EUROPEAN CENTRAL BANK
BANKING SUPERVISION

FAQs on the NPL guidance

1 What is the purpose of the guidance to banks on non-performing loans (NPLs)?

The guidance contains qualitative supervisory expectations while also requesting banks to define and implement appropriate quantitative policies and targets to address the issue of NPLs. The guidance is based on best practices in different member states and beyond. It covers a multitude of aspects related to the management of NPLs. ECB Banking Supervision is consulting on the guidance to ensure that all relevant market-specific issues are appropriately taken into account.

One key focus is to implement NPL strategies in the banks directly supervised by ECB Banking Supervision. The banks are requested to implement in the coming months approved NPL strategies with NPL reduction targets. The targets need to be properly reflected in incentive schemes for the banks' management and need close monitoring by their management bodies. Banks are further requested to implement appropriate NPL workout operations and governance structures.

2 The problem of NPLs has existed for quite some time. Why is ECB Banking Supervision only addressing this now?

Addressing the high level of NPLs in some banks and euro area countries has been a process that started with the 2014 comprehensive assessment. That exercise marked the first time that the banks' assets were evaluated using the same yardstick and resulted in a more adequate level of provisions, providing supervisors with a solid basis to further address the issue. ECB Banking Supervision then addressed the problem of NPLs with individual banks in its supervisory work and has already been applying some of the expectations outlined in the guidance document in its day-to-day supervisory work.

In the past there have been varying supervisory approaches and practices, so the main aim of publishing this guidance is to ensure a level-playing field and also make transparent our expectations towards significant institutions.

We also intend to extend the scope of the guidance based on the continuous monitoring of developments concerning NPLs. As a next step in this regard, while recognising that it will take some time until NPLs will have been reduced to reasonable levels, the ECB plans to gradually put a stronger focus on the timeliness of provisions and write-offs.

3 What happens next? When will you put quantitative targets and timelines in place for banks to act?

In the first instance, the banks themselves are responsible for implementing adequate strategies to manage their NPL portfolios. Therefore, the guidance will work as a basis for the supervisory dialogue with individual banks. Some banks need to move faster to address their NPL problems. They need to work intensively to put in place credible and properly resourced plans to tackle this issue. The ECB will review, benchmark and, as part of its supervisory process, ascertain whether banks have reacted appropriately.

The ECB will also increase supervisory reporting requirements for banks with high levels of NPLs and, as outlined in the guidance, it expects banks to disclose more information related to NPLs.

4 Are banks required to follow your guidance on NPLs? Can they opt to wait until, for example, asset prices recover?

The guidance is currently issued for consultation, and therefore is not yet fully finalised. As this is guidance, it is a non-binding instrument, although we expect the banks to consider guidance from their supervisors very seriously. The ECB therefore expects the institutions it directly supervises to apply the guidance, in line with the scale and severity of the NPL challenges they face.

The "wait-and-see" approach, too often observed in the past, has not solved the issue. Economic recovery is an important ingredient for addressing large-scale NPL issues, but it should also be noted that only sound banks that actively address their problems – including that of NPLs – are able to ensure the adequate funding of the economy and hence bring that recovery about. Therefore, ECB Banking Supervision expects banks with high levels of NPLs to implement targets for reducing those NPLs that are both realistic and ambitious.

5 What was the purpose of the stocktake? How is it different from the guidance?

The stocktake contains examples of best practices from eight member states and is aimed at, on the one hand, explaining a number of elements contained in the guidance and, on the other, suggesting possible national legislative or other changes that can help fix the issue.

It also highlights that solving NPL issues goes beyond banking supervision, given the differences in the national legal frameworks and constraints. Therefore, strategies for individual banks need to take into account the national context and tools available as well as banks' specific circumstances. However, unavailability of certain tools, such as a liquid secondary market for NPLs, cannot serve as an excuse for not addressing NPL issues.

This stocktake will be completed in the coming months to cover the countries that have not yet been addressed by the NPL Task Force.