European Parliament

Setting minimum coverage for potential losses stemming from non-performing loans (NPLs)

In March 2018, the Commission adopted a package of measures to tackle the risks stemming from the high levels of non-performing loans on EU banks' balance sheets. The package includes a proposal to amend the Capital Requirements Regulation, to introduce common minimum coverage levels acting as a 'statutory prudential backstop' for newly originated loans that become non-performing. Parliament is due to vote on the proposal in March.

Background

When a borrower has failed to make a scheduled payment for a loan beyond a specific time (90 days) or is likely to be unable to repay in full, the loan is considered 'non-performing'. Due to the recession brought about by the financial crisis, more and more EU companies and citizens have faced economic difficulties in recent years, and been unable to repay their loans. Consequently, many EU banks have accumulated high volumes of non-performing loans (NPLs) on their balance sheets. NPLs represent a risk to banks' balance sheets, insofar as banks have not sufficiently provisioned for future losses that such NPLs might generate.

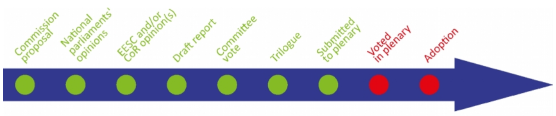
European Commission proposal

On 14 March 2018, the Commission proposed to amend the Capital Requirements Regulation (CRR) in order to establish a requirement for credit institutions to build their loan loss reserve up to common minimum levels to cover the incurred and expected losses on newly originated loans that become non-performing ('minimum coverage requirement'). Where the minimum coverage requirement is not met, the difference between the actual coverage level and the requirement should be deducted from a bank's own resources (CET1). The minimum coverage levels would thus act as a 'statutory prudential backstop', conceived as a 'Pillar 1' requirement. Different coverage requirements would apply depending on whether NPLs are 'secured' (i.e. covered by eligible credit protection, as determined in the CRR) or 'unsecured'. The requirements would increase gradually depending on how long exposures have been classified as non-performing. For this purpose, the Commission proposes to introduce a common definition of non-performing exposures (NPEs), in accordance with that already used for supervisory reporting purposes.

European Parliament position

On 6 December 2018, Parliament's Committee on Economic and Monetary Affairs (ECON) adopted its report on the proposal. Following trilogue discussions, Parliament and Council reached a provisional agreement on 18 December, which was endorsed by Coreper on 7 January 2019 and then approved in the ECON committee meeting of 22 January. It confirms that different coverage requirements would apply depending on whether NPLs are classified as unsecured or secured, and on the kind of collateral. Unsecured loans would have to be fully provisioned three years after being classified as non-performing, while for loans secured by immovable collateral or other CRR-eligible collateral, a gradual increase of the annual minimum loss coverage would apply over a period of nine or seven years respectively, starting three years after being classified as non-performing. The agreed text confirms the Parliament’s proposal on the treatment of NPLs purchased on the secondary market. This should reduce possible disincentives for credit purchasers, while protecting borrowers from undue burden. The new rules would apply solely to loans issued after the new regulation comes into force. The text now needs to be formally adopted by Parliament, and is due to be voted in plenary in March.

First-reading report: 2018/0060(COD); Committee responsible: ECON; Rapporteurs: Esther de Lange (EPP, the Netherlands) and Roberto Gualtieri (S&D, Italy). For further information see our 'EU Legislation in progress' briefing.



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