afme/
Finance for Europe

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Hon. Vladislav Goranov
Minister for Finance, Bulgaria
102 "G. S. Rakovski" Str.
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Bulgaria

Dear Minister

**ECOFIN discussions on non-performing loans in Europe**

As the trade body representing Europe's wholesale financial markets, AFME has been very engaged with our members in the various workstreams stipulated in the Council conclusions on an Action Plan to tackle NPLs in Europe adopted in July 2017 (the "Action Plan").

**Since the adoption of the Action Plan, the ratio and volume of NPLs in Europe has continued to follow a downward trend**[1]**.** Many European banks, including AFME members, are currently implementing NPL strategies and management processes. It is important to allow these strategies, which may vary according to an institution's specific situation and needs, to continue to be effectively implemented over a period of time and with appropriate supervisory oversight.

While we remain supportive of the overall Action Plan, we believe that certain components should be reviewed or re-prioritised at this point to ensure that all measures remain appropriate, proportionate and adjusted to market developments. In 2018 EU authorities should prioritise measures that clearly support, and do not risk unsettling, the progress being made by several financial institutions and Member States.

More specifically, AFME and its members would like to share the following recommendations:

- A new Council statement on NPLs which should take stock of the progress being made and clearly articulate the need for further measures which reinforce current market trends;
- The Action Plan and its components should be subject to clear accountability lines and coordination mechanisms to ensure consistency and clarity in the specific mandates;

[1] We are encouraged by the latest EBA figures (January 2018) showing that the ratio of the stock of NPLs for EU banks has continued to decrease and stood at 4.2% of loans in the third quarter of 2017 (compared to 5.4% at June 2016). We expect the trend to continue, but at a gradual pace, as banks' NPL workout programmes are supported by more robust economic growth in the Eurozone and a healthier and stronger financial system following the implementation of post-crisis reforms.

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- The workstreams should be re-prioritised: in particular, more priority should be given to harmonising insolvency laws in the EU and less to further measures targeting Pillar 1 bank capital requirements;

- Further efforts should be directed towards removing impediments to the development of secondary markets for NPLs and distressed debt on the basis of cost-benefit analyses.

We provide further details on these topics and our recommendations below.

## Implementation of NPLs Action Plan

The current Action Plan features a range of actions and several workstreams running in parallel. We believe that EU authorities could take the opportunity in early 2018 to establish priority actions for the year and focus institutional resources on their delivery. As explained further below, we believe that the priority actions for 2018 should be:

- Intensifying efforts towards the harmonisation of insolvency laws in the EU as well as improving their effectiveness; and

- Advancing the measures necessary to remove impediments to the development of EU secondary markets for NPLs and distressed debt.

Following the established priorities, it is important that the various European and national institutions involved[2] ensure strong levels of transparency and coordination, as well as adequate consultation processes, in their respective workstreams and mandates. As addressed further below, the work on supervision and bank capital is an area where there are concerns in this regard. AFME members stress the need to avoid unnecessary duplication of resources and requirements both for banks and for their supervisors.

Authorities should also ensure that the Action Plan workstreams are subject to realistic expectations and timelines. In this context, it is unclear to AFME members if certain workstreams are being delivered as planned[3].

## Secondary markets for NPLs and distressed debt

AFME strongly agrees that building a deeper European secondary market for NPLs and distressed debt should remain a key priority. More robust secondary markets can contribute to the acceleration of the NPL adjustment process as banks continue their internal processes related to restructuring their NPL portfolios[4].

[2] European Commission, European Central Bank, European Banking Authority, European Systemic Risk Board, as well as national central banks and ministries.

[3] AFME is unclear if, for example, the AMC blueprint and the insolvency benchmarking exercise have been delivered as expected by the end of 2017.

[4] We understand that the volume of loan portfolio sales totalled €86bn in 2017, with an aggregate value of sales of €197bn between 2016 and 2017. This volume of NPL sales remains relatively low compared to the total stock of European NPLs. There are various reasons for this, including the low level of prices offered for such loans compared to their carrying or book value and the different levels of development of national secondary markets for NPLs across Europe and lack of a true pan-European NPLs and distressed debt market.

There are a number of impediments to address in this area. We provided detailed views in our submission to the Commission of October 2017[5], suggesting that various impediments could be tackled by measures that seek to standardise the NPLs sale process, including data requirements, as well as the approach and organisational needs of sellers and buyers. We support the voluntary use of the NPL data templates as developed by the EBA, but stress that they should be designed to provide the necessary incentives so that they are widely recognised by industry participants as an easier, more valuable and more efficient alternative than what is currently in use.

A broad EU legislative initiative might be a suitable vehicle to pursue measures needed to address certain impediments. However, it is important that any actions are accompanied by a rigorous impact assessment that analyses the cost-benefit of different proposals.

## Insolvency reform

The inconsistencies between the substance and the quality of national insolvency regimes remain major impediments to avoiding a loan becoming an NPL, and may also impede quick and efficient resolution of NPLs by banks and other entities. It is therefore critical that authorities intensify efforts towards further harmonisation of minimum insolvency standards across Europe.

Subject to certain clarifications regarding the protection of secured creditors, the proposed Directive on preventive restructuring measures and second chance would help to facilitate more predictable and orderly outcomes for corporate restructurings. We urge EU authorities and the Bulgarian Presidency to prioritise the adoption of an ambitious new framework on the basis of this proposal.

## Supervision and bank capital

The workstreams related to bank capital and supervisory actions have given rise to a degree of concern among AFME members. The simultaneous consultations that the ECB and the Commission carried out in late 2017 were not perceived as ideally coordinated and therefore caused some uncertainty over the direction of policy in this area and what this implied for banks. We note that ECB's Addendum consultation was not announced in the Action Plan and that the Commission's consultation was subject to a very short deadline.

As we expressed to the Commission[6], we remain unconvinced that statutory prudential backstops are a necessary and appropriate tool as they are not designed to cater for the complexity and diversity of legal and other practices in individual Member States banking markets or the diversity of institution portfolios of NPLs.

There should instead by a true Pillar 2 approach applied on an institution-specific basis. However, the recent ECB proposal for introducing a Pillar 2 prudential backstop for SSM banks was unexpected, particularly as it applies to new non-performing exposures (NPEs), rather than newly originated

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[5] Available at https://www.afme.eu/globalassets/downloads/consultation-responses/afme-ppa-response-to-consultation-on-secondary-markets-for-non-performing-loans-and-distressed-assets.pdf

[6] Our response to the consultation is available at: https://www.afme.eu/globalassets/downloads/consultation-responses/afme-npl-statutory-prudential-backstops-for-npls.pdf

loans as envisaged in the Action Plan and in the Commission consultation on statutory backstops. While we recognised and welcomed that the ECB publicly set out its supervisory expectations with respect to prudential provisioning of new NPEs, we nevertheless found[7] its proposed Guidance to be closer to a Pillar 1 approach, even though it is formally presented as a Pillar 2 approach. We also see that this measure could negatively impact banks efforts to address legacy NPEs particularly in countries where the issues is of a systemic nature and secondary markets for NPLs are either non-existent or not yet well established.

We hope that the views and recommendations presented above are useful and we stand ready to continue to work with EU authorities and the Bulgarian Presidency on these issues.

Yours sincerely

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Andrea Enria, Chairperson of the EBA
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[7] Our response to the ECB consultation on a Draft Addendum to the ECB NPL Guidance is available at: https://www.afme.eu/globalassets/downloads/consultation-responses/afme-prd-draft-addendum-to-the-ecb-npl-guidance.pdf