POSITION PAPER

ESBG response to the ECB consultation on the draft guidance to banks on non-performing loans

ESBG (European Savings and Retail Banking Group)

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ESBG

Dear Sir/Madam,

Thank you for the opportunity to comment on the ECB consultation on the *draft guidance to banks on non-performing loans*. We would like to share with you the following reflections that we hope will be taken into account by the ECB.

<u>"EU average NPL"</u>

ESBG believes that setting the "EU average NPL" as a benchmark and incentivising banks to be below this threshold would have unintended negative consequences. In particular:

- Such an average would be a moving target and in the proposed set-up it would become continuously lower. After a while, the threshold would not only be unsustainable but also economically unjustifiable.
- The banks' business models are very different: the share of private individuals, micro, SMEs and corporates is different and each of these segments have a different level of healthy and manageable NPLs. In addition, banks have to pursue different workout strategies based on the regulatory environment in which they operate. So for some, NPL sell-off options are limited, while others can benefit from a regular sell-off process. Hence, setting one non-performing exposure target (NPE) for all, independently from business and operating models, does not create a level playing field, in ESBG's opinion. On the contrary, it would create an environment where some businesses become indirectly promoted whilst others would experience a silent cutback. We would not appreciate if an intention for risk reduction became reality by increasing the focus on diminishing the variety of businesses.

As an alternative, ESBG proposes the following: the entry trigger could be the EU average NPL plus 1.5%, but not lower than an absolute NPL level of at least 6%. In addition, a differentiation between business lines should be (re-)considered.

<u>Banking groups</u>

It is not clear whether - in the case of a banking group - the proposed benchmark for a "high NPL bank" applies to individual entities or to the group as a whole or both.

Related to this (which is also not clear to us), in case a banking group is breaching the threshold, will the proposed strict regulatory measures have to be applied to the whole group or to the individual entity? Or is it the decision of the banking group as to where the regulatory measures would have to be applied as well as setting a timeline for these measures to be implemented?

<u>Breach of the NPE threshold</u>

The proposed regulatory measures (defined in chapters 2 and 3) for those banks that breach the NPE threshold are rather formulated at detailed procedure's manual level than as policy requirements. Given the wide range of business models of banks, trying to formulate detailed process level requirements could be counter-productive.

An alternative could be to allow banks in 'breach' a reasonable timeframe (e.g. 1-2 years) to reduce their NPLs to the required level within their own operative environment. In case no progress is made or the

NPL target is not reached, a detailed work-out strategy could be requested for application. This, in our view, could also help to phase out NPL workout actions in any market in order to avoid a market situation where several banks are trying to work out their NPL influencing asset prices and reducing the recovery potential for all.

Frequency of individual valuations

Section 7.3 (page 89) states: "Notwithstanding the provisions of section 7.2, banks should update individual valuations for the collateral of all exposures on a frequent basis and at a minimum every year for commercial immovable property and every three years for residential immoveable property.

The valuation of the immovable property collateral should be updated on an individual basis at the time the loan is classified as a non-performing exposure and at least annually while it continues to be classified as such. This applies to all loans classified as non-performing as per chapter 5 of this guidance."

ESBG would like to ask the ECB to clarify whether they are asking for (at least) annual updates of individual valuations for the collateral of all exposures if the collateral is a commercial immovable property irrespective of its classification (as normal or non-performing exposure). We need to delimit which loans are included in "all exposures" and their possible difference with the ones included in "non-performing exposures".

Removal of identification of an exposure as forborne:

Section 5.3.4 (page 57) states: "Once forborne exposures are classified as performing, either because they have met the conditions for being reclassified from the non-performing category or because the granting of forbearance measures did not lead to the classification of the exposure as non-performing, they will continue to be identified as forborne until all the following conditions are met:

1. an analysis of the financial condition of the debtor showed that the transactions no longer met the conditions to be considered as non-performing;
2. a minimum of two years has elapsed since the later of the date of the concession or the date of reclassification from non-performing;
3. the borrower has made regular payments of more than an insignificant aggregate amount of principal or interest during at least half of the probation period;
4. the borrower does not have any other transactions with amounts more than 30 days past due at the end of the probation period.

Once all the requirements above have been met, the elapsing of the two-year period does not automatically lead to a removal of the identification of the exposure as 'forborne'."

ESBG does not fully understand the intention of the last sentence of the quoted section. On one side, the ECB is enumerating the conditions to stop being classified as forborne, on the other side the question arises what is the meaning of including this last sentence, which seems to contemplate that even if all the requirements have been met this will not lead to an automatic removal of the identification of the exposure as forborne.

Market price discount

We would also like to ask for clarifications regarding the concept of market price discount included in chapter 7 (page 91). Specifically, we would like to know the precise components that it includes (e.g. selling expenses or exclusively the discounted price at which the property was sold).

Impairment

Although the draft Guidance speaks about the treatment of foreclosed assets, it has not, in our view, developed the specific aspects for the measurement of their impairment. ESBG considers that this point should also be included and developed in the ECB's final Guidance.

About ESBG (European Savings and Retail Banking Group)

ESBG brings together nearly 1000 savings and retail banks in 20 European countries that believe in a common identity for European policies. ESBG members represent one of the largest European retail banking networks, comprising one-third of the retail banking market in Europe, with 190 million customers, more than 60,000 outlets, total assets of €7.1 trillion, non-bank deposits of €3.5 trillion, and non-bank loans of €3.7 trillion. ESBG members come together to agree on and promote common positions on relevant regulatory or supervisory matters.

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