusion, European banks would like to reaffirm the importance of keeping a clear-cut separation between Pillar 1 rules, for which firms follow internationally agreed methods of calculation and calibration, and Pillar 2 bank-specific assessments, which will include supervisory judgement. The addendum and any future supervisory guidance should adhere to this principle to ensure the indispensable regulatory certainty.

I hope these observations from the practical viewpoint of European banks will be taken into consideration for the development of regulatory and supervisory actions, including the draft addendum, in order to achieve the important objectives pursued by your respective institutions in a climate of regulatory predictability and certainty for banks and banking stakeholders.

Yours sincerely,

Wim MIJS
Chief Executive Officer