European Commission - Fact Sheet

Banking Union: Third Progress Report on risk reduction and the declining trends as regards non-performing loans

Brussels, 28 November 2018

What is the Banking Union?

Making banks stronger has been one of the Commission's main goals since the financial crisis. The EU has established a new regulatory framework and institutional set-up to effectively address financial risks in the Banking Union, delivering a strong improvement in banks' capital and liquidity positions, ensuring better monitoring of banks' health and setting in motion a process to deal with banks in difficulties. That said, work to strengthen financial stability must continue and the momentum must be used to reinforce further the **Economic and Monetary Union** (EMU).

As the Commission emphasised in its Communication of 11 October 2017, the Banking Union should be completed by achieving risk-reduction and risk-sharing in parallel, based on the Council's June 2016 Roadmap. Progress in all areas, including agreement on the backstop to the Single Resolution Fund (SRF) and a European Deposit Insurance Scheme (EDIS), is now urgent.

What are non-performing loans and why are they a problem?

One of the key areas for reducing risk in the European banking sector is the further decline in the number of **non-performing loans** (NPLs). The financial crisis and subsequent recessions led to a more widespread inability of borrowers to pay back their loans, as more people and companies faced continued payment difficulties and even bankruptcy. This was particularly so in Member States that faced long or deep recessions. Consequently, many banks saw a build-up of NPLs on their books. High NPL ratios remain an important challenge in some banks in particular and can considerably weigh on the performance of these banks.

First, NPLs generate less income for a bank than performing loans and thus reduce its profitability. They may cause losses that reduce the bank's capital. Second, NPLs tie up significant amounts of a bank's resources, both human and financial. This reduces the bank's capacity to lend, including to small and medium-sized enterprises. In turn, this negative effect in terms of credit supply also reduces the capacity of businesses to invest, creating a tangible effect on the real economy.

What has the Juncker Commission done to tackle NPLs and reduce risks in the banking sector?

In addition to the enhanced regulatory and supervisory framework put in place by the EU in the aftermath of the crisis, the Commission has been working together with Member States concerned to address the high level of NPLs, including through the European Semester and the setting up of ad hoc and system-wide impaired assets measures, compatible with state aid rules. Member States' supervisors and banks have themselves also made considerable progress in cleaning up bank balance sheets since the crisis.

More recently, the Commission has put forward several further substantial risk-reduction measures, including in the banking risk reduction package of November 2016. The Commission welcomes significant progress in trilogue discussions on this package, which should pave the way for an agreement shortly.

In 2016, the Commission also adopted a proposal on business insolvency, including preventive restructuring rules that are essential to avoid the liquidation of viable companies and thus contribute to the reduction of NPLs and a well-functioning Capital Markets Union (CMU).

In March 2018, the Commission put forward a comprehensive package of measures as part of the EU Action Plan to tackle non-performing loans. The Commission continues to call on the European Parliament and the Council to show determination on these important files in order to facilitate their swift adoption which would further contribute to the reduction in the number of NPLs and a well-functioning Capital Markets Union (CMU).

Furthermore, the Commission has been working constructively with Member States to enable case-specific solutions for banks within the framework of EU State aid and banking rules, with a clear objective of limiting costs to taxpayers whilst making sure depositors remained fully protected at all times. This enabled transactions that removed some **€133 billion*** of gross NPLs from the balance sheets of banks over the last three years (around €103 billion* in Italy; around €24 billion in Portugal; around €6 billion in Cyprus). The Commission has also worked with Member States on solutions that enabled retail investors who have been the victims of mis-selling of subordinated debt instruments to receive compensation.

Today's third progress report responds to the Council's expectation to complete a regular stocktake of NPLs in the EU and is accompanied by a staff working document which explores a potential NPL transaction platform - one of the final deliverables of the Action Plan.

What does the latest progress report on NPLs show?

Today's Report shows that the declining trend in NPL ratios continues and that the quality of banks' loans portfolios has improved. This is the result of continuing economic growth in the EU as well as the outcome of various pro-active measures, including sales of NPL portfolios.

Some of the **key findings** include:

- The gross NPL ratio for all EU banks further declined to **3.4 %** by the end of Q2-2018, down by 1.2 percentage points year-on-year. The NPL ratio of significant institutions also decreased over the same timeframe by almost one percentage point to 4.4 %. The provisioning ratio has also further improved and has risen to 59 % (Q2-2018). Additional data sources with regard to the longer term trend indicate that the NPL ratio is approaching pre-crisis levels again.
- Nevertheless, the total volume of NPLs across the Union still stands at €820 billion. Uneven NPL ratios across the EU – ranging from 0.6 % to 44.9 % – and slow progress in some Member States remain a source of concern.
- Structural impediments continue to hamper a faster decline in NPL stocks. Among other elements, debt restructuring, insolvency and debt recovery processes continue to be a significant hurdle in some cases, as they remain too slow and unpredictable.
- Activity on **secondary markets** for NPLs is growing in some Member States, supported by relevant policy actions, but not yet sufficient to substantially and structurally contribute to NPL reduction efforts. That being said, the sustained and continued development of the secondary market is encouraging, as it has momentum in several Member States, with banks selling large portfolios. Interest from investors is rising and the volume of NPL-related transactions is increasing.

What is an NPL transaction platform and why are Commission services publishing a dedicated staff working document on the matter?

As markets for non-performing loans remain poorly developed, well-functioning transaction platforms may help create liquid and efficient secondary markets for NPLs in Europe. In the July 2017 Action Plan, Member States called on the European Central Bank, the European Banking Authority and the Commission to consider setting up a NPL transaction platform in order to stimulate the development of secondary markets. Today's Report is therefore accompanied by a staff working document drafted jointly with the European Central Bank and the European Banking Authority exploring a potential set-up of such a platform and how it could work in practice.

A **European NPL transaction platform** would be an electronic marketplace where holders of NPLs and interested investors can exchange information and trade. Such a platform has the potential to address several current sources of market failure in the secondary market for NPLs, including asymmetry of information between sellers and buyers and high transaction costs. As a result, it could help banks increase sales and obtain higher sales prices than currently possible, ease investor access to NPL markets, and thereby allow banks to dispose of NPLs and clean up their balance sheets faster. Such a platform could help deal with current stocks of NPLs and provide a permanent channel for the efficient disposal of future NPLs as they arise. In this sense, it could be an important, yet low-cost, infrastructure investment, preventing a new build-up of large stocks of NPLs in the future. It could therefore be an essential means of contributing to a sustainable solution to the NPL issue in Europe.

The Commission has also today invited industry stakeholders to a roundtable in order to kick-start work on EU-wide NPL platforms and will ask them to agree, by spring 2019, on the concrete forms for developing and issuing industry standards for European NPL platforms. Together with the European Central Bank and the European Banking Authority, the Commission will continue to play a key role in facilitating the taking of the necessary steps to promote the emergence of Union-wide NPL platforms by all relevant stakeholders.

What is the state-of-play of the Commission NPL package presented in March 2018?

This ambitious package of measures, adopted in March 2018, is the Commission's main response to the call by the Council for further measures to address the problem of non-performing loans in the EU as set out in the Council's Action Plan of July 2017.

The package consists of the following key measures:

1. A proposal to amend the existing Capital Requirement Regulation (CRR) for banks, establishing common minimum levels for the amount of money banks need to set aside to cover losses caused by future loans that turn non-performing. In case a bank does not meet the applicable minimum level, deductions from own funds would apply. The minimum coverage levels will act as a **statutory prudential backstop** for newly originated loans that become non-performing.

2. A proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral, which has two objectives:

- Providing more efficient value recovery from secured loans, by facilitating **out-of-court collateral enforcement**, which will allow banks to seize the collateral that underpins a loan in an expedited way, without going to court. It is important to note that this out-of-court collateral enforcement is strictly limited to loans granted to businesses. **Consumer loans are excluded**. It is only applicable where the business explicitly agreed to it when concluding the loan contract.
- Fostering the **development of a secondary market for NPLs** by removing undue barriers to credit servicing and to the transfer of bank loans to third parties across the EU. **Consumer protection is ensured by legal safeguards and transparency rules** so that the transfer of a loan does not affect the rights and interest of the borrower.

3. Technical guidance on how to set up national **Asset Management Companies** (AMCs). This is a non-binding, non-legislative 'blueprint' for how such AMCs or other measures can be set up by Member States, in compliance with existing EU banking and State aid rules, should they find it useful.

The legislative measures of this package are currently under discussion in the European Parliament and the Council. The Council has agreed its negotiating position on the proposed Regulation and the Commission calls on the Parliament to do the same so that a final agreement can be struck before the end of the current legislature.

As regards the proposed Directive, a position has been reached neither by the Parliament, nor by the Council. The Commission is calling for these negotiations to be finalised before the end of the current legislature.

*corr. 28/11/18 12:40

MEMO/18/6547

Press contacts:

Johannes BAHRKE (+32 2 295 86 15)
Letizia LUPINI (+32 2 295 19 58)

General public inquiries: Europe Direct by phone 00 800 67 89 10 11 or by email