Nederlandse
Vereniging van Banken

Advisor Banking Supervision (NVB)

Date 8 December 2017

Reference NVB response to the ECB Consultation: "Public consultation on the draft addendum to the ECB Guidance to banks on non-performing loans".

To: **European Central Bank**
Secretariat to the Supervisory Board
"Public consultation on the draft addendum to the ECB Guidance to banks on non-performing loans"
60640 Frankfurt am Main
Germany

Dear Sir/Madam,

We welcome the opportunity to provide feedback to your Consultative Document: "Public consultation on the draft addendum to the ECB Guidance to banks on non-performing loans". Complementary to the EBF consultation response, which we support, we wish to put additional focus on the following:

1. Discrepancy between EC consultation on provisioning backstop and ECB Addendum

We notethe differences in the draft texts of the "EC consultation on provisioning backstops" and the "addendum to the ECB Guidance to banks on non-performing loans". The main differences are related to 1) scope: newly originated versus newly impaired as of start date, and 2) the requirement on provisioning for the secured part: fully versus the ineffective part of the collateral. These are important aspects of the potential new guidelines and the ECB is requested to provide clarity on how these differences will coincide after the effective date.

2. Impact assessment

To substantiate the effectiveness of the new guidance a thorough ECB assessment on the impact of the ECB guidance including the addendum is required, ahead of the implementation date.
The assessment should cover the impact on our clients (prices, exit strategies); markets (symmetry in markets for non-performing exposures) and the institutions (administrative burden, capital ratios).

3. Provisions and regulatory capital

Next to the provisions for non-performing exposures, institutions also hold pillar I capital against the unexpected losses that might occur on these non-performing exposures. The regulatory capital is based on the difference between the in-default LGD (Loss Given Default) and EL_{BE} (Expected Loss. Best Estimate). Often the in-default LGD's increases the longer an exposure is classified as defaulted The in-default LGD models are supervised by the ECB-SSM. In our view the ECB should demonstrate per institution whether the sum of the capital and provisions are considered to be too low compared to the actual risk profiles before additional pillar II capital would be required.

If an institution would report too low levels of provisions in combination with the regulatory capital (pillar I) for non-performing exposures, based on the addendum the ECB could require an individual institution to set aside additional pillar II capital. The applicable 'comply or explain' process is an individual process, and therefore a pillar II process: it becomes part of the ICAAP and SREP cycle. Nevertheless, this seems to conflict with page 5 of the addendum where it states that 'a CET 1 deduction from own funds' would be required, which is a pillar 1 process. We would welcome clarity on this important issue.

4. After seven years 100% of the secured part should be provisioned

As we read it, after two years the unsecured part of a non-performing exposure should be fully provisioned (100%), following a linear path. For the secured part a seven years linear path will be applicable. We would appreciate clarification on the start date for calculating the provisions for the secured part of a loan. Is the start date at t=0 or t=2?

In addition, we would like to understand how the value of collateral is taken into consideration. For Example: a non-performing loan of 100 of which 40 is unsecured and 60 is secured. After two years the unsecured part of 40 is fully provisioned for. When re-examining the value of the collateral the liquidation value is adjusted (due to market developments) to 35. Hence, 25 should be labelled as unsecured and as two years already passed by, the 25 should be fully provisioned for. We question whether the fully secured part (the value of the collateral which equals 35) needs to be provisioned for up to 100% (linear path in seven years) as well? Especially for mortgage loans with strong and sufficient collateral it makes no sense from an economic perspective to fully provision the secured part.

Also, institutions that report (part of) their portfolios on A-IRB should be able to fully take into account the collateral eligible under pillar I for the different portfolios, while complying to the requirements of Part Three, Title II, Chapter 4, Section 3 of the CRR Capital Requirements Regulation (CRR).

5. Duty of care

If Dutch banks are required to provision more in the form of additional Pillar II capital, based on the ECB addendum, the total buffer (provisions and capital) against NPE's could significantly exceed the economic risk profiles. This way, the ECB guidance may create an incentive to terminate the NPE's rather than curing them, also in the first years of the non-performing status. This might lead to conflicts with the banks' duty of care that the Dutch banks take very seriously. Therefore, if banks have proven to adequately provision, these banks should rather 'explain' their provision strategy, rather than 'comply' with the ECB addendum. The banks should also provide cure rates when articulating their provision strategies.

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6. Non performing status during the probation period (related to EBF point on UtP exclusion)

We believe that the ECB should narrow the scope of the addendum. Firstly, non-performing clients who start making regular payments again keep the non-performing status during the probation period. These clients in probation should be excluded from mandatory increasing provisions and increasing Pillar I/II capital charges when they are making regular payments.

7. Comply or explain

Based on the current prudential regulations and accounting rules and based on the checks and balances within individuals institutions (three lines of defence) and the independent review by the external auditors and the supervisors, robust provisioning strategies and processes are expected to be in place. This should ensure the reporting of adequate levels of provisions related to the actual risk profiles of the non-performing exposures. Therefore, before forcing every individual institutions into a ‘comply or explain’ process related to the ECB guidance and addendum, we would expect the supervisor to explain per individual institution if and why the provisioning levels are not adequate. As a suggestion, the ECB could formulate several risk sensitive indicators to assess whether minimum levels of prudential provisions as quantified in the addendum need to be specified for an institution.

Having said this, low NPE institutions with robust provisioning strategies and processes should only be required to ‘explain’ their provision strategy, rather than ‘comply or explain’ with the ECB addendum.

8. Market asymmetry

The public disclosure of NPE’s by vintage and the quantitative expectations of the addendum put banks in a weaker position to sell their NPLs as investors and borrowers will be aware of the obligation of the bank to comply with the supervisory expectation. On the buy side, institutions will see the (capital) costs for taking on NPE’s increasing, which puts an even more downward pressure on the price for these NPE’s.