



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Feedback statement

Responses to the public consultation
on the draft Addendum to the ECB
Guidance to banks on non-performing
loans

BANKENTOEZICHT

March 2018

BANKTILLSYN BANKU UZRAUDZĪBA

BANKŪ PRIEŽIŪRA NADZÓR BANKOWY

VIGILANZA BANCARIA

BANKFELÜGYELET

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SUPERVISION BANCAIRE BANČNI NADZOR

MAOIRSEACHT AR BHAINCÉIREACHT NADZOR BANAKA

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PANGANDUJSJÄRELEVALVE

SUPERVISÃO BANCÁRIA

BANKOVNI DOHLED

БАНКОВ НАДЗОР BANKTILLSYN

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ΤΡΑΠΕΖΙΚΗ ΕΠΟΠΤΕΙΑ PANKKIVALVONTA

SUPRAVEGHERE BANCARĂ BANKOVÝ DOHL'AD

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This document is intended to give an overview of the comments received during the public consultation on the draft Addendum to the ECB Guidance to banks on non-performing loans, and provide an assessment of those comments. It also explains the amendments made to the draft Addendum as a result of the public consultation.

1 Introduction and overview of responses

1.1 Context

On 4 October 2017 the European Central Bank launched a public consultation on the draft Addendum to the ECB Guidance to banks on non-performing loans (“the Addendum”). The public consultation ended on 8 December 2017. In addition to soliciting written comments, the ECB also gave industry participants and interested parties the opportunity to provide additional input at a public hearing with senior representatives of the ECB, held in Frankfurt on 30 November 2017. While the comments made during the public hearing are not reflected in the figure below, they have nonetheless been taken into account. Moreover, most (if not all) of the comments made at the public hearing were also reiterated via written submission. Accordingly, the ECB has given due consideration to all of the comments received during the consultation period.

1.2 Structure of the feedback statement

This feedback statement presents an overall assessment of the comments received during the public consultation and aims to address the most relevant issues raised by those comments. Amendments to the draft Addendum have been made as a result of the comments received.

Part 3 of this document summarises the key comments received and the resulting drafting amendments to the Addendum. It does, however, only list the most relevant groups of comments and amendments. A tracked changes version of the Addendum is available, showing all amendments made.

1.3 Statistics on the responses

In total, 35 responses were received involving almost 500 individual comments, mostly in English. A broad participation by the relevant stakeholders was observed.

Figure 1 and **Figure 2** show the breakdown of the responses to the public consultation by country of origin and category of respondent.

Figure 1
Responses by country of origin

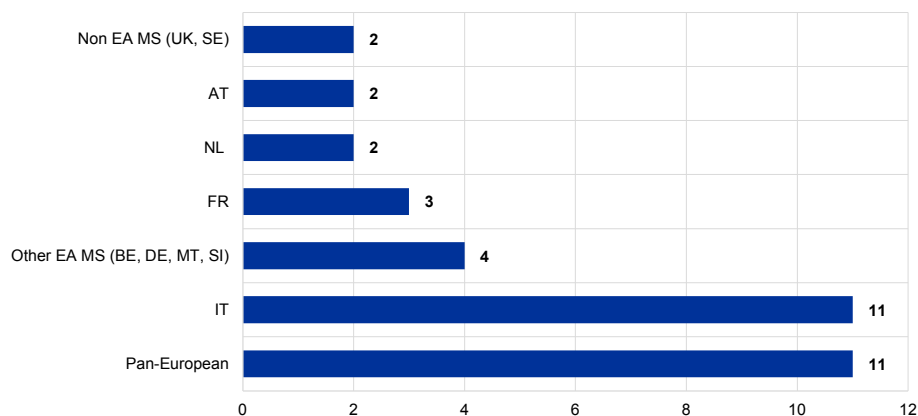
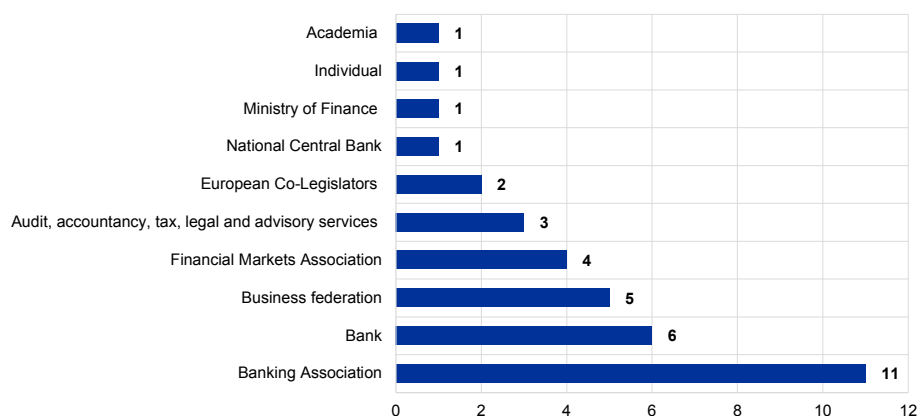


Figure 2
Responses by category



1.4 Adoption of the Addendum

A complete draft proposal for the adoption of the draft Addendum was submitted by the Supervisory Board to the Governing Council of the ECB on 23 February 2018. The ECB Addendum, as adopted by the Governing Council of the ECB on 2 March 2018, was published on the ECB's banking supervision website together with this feedback statement on 15 March 2018.

2 Explanation of the proposal and policy rationale

High levels of non-performing loans (NPLs) pose a risk to the banking system, as NPLs curb profits and limit the capacity of banks to lend to the economy. Given the relevance of this risk for many banks under ECB supervision, addressing this vulnerability has been a key priority since the Single Supervisory Mechanism was established.

In order to address this vulnerability, a high-level group has been established within the SSM consisting of representatives of the national competent authorities and the ECB, with the European Banking Authority (EBA) acting as observer. The group has been tasked with establishing a consistent and effective supervisory approach to the problem, building on European and international best practices to reduce the level of NPLs on banks' balance sheets.

As a result of this joint initiative, in March 2017 (after a successful public consultation process) the ECB published its Guidance to banks on non-performing loans ("NPL Guidance") setting out its expectations as to how banks should manage their NPLs in the context of existing regulations, directives and guidelines. In June 2017 the ECB published an extensive stocktake of national practices related to NPLs across the 19 Member States participating in the banking union, which identified the need for further joint actions by all relevant stakeholders to address existing and future NPL issues.

In October 2017 the ECB launched a public consultation on the draft Addendum, which specifies the ECB's supervisory expectations when assessing a bank's levels of prudential provisions for non-performing exposures (NPEs)¹. The importance of timely provisioning and write-off practices related to non-performing loans² was already stressed in the NPL Guidance, which already announced that "as a next step [...] the ECB plans to place a stronger focus on enhancing the timeliness of provisions and write-offs"³. The ECB will in this context assess, among other things, the length of time an exposure has been classified as non-performing (i.e. its "vintage") as well as the collateral held (if any). The ECB's supervisory expectations set out what the ECB considers to be a prudent treatment of NPEs irrespective of their accounting treatment. The aim is to avoid an excessive build-up of non-covered aged NPEs on banks' balance sheets in the future, which would warrant supervisory measures.

¹ As in the NPL Guidance, "NPL" and "NPE" are used interchangeably within this Addendum.

² See Section 6.6 of the [NPL Guidance](#).

³ See Section 1.1 of the [NPL Guidance](#).

3 Comments and amendments to the draft Addendum to the ECB Guidance to banks on non-performing loans

3.1 Application date and phase-in

#	Topic	Details	Response	Change
1	Date of application of the Addendum	Comment(s) expressed concern about the proposed date of application of the draft Addendum and proposed that the supervisory expectations in the Addendum be considered by the ECB at a later date.	<ul style="list-style-type: none"> The Addendum outlines supervisory expectations on timely prudential provisioning for NPLs. In order to take a balanced approach and to avoid cliff edge effects for banks, the ECB has decided that those expectations will be considered for exposures that are reclassified from performing to non-performing in line with the EBA's definition after a given cut-off date in 2018 only. In the final Addendum text, the initially specified cut-off date of 1 January 2018 was replaced by 1 April 2018, also considering the publication date of the final Addendum. 	Yes
2	Phase-in arrangements	Comment(s) suggested considering phase-in arrangements for the supervisory expectations outlined in the Addendum.	<ul style="list-style-type: none"> The supervisory expectations outlined in the Addendum focus on new NPLs. This scope results in a natural phase-in, especially taking into account the significantly reduced NPL inflows recently experienced across the euro area. 	No

3.2 Scope

#	Topic	Details	Response	Change
1	Treatment of legacy NPLs	Comment(s) requested clarity regarding the use of the supervisory expectations outlined in the Addendum for legacy NPLs.	<ul style="list-style-type: none"> Following the public consultation process and an extended internal assessment on the potential consideration of supervisory expectations set out in the Addendum for legacy NPLs, the ECB will continue to engage with banks with high levels of NPLs through their respective JSTs. This work focuses on the banks' strategies and progress in the context of their own internal targets. In addition, the ECB will continue to prioritise work on addressing NPLs and will continue its consideration of further policies to address the existing stock of NPLs. 	No
2	Treatment of NPLs defined as unlikely to pay (UTP), going concern or in probation	Comment(s) suggested that the ECB should not consider supervisory expectations for the following exposures: (a) "unlikely to pay" according to the EBA definition, (b) not defaulted/ going concern/ not in legal proceedings, (c) in probation where viable forbearance measures are in place, and (d) triggered by a pulling effect.	<ul style="list-style-type: none"> The Addendum contains supervisory expectations for all new NPEs classified as such in line with the EBA definition after 1 April 2018 (regardless of the trigger, i.e. past due or UTP). Thus, the supervisory expectations will be considered for any sub-portfolios of NPEs. However, in the context of the supervisory dialogue, banks will be able to outline reasons for any differences between the supervisory expectations and their actual prudential coverage on a case-by-case basis. In the context of the situations outlined under (a) to (c), if there have been evidenced regular repayments of a significant portion of the initial contractual payments, the supervisory expectation might be changed. Regarding (c), given the time lag in the Supervisory Review and Evaluation Process (SREP), banks should in many cases be able to show that debtors have indeed successfully passed the probation period by the time the SREP decision is issued. Regarding (d), the Addendum already provides for this example. The final text was rephrased by adding "if the payments enable the exposure to be cured irrespectively of whether it is past due or unlikely to pay". 	Yes
3	Treatment of certain other sub-	Comment(s) suggested that the ECB should not	<ul style="list-style-type: none"> Regarding (a) to (i), the Addendum contains supervisory expectations for all new NPEs classified as such in line 	Yes

	portfolios of NPLs	consider supervisory expectations for certain other sub-portfolios of NPLs such as: (a) new NPLs resulting from legacy exposures, (b) factoring/leasing NPLs, (c) public NPLs, (d) retail NPLs, (e) purchased NPLs, (f) off-balance-sheet NPLs, (g) NPLs in international subsidiaries, (h) NPLs in low NPL banks, and (i) NPLs in IRB banks.	<p>with the EBA definition after 1 April 2018. Thus, the supervisory expectations set out in the Addendum will be considered for any sub-portfolios of NPEs. However, in the context of the supervisory dialogue, banks will be able to outline reasons for any differences between the supervisory expectations and their actual prudential coverage on a case-by-case basis.</p> <ul style="list-style-type: none"> Regarding (e), banks with the financial and operational means to acquire sizeable NPL portfolios would conduct sound due diligence processes ahead of such transactions. Evidence that the documented assumptions made during the due diligence process are materialising will be taken into account by supervisors. In this context, it should also be noted that at this stage there are no significant institutions with a sole focus on NPL purchasing and workout. Furthermore, some questions have been raised about the “vintage count” for purchased NPLs. As a general rule and subject to case-by-case assessment, a purchase of NPLs should not reset the initial vintage count of those exposures. Regarding (f), the EBA definition includes off-balance-sheet exposures. However, as the ECB Supervisory Statistics show, those are not very relevant for significant institutions on the whole. Regarding (g), the supervisory expectations set out in the Addendum will also be considered for non-performing loans in international subsidiaries of significant institutions in line with the NPL Guidance. Regarding (h), as outlined in the draft Addendum, the Addendum supplements the NPL Guidance, and more specifically Chapter 6 of that document, the supervisory expectations of which are considered for all significant institutions. Therefore, this Addendum uses the same scope. The draft Addendum text already specified the full alignment with the EBA NPE definition. In the final Addendum text, further explanations regarding points (e), (f) and (g) were added. 	
4	Level of application of the expectations	Comment(s) requested clarity regarding the level of application of the supervisory expectations related to reporting granularity, e.g. on exposure, portfolio, legal entity or consolidated level.	<ul style="list-style-type: none"> The general relevance of the Addendum is to be assessed on exposure level (i.e. the date of the last NPE classification and respective NPE vintage). The starting point of the supervisory dialogue will be an assessment performed at the applicable consolidation level (solo, sub-consolidated or consolidated in line with the SREP approach). This could be followed by further supervisory analysis on a more granular level if need be (e.g. portfolio or debtor level). In the final Addendum text, the above has been clarified. In practical terms, the starting point of the supervisory dialogue will be an overview of NPE coverage by vintage bucket and degree of collateralisation (secured/unsecured) at the applicable consolidation level. 	Yes

3.3 Functioning of the quantitative expectations

#	Topic	Details	Response	Change
1	Vintage count	Comments(s) raised questions on how the vintage count works.	<ul style="list-style-type: none"> The vintage count starts from the classification of an exposure as non-performing in accordance with the EBA definition. This ensures a fully consistent approach across different jurisdictions. If the position is no longer non-performing in accordance with the EBA definition, the supervisory expectations established in the Addendum are not taken into account. A sale of NPLs does not alter the vintage count. 	No
2	Collateral definitions and changes in collateral values	Comment(s) suggested that the ECB should (a) review the currently strict definition of collateral in the Addendum, (b) ensure a level playing field across IRB and SA banks in this context, and (c) clarify the functioning of changes in	<ul style="list-style-type: none"> Regarding (a), the definition of collateral contained in the Addendum is based on the current regulatory framework. In this context, certain types of instruments, such as personal guarantees or factoring-related instruments, are therefore currently not included. However, as stated above, in the context of the supervisory dialogue, banks will be able to outline reasons for any differences between the supervisory expectations and their actual prudential coverage on a 	Yes

		the collateral situation.	<p>case-by-case basis.</p> <ul style="list-style-type: none"> Regarding (b), the Addendum assumes an equal treatment of banks using the standardised approach (SA) and banks using the internal ratings based (IRB) approach with regard to eligible collateral. A more explicit clarification in this regard has been added in the final Addendum text. Regarding (c), the ECB confirms that any relevant collateral (see the related section on definitions in the Addendum) obtained by the bank after the NPE classification will be considered for the purpose of the supervisory expectations in the Addendum. Thus, in such a situation the split between the secured and unsecured parts of the exposure would alter (with the vintage count remaining the same). Furthermore, as banks are encouraged to perform annual revaluations of the collateral backing NPLs (in line with the NPL Guidance), resulting changes in the split between the secured and unsecured balance should be accounted for accordingly. 													
3	Disregarding collateral after seven years	Comment(s) raised concerns around excluding all value from collateral held after seven years in NPE status and the resulting inconsistency with accounting.	<ul style="list-style-type: none"> As part of the prudential framework, a bank needs to be able to realise its security in a “timely manner”. If collateral has not been realised after a period of several years from the date when the underlying exposure was classified as non-performing, the collateral would in principle be deemed ineffective and as such, the exposure is expected to be treated as unsecured from a prudential perspective in the context of the Addendum. Therefore, the Addendum does not question the value of collateral after seven years, but rather questions its recoverability. 	No												
4	Linear path for secured parts of NPLs	Comment(s) queried the supervisory expectation of a linear path and the potential implications of such an approach.	<ul style="list-style-type: none"> First, a linear path is not expected to be applied for the unsecured parts of NPLs. For the secured parts of NPLs, the ECB acknowledges that an assumption of collateral enforcement is not always appropriate in the first couple of years, when viable forbearance solutions are implementable and more efficient. In this context, in the final Addendum text, the linear path will not be considered during the first two years as follows: <table border="1"> <thead> <tr> <th>NPE vintage – secured part</th> <th>Supervisory expectation</th> </tr> </thead> <tbody> <tr> <td>3 years</td> <td>40%</td> </tr> <tr> <td>4 years</td> <td>55%</td> </tr> <tr> <td>5 years</td> <td>70%</td> </tr> <tr> <td>6 years</td> <td>85%</td> </tr> <tr> <td>7 years</td> <td>100%</td> </tr> </tbody> </table> <ul style="list-style-type: none"> In the context of the above and in alignment with the SREP framework, the frequency of determining and reviewing supervisory expectations (and the linear path) is expected to be annual. 	NPE vintage – secured part	Supervisory expectation	3 years	40%	4 years	55%	5 years	70%	6 years	85%	7 years	100%	Yes
NPE vintage – secured part	Supervisory expectation															
3 years	40%															
4 years	55%															
5 years	70%															
6 years	85%															
7 years	100%															
5	Inputs used to determine the supervisory expectations	Comment(s) queried the way the supervisory expectations in the Addendum were calibrated, specifically the 2 years/100% and 7 years/100% parameters.	<ul style="list-style-type: none"> A range of inputs were used to determine the final calibration of the supervisory expectations set out in the Addendum. These included supervisory judgement, international practices regarding provisioning and write-off requirements, and the speed of resolution processes across the EU, including recent related improvements. ECB Banking Supervision considers that the calibration of the supervisory expectations provides a balanced approach which aims to encourage timely NPL provisioning practices in the future. 	No												
5	Shortfall calculation	Comment(s) suggested extending the current definition of “supply” to include shortfall from performing assets.	<ul style="list-style-type: none"> The Addendum states that only the shortfall for defaulted assets will be considered as “supply”. It is not considered appropriate to extend this definition. 	No												

6	Disclosure and reporting references	Comment(s) raised concerns over the potential market impact of the disclosure recommendations included in the Addendum and requested that any related reporting templates be shared with significant institutions well in advance.	<ul style="list-style-type: none"> Regarding the disclosure recommendations, it should be noted that these are fully consistent with the recommendations contained in Annex 7 of the NPL Guidance. These are based on the fact that a public disclosure of NPE coverage by vintage is an important tool for banks to convey their credit risk profiles comprehensively to market participants. Regarding the supervisory reporting referred to, this will be integrated into the annual SREP and banks will be notified well in advance. Given the nature of the Addendum's content and the 2018 cut-off date, the first SREP formally integrating the Addendum's content will be the one for the year-end 2020 reference date, i.e. the 2021 SREP. 	Yes
7	Tax treatment	Comment(s) suggested introducing a corrective mechanism to replicate a CET1 deduction net of fiscal effects.	<ul style="list-style-type: none"> The ECB has no mandate in the area of taxation. Since it aims to ensure the safety and soundness of credit institutions and the stability of the financial system, the ECB is concerned about risks stemming from NPLs. As the Addendum sets out supervisory expectations and does not intend to interfere with accounting, any CET1 deduction on the banks' own initiative is made on a gross-of-tax basis. 	No
8	Securitisation	Comment(s) asked for an explanation of the interaction between the approach adopted for prudential provisioning and the securitisation proposals regarding significant risk transfer for NPL transactions.	<ul style="list-style-type: none"> Supervisory expectations regarding significant risk transfers of NPLs are outlined in the NPL Guidance. 	No

3.4 Supervisory implementation

#	Topic	Details	Response	Change
1	Specification of potential supervisory measures	Comment(s) suggested that it would be useful to specify potential supervisory measures that could be adopted when banks do not meet the supervisory expectations.	<ul style="list-style-type: none"> It should be noted that the supervisory expectations set out in the Addendum will be taken into account in the SREP. Following a case-by-case assessment, potential supervisory follow-up actions and measures will be determined on an institution-specific basis. 	No
2	Functioning of supervisory dialogue	Comment(s) asked for clarifications on how the supervisory dialogue in the context of the Addendum will work in practice.	<ul style="list-style-type: none"> It is important to note that the Addendum is not in itself a Pillar 2 measure. The Addendum contains supervisory expectations that will serve as part of the supervisory dialogue. Further clarifications on the supervisory assessment process have been added to the final Addendum text. 	Yes
3	List of acceptable deviations/evidence	Comment(s) suggested that there should be a more comprehensive list of acceptable exceptions/deviations.	<ul style="list-style-type: none"> Clarification was added that any portfolio-specific robust evidence could be used to inform the supervisory dialogue. 	Yes

3.5 Impact consideration

#	Topic	Details	Response	Change
1	Microprudential impact	Comment(s) suggested that there should be an in-depth impact analysis to assess the impacts on banks deriving from the consideration of the supervisory expectations set out in the Addendum.	<ul style="list-style-type: none"> It is noted that the Addendum does not impose binding obligations on credit institutions and is not intended to produce legal effects on banks. Bank-by-bank monitoring and assessment will be carried out regularly by the JSTs in the context of the SREP. Any supervisory measure to be adopted will always be addressed to the individual bank concerned, taking into account its specific circumstances. Therefore, it would be difficult to model the impact ex ante. Moreover, since the supervisory expectations will be considered for new inflows of NPLs only, the impact will in any case materialise gradually, giving banks time to adjust. 	No

			<ul style="list-style-type: none"> The ECB considers that the resolution of NPLs is important for bank viability. Furthermore, it considers that now is the right time to encourage banks to prevent a future build-up of NPLs without adequate provision coverage, also taking advantage of the strong macroeconomic performance of the euro area and a significantly reduced inflow of new NPLs in the supervised significant institutions. 	
2	Macroprudential impact	<p>Comment(s) suggested that the supervisory expectations set out in the Addendum could have potential adverse macroeconomic effects in terms of credit growth and lending activities.</p>	<ul style="list-style-type: none"> It is important to note that the Addendum does not impose binding obligations on credit institutions and is not intended to produce legal effects on banks. A high number of NPLs affects capital and funding, puts pressure on banks' profitability, and consequently inhibits the supply of credit as also outlined in Section 2 of this feedback statement. Against this background, the supervisory expectations in the Addendum encourage healthier bank balance sheets in the medium term and thus enable banks to refocus on their core business by increasing their lending capacity. Furthermore, in a "steady state" scenario, the potential quantitative impact of the supervisory expectations specified in the Addendum (while bearing in mind the bank-specific assessments carried out by the JSTs) should at most be interpreted as a shift in the timing of establishing the risk cover rather than an additional need for provisioning. For example, if a bank indeed recovers parts or all of a secured exposure after seven years, this recovery will offset the prudential provisions made. 	No
		<p>Comment(s) raised concerns about negative economic effects resulting from potentially created moral hazard, on the side of debtors (strategic defaults) and of creditors (quicker legal enforcement).</p>	<ul style="list-style-type: none"> It is noted that the Addendum does not impose binding obligations on credit institutions and is not intended to produce legal effects on banks. Furthermore, the Addendum does not affect the legal rights and obligations of the parties to a lending agreement. Notably, the expectations set out in the Addendum do not affect the legal obligation of the borrower to repay the loan. The ECB therefore does not consider that it causes moral hazard or provides incentives for strategic default. Notably, the Addendum does not remove any of the legal protection afforded to going-concern borrowers. Where it would be more economically justified to restructure a loan on a going-concern basis, banks are encouraged to pursue that outcome, also in line with the ECB's qualitative guidance, and this information will be taken into account in the course of the supervisory assessment. Moreover, the path over which the expected provisioning on secured exposures should be reached (if that were indeed the outcome of the supervisory assessment) provides the flexibility to restructure viable exposures early on. The final text of the Addendum does not include the supervisory expectations for the linear path for secured exposures during the first two years to remove potential adverse incentives to pursue a legal route too quickly where viable forbearance solutions might be more effective. 	Yes
		<p>Comment(s) suggested considering potential changes in banks' practices related to unsecured lending.</p>	<ul style="list-style-type: none"> The ECB notes that the EBA has been given the mandate by the European Council to develop guidelines on loan origination. These will promote good practice with respect to origination and credit analysis. 	No
3	International level playing field	<p>Comment(s) pointed to "level playing field" issues with respect to credit institutions outside the scope of the SSM as well as LSIs.</p>	<ul style="list-style-type: none"> The ECB is only responsible for the supervision of credit institutions established in the participating Member States. Therefore, the ECB's supervisory expectations will be considered for all banks directly supervised by it, which collectively account for a large majority of the banking market in the euro area. It should be noted, however, that the Addendum was also inspired by international best practice, as numerous jurisdictions across the world use quantitative rules or guidance to ensure a sufficiently timely coverage of NPLs from a prudential perspective. 	No
		<p>Heterogeneity among EU countries (for instance in terms of asset repossession and foreclosure), which has negative effects on economic growth, is not taken into account.</p>	<ul style="list-style-type: none"> The ECB considers foreclosure and repossession to be part of the range of tools available to banks to resolve NPLs. Some of these tools may be faster and more efficient than repossession. The ECB notes that across the euro area various initiatives aiming to address remaining inefficiencies in legal and judicial systems are under way. 	No

4	Secondary market of NPLs	Comment(s) highlighted possible consequences for the secondary market for NPLs.	<ul style="list-style-type: none"> The nature of the Addendum is microprudential, as it aims to ensure an adequate prudential coverage of NPL-related risk on a bank-by-bank basis. Furthermore, a number of other European initiatives aiming to improve the framework of secondary NPL markets are under way, which should help to overcome certain inefficiencies in those markets in the medium term. 	No
5	Procyclicality	Comment(s) suggested that a potential procyclicality could arise from the introduction of the supervisory expectations set out in the Addendum, and also suggested the possibility of suspending the measure during a recessionary phase.	<ul style="list-style-type: none"> The supervisory expectations set out in the Addendum aim to address risks from a microprudential perspective. Any supervisory measure to be adopted will always be addressed to the individual bank concerned, taking into account its specific circumstances. The final Addendum text provides more clarity in this respect. There are a wide range of macroprudential instruments for addressing procyclicality available to the designated authorities. 	No

3.6 Legal considerations

#	Topic	Details	Response	Change
1	Legal basis and nature of the supervisory expectations outlined in the Addendum (Section 2.2)	Comments expressed concerns about the legal nature of the Addendum. In particular, some commenters interpreted the supervisory expectations outlined in the draft Addendum as being a binding Pillar I measure. As such, in their view, the adoption of the Addendum would overstep the ECB's mandate.	<ul style="list-style-type: none"> The Addendum does not impose binding obligations on credit institutions and is not intended to produce legal effects on banks. Therefore, the Addendum is not a Pillar I measure. The Addendum only aims to provide an indication of how the ECB interprets certain provisions in the existing regulatory framework and what it expects from banks when complying with those provisions. It is important to note that the Addendum is not in itself a Pillar 2 measure, and does not aim to impose any obligations on banks. The Addendum provides an indication of what the ECB expects from banks when they assess the risks they are exposed to. In this respect, the accounting allowances of a bank serve as a starting point for the supervisory dialogue in determining whether these allowances adequately cover expected credit risk losses. The accounting allowances are then compared with the supervisory expectations set out in the Addendum, using timelines which, in principle, may point to a deterioration of the exposures' quality. Banks are expected to discuss why their respective approaches differ from the supervisory expectations set out in the Addendum. If the ECB is satisfied with the explanations, then no further action is proposed. However, if, after giving due consideration to a bank's explanations and in view of the specific circumstances of that bank, the ECB is still of the view that that bank's provisions do not adequately cover the expected credit risk, a supervisory measure under the Pillar 2 framework might be considered. Any supervisory measure to be adopted will always be specified in a supervisory decision addressed to the individual bank concerned, taking into account its specific circumstances. 	Yes
2	"Comply or explain" mechanism	Some commenters argued that the "comply or explain" mechanism inverts the burden of proof. As a result, rather than being up to the supervisor to provide evidence that the provisioning level of the supervised bank is inadequate, it would be up to the bank to demonstrate that its provision policy is adequate.	<ul style="list-style-type: none"> The use of the term "comply or explain" is meant to illustrate how the supervisory dialogue with institutions will take place. It is not used in the meaning of the EBA regulation, which provides for a "comply or explain" mechanism for recommendations (guidelines) issued by the EBA. The latter provides for a legal mechanism to ensure convergence in supervisory practices, whereas the "comply or explain" concept in the Addendum describes the ECB's dialogue with individual institutions, which will provide input into an individual assessment of those institutions and may lead to the adoption of supervisory measures under the Pillar II framework. Therefore, the Addendum does not reverse the burden of proof. It will merely serve as a basis for a supervisory dialogue between the ECB and banks, in the course of which it is commonly accepted that banks and supervisors exchange their views. The ECB must still justify why a specific supervisory measure under the Pillar II framework is warranted in each case. 	Yes

3	Conflict with existing accounting standards	Comments expressed the view that the supervisory expectations set out in the draft Addendum conflict with existing applicable accounting rules both at national and international level, and in particular with IFRS 9.	<ul style="list-style-type: none"> The Addendum does not conflict with the applicable accounting regime. The accounting allowances of a bank serve as a starting point for the supervisory dialogue in determining whether these allowances adequately cover expected credit risk losses. The accounting allowances are then compared with the supervisory expectations set out in the Addendum, using timelines which, in principle, may point to a deterioration of the exposures' quality. Banks are expected to discuss why their respective approaches differ from the supervisory expectations set out in the draft Addendum. If the applicable accounting treatment does not match the prudential provisioning expectations, banks may consider to what extent to adjust their Common Equity Tier 1 capital on their own initiative. The Addendum does not interfere with the applicable accounting framework, as it sets out supervisory expectations for prudential purposes. 	No
4	Clarifications concerning the reference to Article 3 of the CRR (Section 2.3)	Commenters argued that the reference to Article 3 of the CRR in the draft Addendum introduces a mandatory CET1 deduction for banks that do not comply with the supervisory provisioning expectations.	<ul style="list-style-type: none"> Article 3 of the CRR clarifies that the CRR does not prevent institutions from holding own funds and their components in excess of, or from applying measures that are stricter than, those required by that Regulation. By referring to Article 3 (page 6), the Addendum does not require banks to make additional CET1 deductions from own funds to fulfil a prudential provisioning backstop. The Addendum merely states that banks can make CET1 deductions from own funds on their own initiative pursuant to Article 3 of the CRR. In doing so, it simply reminds banks of a possibility they may use and which is already provided for in the CRR, namely, if they reach the conclusion that, owing to their accounting treatment, the prudential risks which may stem from some of their exposures are not properly covered, they may make additional CET1 deductions from own funds to fulfil prudential provisioning expectations. 	Yes
5	Deviation from the supervisory expectations set out in the Addendum	Some comments suggested that the Addendum explicitly limits the circumstances under which banks may deviate from the supervisory expectations set out in the Addendum.	<ul style="list-style-type: none"> The Addendum does not limit the circumstances under which banks may deviate from supervisory expectations. On the contrary, the consultation document provided the following: <i>"Deviations...are possible if a bank can demonstrate...that..."</i> <i>"(b) the application of the backstop is not reasonable in justified circumstances (e.g. pulling effect on a debtor's performing exposures)."</i> "Justified circumstances" under (b) above can be anything, and therefore the draft Addendum does not precisely delimit the ambit of permitted exemptions from compliance. The final text of the Addendum has been clarified in this respect. 	Yes

3.7 Relation to existing prudential and accounting frameworks

#	Topic	Details	Response	Change
1	CRR eligibility of all forms of credit risk mitigation	Chapter 4 of the CRR does not apply to banks using the IRBA; the reference to the CRR text needs to be adjusted accordingly so that CRM eligibility is considered for those banks.	<ul style="list-style-type: none"> The final Addendum text clarified further that collateral eligible under the CRR will also be considered for the purpose of the supervisory expectations set out in the Addendum, while ensuring a level playing field across banks using standard and internal model-based approaches. 	Yes
2	Interplay with Pillar 1 capital requirements	If the own funds requirement for NPL exposures is not recognised, risks will be double-counted.	<ul style="list-style-type: none"> The Addendum states that any Pillar 1 capital requirement for credit risk should be taken into account in the supervisory dialogue. 	No
3	Relationship with the NPL Guidance	Comment(s) queried the interplay with Chapter 7 of the NPL Guidance.	<ul style="list-style-type: none"> The Addendum does not call the valuation of collateral (covered in Chapter 7 of the NPL Guidance) into question, but rather questions whether the execution of collateral, and hence the credit risk mitigation in the prudential regime, is timely. Once the respective secured part of an NPL is fully covered, banks may decide to review the frequency with 	No

			which they update collateral valuations (Chapter 7 of the NPL Guidance encourages an annual update).	
4	ECOFIN conclusions	Coordination of supervisory expectations with related Pillar 1 legislative proposals.	<ul style="list-style-type: none"> The ECB is in close communication with the Commission regarding this very important topic, as the two initiatives are complementary. The ECB considers that the supervisory expectations in the Addendum are a very useful complement to the relevant Pillar 1 measures. 	No
5	Non-compliance with accounting standards	A number of commenters remarked that the Addendum is not consistent with accounting standards (i.e. IFRS 9).	<ul style="list-style-type: none"> The Addendum has a purely prudential function, and does not modify/override the accounting provisions of the bank. 	No
6	Implications on Article 26(2) of the CRR	A number of respondents questioned the interplay of the supervisory expectations set out in the Addendum with Article 26(2)	<ul style="list-style-type: none"> Provisions booked for NPLs within the scope shown in Figure 1 (at the relevant reporting date) are recognised immediately without them having to meet the criteria set out in Article 26(2) of the CRR. Significant events after the reporting date are taken into account in the supervisory assessment. 	No
7	Impact of write-offs on the Addendum	A number of commenters sought clarity on how partial write-offs are to be considered within the supervisory expectations set out in the Addendum.	<ul style="list-style-type: none"> The Addendum has been amended to highlight that partial write-offs made since the most recent NPE classification can be considered as provisioning in the linear path assessment and contribute to the existing coverage ratio of the bank. 	Yes