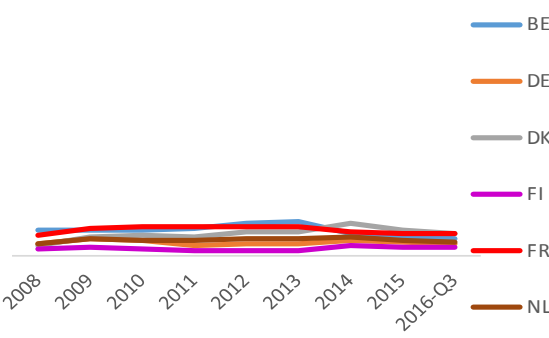
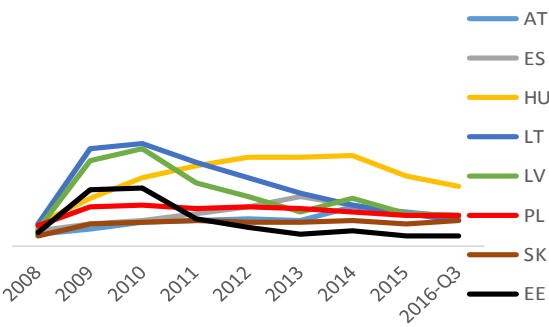
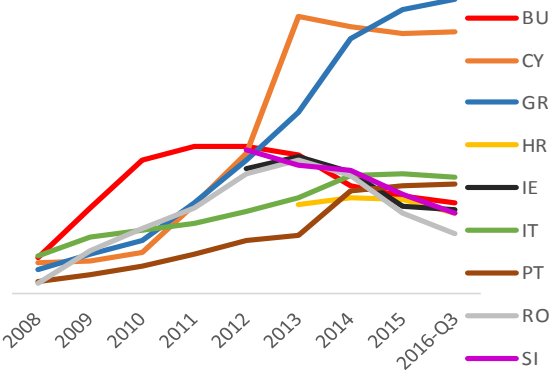


BRIEFING

Non-performing loans in the Banking Union: state of play

This briefing presents the state of play of non-performing loans (NPL) in the euro area, and provides an overview of the various measures implemented across Member States to facilitate their resolution. It also takes stock of the various workstreams at European level, including the work of the Council's Financial Services Committee (FSC) and the Council's action plan adopted on 11 July. This briefing is an update of a longer version published in [March 2016](#).

NPL ratios in Member States as of December 2016

MS	NPL ratio	Forb. ratio	Cov. ratio	NPL * (bnEUR)	% total*	Evolution of non-performing exposures
Group 1: low level of NPL and no significant increase throughout the crisis						
BE	3,2%	1,6%	44%	21	2%	
DK	3,1%	1,9%	30%	20	2%	
FI	1,6%	1,7%	30%	4	0%	
DE	2,5%	2,1%	37%	68	6%	
LU	1,1%	0,3%	45%	2	0%	
NL	2,5%	2,4%	35%	45	4%	
FR	3,7%	1,2%	52%	148	14%	
SE	1,0%	1,1%	29%	11	1%	
UK	1,9%	1,4%	30%	91	8%	
Total Group 1:				410	37%	
Group 2: relatively low level, after a significant increase during the crisis						
AT	5,3%	3,2%	55%	25	2%	
EE	1,3%	2,0%	32%	0	0%	
CZ	2,5%	0,8%	63%	2	0%	
PL	6,1%	2,4%	59%	7	1%	
HU	11,5%	5,5%	64%	6	1%	
SK	4,2%	2,0%	55%	2	0%	
ES	5,7%	6,2%	44%	141	13%	
LV	3,2%	4,4%	29%	0	0%	
LT	3,8%	3,1%	30%	1	0%	
Total Group 2:				184	17%	
Group 3: high level of non-performing loans						
BG	12,5%	7,8%	58%	2	0%	
HR	10,1%	5,1%	63%	3	0%	
CY	44,8%	26,4%	40%	21	2%	
EL	45,9%	23,2%	48%	115	11%	
IE	13,6%	12,7%	35%	33	3%	
IT	15,3%	5,4%	49%	276	25%	
MT	4,4%	4,2%	36%	1	0%	
PT	19,5%	12,7%	44%	41	4%	
RO	10,1%	6,1%	66%	3	0%	
SI	14,4%	9,7%	64%	3	0%	
Total Group 3:				499	46%	
EU	5,1%	3,2%	45%	1092	100%	

Source: EBA, ECB (* refers to data available as of June 2016)

Non-performing loans in the euro area: where do we stand?

In the EU the average rate of non-performing loans is slowly decreasing, and amounts to 5.1% in December 2016 (from 6.5% in December 2014 and 5.7% in December 2015; in comparison: the level of NPLs of larger European banks - i.e. that of directly supervised significant institutions - was at the end of 2016 on average slightly higher, with an average ratio at 6.17% according to the [Supervisory Banking Statistics Fourth Quarter 2016](#), Tab 03.05.1 f.)). However this level remains higher than in other major developed countries. In comparison, the [World Bank](#) reported NPL ratios of about 1.5% for the United States and Japan at the end of 2016. In particular, compared to the financial crisis in the US, the recognition of losses has been slower in Europe than in the US (NPL ratios peaked in 2012 in the EU vs 2009 in the US), and the subsequent reduction in NPL is also more gradual.

Since the start of the crisis, the distribution of NPL has been highly uneven among Member States, with crisis-hit countries suffering major increases in NPL ratios. At the end of December 2016, the two countries which had to implement strict capital controls, Greece and Cyprus, reported NPL ratio of 46% and 45% respectively. Bulgaria, Croatia, Hungary, Ireland, Italy, Portugal, Slovenia and Romania all report NPL ratio between 10% and 20%, while other EU countries report NPL ratios below 7% (including 8 with NPL ratio below 3%, see figure 1). (See [EBA Risk Dashboard as of Q4 2016](#)). The distribution of NPL ratios can also show significant differences within Member States (see, for example, the distribution in Italy according to an [IMF working paper](#), p. 7).

The [European Commission](#) identifies three groups of Member States:

- 9 Member States with low levels of NPLs, and with no significant rise in NPLs during the crisis (group 1: BE, DE, DK, FI, FR, LU, NL, SE, UK);
- 9 Member States with low levels of NPLs but which have reported a high level or a high increase of NPLs during the crisis (group 2: AT, CZ, EE, ES, HU, LT, LV, PL, SK);
- 10 Member States with currently high level of NPLs (group 3: BG, CY, EL, HR, IE, IT, MT, PT, RO, SI). Those three groups are presented in the table on the previous page.

There is a strong correlation between high NPL and weak economic performances. Real GDP growth and unemployment are two traditional drivers of NPLs, together with the quality of the supervisory and legal frameworks, as well as the idiosyncratic bank lending practices. But conversely NPLs also have a detrimental impact on economic growth: high NPLs reduce profitability, increase funding costs and tie up bank capital, which negatively impact credit supply and ultimately growth (See European Commission, [March 2017](#)).

Examples of measures implemented in Member States

System-wide restructuring of the banking sector

For countries severely hit by the financial crisis, the response to the rise in non-performing assets has usually been comprehensive, and aimed at restructuring the whole banking sector. This was notably the case in Ireland, Spain, Slovenia, Cyprus and Greece, where many banks received capital support, through direct State recapitalisation or impaired asset measures (guarantees on losses or transfer to bad banks, see below). Such aid was approved by the European Commission subject to strict conditionality (viability, burden sharing and distortions of competition). In all of those cases, many competitors exited the market, through either liquidation or mergers: in Greece [12 banks](#) were liquidated, and the Bank of Greece monitors the management and liquidation of the remaining NPLs.

Transfer of assets in specialised asset management companies

Ireland (NAMA), Spain (SAREB) and Slovenia (BAMC) setup system-wide bad banks where non-performing assets were transferred from banks under restructuring. This can create scale economies in the management of illiquid assets, through the recruitment of NPL workout specialists

for example. While NAMA and SAREB are both mainly privately owned, the Slovenian bad bank is fully publicly owned. Other measures include state guarantee on individual portfolios, individual bad banks, as well as guarantees or transfers of assets at market price. In any case prior loss recognition is needed and is usually ensured through a comprehensive assessment of the loan portfolios of the rescued banks.

Enhanced supervision

Incomplete information on borrowers and overvalued collateral/inadequate provisioning of NPLs are among the main impediments to the development of liquid secondary markets for NPLs. So-called asset quality reviews and stress tests were thereby important milestones financial assistance programmes, and were carried out before the transfer of assets to system-wide bad banks in Ireland, Spain and Slovenia. The ECB also carried out such exercise when it took over the direct supervision of about 130 banking groups.

Beyond the provisioning policy, supervisors shall ensure that banks dedicate sufficient resources to the management of their non-performing portfolio. Such efforts could take the form of supervisory guidance, as was done in [Ireland and Cyprus](#). In 2013 and 2014 the Central Bank of Ireland imposed quantitative targets on the resolution of non-performing mortgage loans. In Greece, Cyprus and Ireland *codes of conduct* governing the interactions between banks and indebted customers were introduced to facilitate the prioritization and triage of customers. In [Greece](#), the supervisor also completed a thorough review of banks' practices regarding the management of NPL, which lead, inter alia, to the establishment of internal restructuring units in all large Greek banks.

Legal frameworks (servicing of NPLs and insolvency proceedings)

Legal and regulatory barriers impede the workout of NPLs and the development of liquid secondary markets, and incentivize forbearance from creditors. At the end of 2015 [Greece](#) has passed law 4354/2015 (the "NPL Law") to facilitate the sale of NPLs to non-bank companies. Facilitating the access of investors to recent information on borrowers, collateral and NPL sales could also facilitate bridging the gap between demand and supply on this market (See IMF [staff discussion note](#)). A smoother functioning of markets for collaterals (auction mechanisms), the creation of out-of-court procedures and the acceleration of in-court proceedings, by reducing the timeline for debt restructuring, also improve the value of NPL and reduce creditors' losses. Greece and Italy enacted such reforms in 2015, with a positive impact on the volumes of loan sales (see below).

Reform of the tax system

Appropriate tax incentives may accelerate loss recognition. Conversely, tax systems which do not allow for the deductibility of loan impairments do not encourage the swift recognition of loan losses. In 2012, [Italy](#) shortened the timeline for full loan loss deductibility from 18 years to 5 years, and then in 2015 from 5 year to immediate full deductibility.

Initiatives undertaken at European level

Enhanced supervision

Both the EBA and the ECB have played a decisive role. The EBA has worked towards a common EU definition of NPLs. In March 2017, the ECB published its [guidance to banks on tackling non-performing loans](#). It also took actions regarding a number of individual banks, which received [letters](#) setting quantitative objectives regarding the reduction of NPL portfolio.

Reform of the insolvency frameworks

The Commission proposed on 22 November 2016 a directive on insolvency frameworks aiming at facilitating the restructuring of non-performing debt and giving entrepreneurs a second chance. Both the European Parliament and the Council have started their work on the proposal.

Towards a comprehensive EU strategy to tackle NPLs

Several initiatives are on-going at European level. The European Systemic Risk Board has set up a dedicated working group on NPLs, gathering the EU supervisory community and co-chaired by the ECB and the EBA. On [30 January 2017](#), Mr. A. Enria, Chairman of the EBA, presented his proposal for an EU-wide asset management company which could free up EU banks from the burden of NPLs. The Council's Financial Services Committee submitted on 31 May 2017 its [final report on NPLs where it](#) analyses the situation of NPLs in Europe and the policies implemented so far and proposes to the Council a number of policy options going forward. The Commission [reflection paper on deepening the Economic and Monetary Union](#) of 31 May 2017 stresses the importance of a European strategy for non-performing loans to help to address the issue and support national actions.

Based on the recommendations of the FSC report, the Council adopted an action plan to tackle NPLs at its meeting on 11 July 2017 (See Annex). The agreed action plan outlines a mix of policy actions to help reduce stocks of non-performing loans (NPLs), which remain at high levels within the EU and to prevent their future emergence. On 10 July, the Commission launched [a public consultation](#) on the development of secondary markets for NPLs. The objective of the consultation is to inform the work of the Commission on possible legislative measures to remove impediments to the development of secondary markets for NPLs. Developing secondary markets for NPLs is among the priority actions identified by the Council in its action plan.

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Annex
Council conclusions on [Action plan to tackle non-performing loans in Europe](#)
11 July 2017

The Council identified a number of action to be taken in essentially three areas: i) banking supervision, ii) the reform of insolvency and debt recovery framework, iii) the development of secondary markets for NPLs. It agreed to revert to this issue regularly in order to take stock of the evolution of NPLs in Europe, the restructuring of banking sectors and the development of secondary markets for NPLs. It agreed to coordinate the communication on NPLs in Europe.

– *Banking supervision*

- ✓ Enhance the usability of powers for supervisors as regards provisioning policy of banks (via legislative changes where appropriate, based on a Commission interpretation of the current legal framework);
- ✓ The Commission to consider -as part of the on-going review of CRD IV- to introduce prudential backstops to address potential under provisioning; these statutory backstops could take the shape of prudential deductions from own funds of NPL;
- ✓ the SSM to implement, by the end of 2018, with regard to less significant institutions in the Banking Union a guidance on NPLs similar to the one adopted for significant institutions;
- ✓ the EBA to issue, by summer 2018, general guidelines on NPL management, consistent with the SSM guidance, for all banks in the EU;
- ✓ the EBA to issue, by summer 2018, detailed guidelines on banks' loan origination, monitoring and internal governance addressing in particular issues such as transparency and borrower affordability assessment;
- ✓ the European Systemic Risk Board to develop, by the end of 2018, macro-prudential approaches to prevent the emergence of system-wide NPL problems;

– *Reform of insolvency and debt recovery frameworks*

- ✓ the Commission to publish, before the end of 2017, the results of the benchmarking exercise on the efficiency of national loan enforcement (including insolvency) regimes from a bank creditor perspective;
- ✓ Member States, to consider by the end of 2018 to carry out dedicated peer-reviews on insolvency regimes across the EU.

– *Development of secondary markets for NPLs*

- ✓ the EBA, in consultation with the ESMA, to implement, by the end of 2018, enhanced disclosure requirements on asset quality and non-performing loans to all banks;
- ✓ the EBA to issue, by the end of 2017, guidelines for banks on loan tapes monitoring;
- ✓ the EBA, the ECB and the Commission, to propose by the end of 2017, initiatives to strengthen the data infrastructure with uniform and standardised data for NPLs and consider the setting-up of NPL transaction platforms;
- ✓ the Commission to develop, by the end of 2017 a "blueprint" for the potential set-up of national asset management companies (AMCs);
- ✓ the Commission to develop, by summer 2018, a European approach to foster the development of secondary markets for NPLs, in particular to remove impediments to the transfer of NPLs by banks to non-banks and to their ownership by non-banks.