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 to banks on NPLs contains qualitative supervisory expectations on NPL workout and resolution, going forward. It outlines that banks should define and implement quantitative policies and targets to address high levels of NPLs. The guidance is based on best practice across different Member States and covers many diverse aspects related to the management of NPLs. ECB Banking Supervision provided a period of public consultation in late 2016 to ensure that all relevant issues could be taken into account in an appropriate manner in the guidance.

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

The high level of NPLs was first addressed with the 2014 comprehensive assessment. That exercise marked the first time bank assets were identified and evaluated using the same yardstick. This provided supervisors with a solid basis to further address this important issue. The guidance ensures a level playing field for significant institutions and clearly sets out the ECB's expectations on addressing NPLs across the Banking Union. The ECB recognises that it will take some time to reduce NPLs and that an effort by policy makers on the European and national levels will also be required.

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

The guidance works as a basis for the supervisory dialogue with individual banks. Some banks need to work intensively to put in place credible and properly resourced plans to tackle high levels of NPLs. As part of its ongoing supervisory work, the ECB will review, benchmark and, as part of its annual Supervisory Review and Evaluation Process (SREP), ensure that 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, 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 a non-binding instrument. However any deviations from it will need to be adequately explained. It should be applied in line with the scale and severity of the NPL challenges different banks face. Supervisory expectations can be turned into binding requirements by implementing them as part of the SREP.

The “wait-and-see” approach that was too often observed in the past will not solve the issue. Only sound banks that actively address their problems – including NPLs – are able to ensure the adequate funding of the economy and hence support the recovery. Therefore, the ECB expects banks with high levels of NPLs to set targets that are both realistic and ambitious for reducing NPLs.

5 The guidance asks banks with high NPLs to devise individual NPL reduction strategies. How exactly will this work?

The guidance contains supervisory expectations that will drive the ongoing supervisory interaction with banks on NPLs. Indeed, banks with high levels of NPLs are expected to define ambitious and realistic NPL strategies, including quantitative NPL reduction targets. These strategies need to be backed up by credible operational plans. JSTs have already started to interact with some banks in this regard. Once the strategies have been defined, JSTs will discuss them with banks. This is expected to be an iterative process which in some cases will likely take some time.

6 How quickly do you expect banks to reduce their NPLs? And will you ask them to sell NPLs?

Banks need to define their own NPL reduction strategies and choose the most suitable solution for each relevant portfolio. It is up to banks to define realistic but ambitious timeframes and appropriate options for each portfolio. These options could, for example, include workout, sale, write-off, or foreclosure. Selling NPLs is only one potential element of a bank’s NPL strategy.

7 What are the three main points which you changed or clarified as a result of the public consultation?

The key comments received are summarised in the published feedback statement. One key amendment was the addition of detail regarding “NPL risk transfers”. The guidance now also clarifies the timeline for implementation of the guidance itself and confirms that it is applicable as of the date of publication. A third clarification is that collateral valuation requirements only apply to non-performing loans, not to performing exposures.

8 What are the exact follow-up actions for banks now that the guidance has been published?

The guidance will now form part of the day-to-day supervisory dialogue with individual banks. The ECB will apply the principle of proportionality and adjust its level of intrusiveness depending on the scale and severity of the NPLs in the banks' portfolios. The supervisors have already commenced their engagement with banks with elevated levels of NPLs. This engagement now continues following the publication of the final guidance document and will include letters being sent to banks with elevated levels of NPLs in the near future as part of normal supervisory activities. The NPL letters will contain qualitative elements and will be focused on ensuring that banks are managing and addressing NPLs in line with supervisory expectations.

9 Will the guidance also apply to less significant institutions, and what about proportionality?

The guidance is applicable only to significant institutions (and to their national, European and international subsidiaries).The ECB applies the principle of proportionality, especially with regard to the extent of the NPL issue in the bank concerned. This means that significant institutions with higher levels of NPLs should comply with the entire guidance while other significant institutions with a relatively low overall level of NPLs only need to comply with a subset of the guidance chapters, as specified in the document. This also means that banks which are sustainably reducing their NPLs to a relatively low level do not fall within the full scope of the guidance.