



Targeted consultation on statutory prudential backstops addressing insufficient provisioning for newly originated loans that turn non-performing

Fields marked with * are mandatory.

Introduction

Non-performing loans (NPLs) have piled up in parts of the EU banking sector in the aftermath of the financial crisis and ensuing recessions, with significant adverse impacts on banks' profitability, viability and ability to lend. High levels of NPLs across a substantial number of banks pose risks to the financial system at large and the overall economy of the EU. While tackling NPLs is primarily the responsibility of affected banks and Member States, there is a distinct European dimension, as clearly manifested in the Commission Reflection Paper on the Deepening of the Economic and Monetary Union and fleshed out in the Commission Communication on completing the Banking Union. Furthermore, the Council concluded a comprehensive action plan to tackle NPLs in Europe inviting the Commission and other actors to act on several fronts to reduce the risk to financial stability, both by addressing the existing stock of NPLs and by preventing the emergence and accumulation of NPLs in the future. The Commission takes active part, together with other European stakeholders and Member States, in the realisation of this Action Plan.


One of the key policy areas in this context is prudential regulation and supervision to be applied to the newly originated loans, which should ensure, inter alia, that new loans that turn non-performing are recognised timely and provisioned adequately in order to prevent loss forbearance and enhance NPL resolution. If sufficiently high provisions credit losses will be made, restructuring, selling or dismissing non-performing assets and non-recoverable collateral will require less, if any, additional capital and will become potentially easier. If, on the contrary, new loans that turn non-performing will be insufficiently provisioned, they are more likely to remain on banks' balance sheets in an attempt by banks to avoid or delay loss recognition. This may cast doubt over banks' future profitability, solvency and long-term viability. In addition, heightened risk perceptions on the part of investors and depositors usually translate into higher funding costs. Together, these factors result in higher lending rates, reduced lending volumes,

and increased risk aversion. Experience in several countries that have dealt with NPLs suggests that binding requirements on NPL recognition and provisioning made a significant contribution to the resolution of NPLs.

As announced in its Communication on completing the Banking Union, and as a follow-up to the July 2017 Conclusions of the Council on tackling NPLs in the EU, the Commission is preparing a report on tackling potential under-provisioning for new loans that turn non-performing. That report will consider the possibility of introducing statutory prudential backstops in the form of compulsory and time-bound prudential deductions of NPLs from own funds to prevent or reduce the future build-up of new NPL stocks with insufficient coverage across Member States and banks. As also announced in the aforementioned Communication, in this context the Commission will also consider introducing a common definition of non-performing exposures (NPEs) in accordance with the one already used for supervisory reporting purposes with the view of providing a sound legal basis for the prudential treatment of such exposures and ensuring consistency.

The Commission services launch this public consultation to gather stakeholders' views on the possible introduction of statutory prudential backstops against insufficient loan loss coverage for new loans that turn non-performing, as well as on the potential functioning, scope, design and calibration of such prudential backstops.

Please note: In order to ensure a fair and transparent consultation process **only responses received through our online questionnaire will be taken into account** and included in the report summarising the responses. Should you have a problem completing this questionnaire or if you require particular assistance, please contact fisma-non-performing-loans@ec.europa.eu.

More information on this consultation [on this consultation](#)  [informal protection of personal data regime for this consultation](#)

1. Information about you

* Are you replying as:

- ☐ a private individual
- ☒ an organisation or a company
- ☐ a public authority or an international organisation

* Name of your organisation:

Associazione Intermediari Mercati Finanziari - ASSOSIM

Contact email address:

The information you provide here is for administrative purposes only and will not be published

assosim@assosim.it

* Is your organisation included in the Transparency Register?

(If your organisation is not registered, [we invite you to register here](#), although it is not compulsory to be registered to reply to this consultation. [Why a transparency register?](#))

- ☒ Yes
- ☐ No

* If so, please indicate your Register ID number:

* Type of organisation:

- | | |
|---|---|
| <input type="radio"/> Academic institution | <input type="radio"/> Media |
| <input type="radio"/> Company, SME, micro-enterprise, sole trader | <input type="radio"/> Non-governmental organisation |
| <input type="radio"/> Consultancy, law firm | <input type="radio"/> Think tank |
| <input type="radio"/> Consumer organisation | <input type="radio"/> Trade union |
| <input checked="" type="radio"/> Industry association | <input type="radio"/> Other |

* Where are you based and/or where do you carry out your activity?

Italy

* Field of activity or sector (*if applicable*):*at least 1 choice(s)*

- ☐ Accounting
- ☐ Auditing
- ☒ Banking
- ☐ Credit rating agencies
- ☐ Insurance
- ☐ Pension provision
- ☐ Investment management (e.g. hedge funds, private equity funds, venture capital funds, money market funds, securities)
- ☐ Market infrastructure operation (e.g. CCPs, CSDs, Stock exchanges)
- ☐ Social entrepreneurship
- ☐ Other
- ☐ Not applicable



Important notice on the publication of responses

* Contributions received are intended for publication on the Commission's website. Do you agree to your contribution being published?

([see specific privacy statement](#) )

- ☒ Yes, I agree to my response being published under the name I indicate (*name of your organisation /company/public authority or your name if your reply as an individual*)
- ☐ No, I do not want my response to be published

2. Your opinion

1. What are your views on the rationale for statutory prudential backstops as described above?
In particular:

a. Do you support the idea that statutory prudential backstops should complement the improvements that the application of IFRS 9 is expected to bring with regards to loan loss provisioning for the new loans that turn non-performing?

- ☒ Yes
☐ No
☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 1.a:

The accounting treatment of IFRS 9 and the prudential backstops are different.

b. Do you support the idea that statutory prudential backstops (Pillar 1 measure) should complement the use of existing supervisory powers to address through institution-specific measures the (under)capitalisation of NPLs (Pillar 2 measure)?

- ☐ Yes
☐ No
☒ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 1.b:

In principle we can agree, but we deem the proposed backstops unsuited to real recovery processes. Therefore they should be revised both in scope of application and calibration.

2. Do you think that the statutory prudential backstops as described above are feasible?

- ☐ Yes
☒ No
☐ Alternative designs of backstops via prudential deductions could be envisaged for new loans that turn non-performing
☐ Don't know / no opinion / not relevant

Please explain what are the features that appear problematic to you and why:

ASSOSIM is firmly convinced that the going concern positions should be excluded from the statutory prudential backstops application. Indeed restructuring plans aim at restoring the economic-financial conditions to ensure counterparty business continuity. A bank's objective goes well beyond the mere credit recovery, pursuing a firm rebalancing necessarily spread along an adequate and generally material period of time. Such positions are subject to specific and reinforced monitoring to verify on a regular basis that counterparty's behaviour is in line with the agreed plan and to eventually timely detect any deviations and

deterioration signals. Backstop application is more suitable to exposures towards counterparts where business continuity is compromised ("gone concern") and where the bank activity is driven by credit recovery based on collaterals. This logic is typical of cases where the bank has terminated the credit contract and not applicable to borrowers with a regular restructuring plan in place. Similar considerations can be raised for counterparts subject to forbearance measures when the concessions have been provided to non performing clients. The adoption of such prescriptions would lead to discourage and limit the corporate restructuring performed by the banking system with impact on overall economic activity

ASSOSIM points out that using a common temporal approach as for both traditional bank and companies whose core activity consists in purchasing and managing NPLs is substantially inappropriate because necessarily NPLs are derecognized by a traditional bank (whose core business consists in originating performing loans, thus earning interests) and by a specialized company at a totally different pace: the former needs to consider the cost of risk to incorporate it within prices, and thus needs to be sure about NPLs values with a sound and fast management of impaired credit positions (a limited time for management activities and sales to third parties); the latter, on the other hand, participates to the process by paying to the traditional bank a price which theoretically equals the value that the originator bank would earn during time, net of the profit justified by the longer collection period (carried out with the support of dedicated infrastructures and processes).

With regard to going concern positions the exclusion from such statutory prescriptions is the only adequate solution when a plan aiming at corporate rebalancing has been agreed and regularly attended by the Client. Similarly the exclusion should be extended to all forborne cases, also in the retail segment, with a repayment plan regularly fulfilled (e.g. promissory notes planned). As per NPL purchasing business, as mentioned in the answer to question 4, it would be necessary to express a backstop calibration that respects the business model of companies whose core activity consists in purchasing and managing NPLs: at least 5 years for unsecured credits and at least 10 years for secured ones.

3. In your view, which should be the cut-off date for the origination of loans that will be covered by the prudential backstop?

- ☐ the date of publication of this consultative document
- ☐ the date of the publication of a possible legislative proposal introducing prudential backstops
- ☐ the date of entry into force of such possible legislative measure
- ☒ a later date of application?

Please explain the reasons for your answer to question 3:

The entry into force of such backstops homogeneous across countries without a strong effort to homogenize underlying legal frameworks related to the recovery process would have disruptive effects especially in some regions, characterized by longer judicial procedures. A radical intervention to streamline such procedures requires time.

3.a. Would you see a need to address explicitly potential circumvention possibilities, for instance through prolongation of existing contracts? Please explain:

4. Do you think a full coverage of unsecured (parts of) NPLs after 2 years and of secured (parts of) NPLs after 6 to 8 years is appropriate?

- ☐ Yes
- ☒ No
- ☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 4:

In Italy a significant portion of recoveries is made after 2 or 6 years, showing that recovery timing envisaged in this proposal is not appropriate.

In addition for companies whose core activity consists in purchasing and managing NPLs, the adoption of a common backstop for two years will cause management asymmetry between the seller and the buyer to cease. Thus, the core resource generating the added value (i.e. time) is subtracted from the NPE buyer.

4.a. For secured (parts of) NPLs, do you think it appropriate to treat them as unsecured after 6 to 8 years, effectively adding two more years before full coverage?

- ☐ Yes
- ☐ No
- ☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 4.a:

The idea to treat the secured exposures as unsecured after a certain period is correct in principle, but the foreseen timing should be extended

In addition should the ECB Supervision confirm the choice to extend the adoption of the Addendum also to players specialized in management and purchasing NPLs, it has to considered a backstop calibration that respects its business model: at least 10 years for secured (5 years for secured).

In any case the vintage must be calculated starting from the contract resolution date. Till then no foreclosure proceeding can be put in place.

4.b. For secured (parts of) NPLs, do you think an alternative approach, such as the introduction of specific levels of haircuts on collateral/guarantee values, would be more appropriate?

- ☐ Yes
- ☐ No
- ☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 4.b:

In the Commission proposal a progressive increase in the haircuts value is present. We can agree with such approach if not added to the required increase in coverage for the unsecured portion of the exposure. Otherwise the impacts of decrease in the recovery probability along the time is doubled.

4.c. If none of the approaches work in your view, how should the backstops be alternatively calibrated? Please explain the reasons for your answer.

- Exclusion of going concern and forborne positions.
- Start of the vintage calculation at the contract resolution date.
- Should the ECB Supervision confirm the choice to extend the adoption of the Addendum also to players specialized in management and purchasing NPLs, it has to be considered a backstop calibration that respects the business model: at least 5 years for unsecured credits and at least 10 years for secured ones. Therefore, the current accounting treatment and the prudential one proposed by the addendum would not be different.

5. Do you agree that prudentially sound collateral valuation is an important element for addressing NPL-related risks?

- ☒ Yes
- ☐ No
- ☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 5:

5.a. In this context:

- ☒ would a common (non-binding) methodology for collateral valuation suffice to foster consistent outcomes and transparency?
- ☐ or would specific (binding) valuation rules be needed?

Please explain the reasons for your answer to question 5.a:

Yes, we think that common precise guidelines for collateral valuation would foster consistent outcomes and transparency. No binding valuations are needed

5.b. More generally, should specific prudent valuation requirements apply to assets and off-balance sheet items accounted for amortised cost as it is already the case for fair-valued assets?

- ☐ Yes
- ☐ No
- ☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 5.b:

6. Do you agree that prudential coverage needs should ultimately depend on the actual recoverability rather than the valuation of the collateral to provide for a backstop?

- ☐ Yes
- ☒ No
- ☐ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 6:

While for unsecured exposures actual recoverability should be accounted for, in case of secured ones main driver for evaluating the recoverability is the collateral.

7. Do you agree that the application of the statutory prudential backstops should not result in cliff-edge effects, but should rather be implemented in a suitably gradual or progressive way by banks from the moment of the classification of the exposure as non-performing?

- ☐ Yes
- ☐ No
- ☒ Don't know / no opinion / not relevant

Please explain the reasons for your answer to question 7:

As already outlined, the starting date for vintage calculation shouldn't be the classification into NPL but the contract resolution date. That said, a gradual or progressive increase in coverage is preferable to avoid excessive volatility or cliff effects.

7.a. In particular, which approach (gradual or progressive) would you consider better suited and why?

Please explain the reasons for your answer:

8. Would you see any unintended consequences due to the design and calibration of the prudential backstops?

- ☒ Yes
- ☐ No
- ☐ Don't know / no opinion / not relevant

If yes, which measures would you consider necessary to prevent or address unintended effects (including double-coverage of risks)? Please explain the reasons for your answer:

The aim of the proposal should be the introduction of a capital buffer additional to a share of residual and incidental assets of a traditional bank, although this introduction could generate distorting effects in its activity. Specifically, with reference to going concern positions, the adoption of the proposed prescriptions would lead to discourage and limit the corporate restructuring performed by the banking system with impact on overall economic activity.

Even more, the introduction of a so strict requirement on the whole NPL portfolio (when fully implemented) held by a specialized company is less acceptable; it can be demonstrated by analyzing its business model that it is capable to earn profits and create value thanks to dedicated personnel, IT systems, procedures and know-how completely focused on this activity. Keeping in mind that the discount applied by these specialized companies includes not only a premium for the risk assumed (which theoretically is the same the selling bank would have faced) but also the cost of managing and funding them, and finally a profit margin, the application of the backstop on the same timeline appears heavily unjustifiable and substantially inappropriate. Above all, we believe that the NPL market will be more and more oriented towards shadow banking players with higher expectations on returns, slowing down the NPLs' disposal process from the assets of traditional banks.

3. Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload your additional document(s) here:

Useful links

[More on the Transparency register \(http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en\)](http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en)

[Consultation details \(http://ec.europa.eu/info/consultations/finance-2017-non-performing-loans-backstops_en\)](http://ec.europa.eu/info/consultations/finance-2017-non-performing-loans-backstops_en)

[Specific privacy statement \(https://ec.europa.eu/info/sites/info/files/2017-non-performing-loans-backstops-specific-privacy-statement_en.pdf\)](https://ec.europa.eu/info/sites/info/files/2017-non-performing-loans-backstops-specific-privacy-statement_en.pdf)

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