



# FAQs on the NPL guidance addendum

## 1 What is the purpose of this addendum? How does it link to the guidance to banks on non-performing loans (NPLs)?

The addendum contains quantitative guidance that is designed to foster more timely provisioning practices for NPLs in the future. It supplements the NPL guidance published by the European Central Bank (ECB) in March 2017 which focused on qualitative aspects.

## 2 What is the scope of the addendum and when will it come into force?

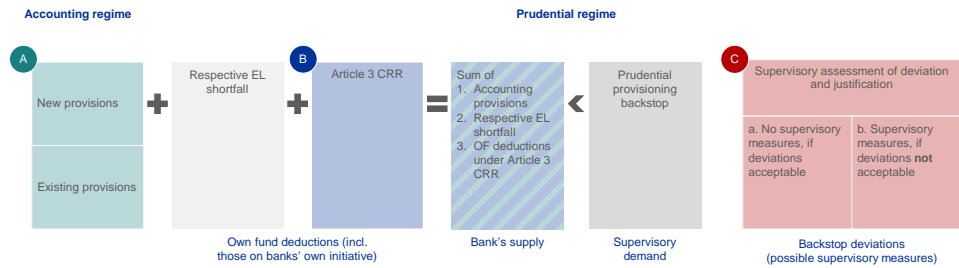
The addendum is applicable to all significant institutions (SIs) and its application is non-binding. However, any deviations from the addendum need to be adequately explained by the banks and could trigger supervisory measures if they are not backed by sufficiently strong arguments and evidence. The prudential provisioning expectations will apply to all exposures that are newly classified as non-performing in line with the EBA definition as of 1 January 2018.

## 3 How does the guidance relate to accounting standards and, more specifically, to IFRS9?

The addendum sets out a prudential tool which allows banks to use own funds deductions under Article 3 of the Capital Requirements Regulation (CRR)<sup>1</sup> as an alternative to accounting provisions to meet the related supervisory expectations. However, any accounting provisions will be taken fully into account when analysing compliance with the prudential provisioning backstop, including potential increases in provisions as a result of IFRS9 coming into force in 2018. Banks should note that such increases in provisions resulting from the first-time implementation of IFRS9 are not P&L relevant and any related capital impacts could be phased in.

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.



4 **What is the expected impact of the provisioning backstop? Could this result in NPL fire sales and has a country-by-country impact analysis been performed?**

The guidance applies only to new NPLs. This means that the exact impact depends on NPL inflows, which have been reduced across the EU in the recent past. Furthermore, the provisioning guidance only addresses those banks that still have unsecured parts of NPLs uncovered after 2 years or secured parts uncovered after 7 years. Regarding the potential impact on secondary NPL market activities, the expectations address the net exposure of NPLs, i.e. NPLs net of prudential provisions. The guidance published on 20 March outlines NPL sales as one of a number of possible tools to address high levels of NPLs.

5 **Why is the backstop only applicable to new NPLs at the moment? And what further measures are you considering for NPL stocks?**

ECB Banking Supervision, through the Joint Supervisory Teams (JSTs), is considering the credibility and ambitiousness of SIs strategies which are also aimed at reducing the existing stock of NPLs via NPL reduction targets defined by the banks. It should be noted that we have seen a reduction in the NPL stock of SIs, which has fallen from €950 billion in Q1 2016 to €865 billion in Q1 2017. Supervisors will continue to monitor bank-specific progress in NPL reductions and present by Q1 2018 their considerations of further policies to address the existing stock of NPLs, including appropriate transitional arrangements.

6 **What impact you have seen since the publication of the NPL guidance in March 2017?**

The JSTs are actively engaging with banks as a follow-up to the publication of the NPL guidance to ensure that SIs are identifying and closing potential gaps in terms of compliance. Furthermore, a number of banks have started to address NPL issues more actively by increasing internal efforts on workout capabilities and also, in part, through sales and securitisation. However, some banks are still not sufficiently focused and ambitious in reducing their elevated NPL levels.

**7**                    **How will you ensure that banks adhere to the guidance provided in the addendum?**

At a minimum, banks should report annually on their compliance with the prudential provisioning backstop outlined in this addendum. Where the coverage does not fully meet the supervisory expectations laid out in the addendum, their reports should be accompanied by explanations for and evidence of such deviations. In cases where the deviations are not sufficiently explained, ECB Banking Supervision will consider supervisory measures.

**8**                    **How did you calibrate the addendum?**

A range of inputs were used to determine the final calibration of the addendum. These included applying supervisory judgement, international practices regarding provisioning respectively write off requirements and the speed of resolution processes across the EU, including related improvements made in the recent past. ECB Banking Supervision considers that the proposed calibration provides a balanced approach to foster timely NPL provisioning practices for the future.

**9**                    **How does this addendum link to EU-wide initiatives on NPLs?**

It is widely acknowledged that a joint effort by all stakeholders is needed to relieve European banks from NPL issues. In this context, ECB Banking Supervision is collaborating very closely with other European stakeholders on this matter.

**10**                   **Is the addendum also applicable to foreclosed assets?**

The addendum is not currently applicable to foreclosed assets. However, ECB Banking Supervision is closely monitoring developments related to foreclosed assets. Where banks are reducing NPLs only by means of foreclosure, without being able to dispose of related foreclosed assets, supervisory measures will follow. In this context, the NPL guidance also strongly encourages banks to apply reasonable haircuts in the valuation of such assets.