Council of the
European Union

Brussels, 16 December 2020
(OR. en)

14136/20

EF 332
ECOFIN 1162
COVID-19 62

COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	COM(2020) 822 final
Subject:	COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN CENTRAL BANK Tackling non-performing loans in the aftermath of the COVID-19 pandemic

Delegations will find attached document COM(2020) 822 final.

Encl.: COM(2020) 822 final

EUROPEAN
COMMISSION

Brussels, 16.12.2020
COM(2020) 822 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN CENTRAL BANK

Tackling non-performing loans in the aftermath of the COVID-19 pandemic

EN EN

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN CENTRAL BANK

Tackling non-performing loans in the aftermath of the COVID-19 pandemic

INTRODUCTION

The COVID-19 pandemic has led to a sharp economic downturn in the EU and worldwide. To shield households and businesses from its impact, EU regulators and supervisors have taken measures to support the immediate ability of banks to continue lending and absorb losses related to the pandemic. In particular, the Commission COVID-19 banking package, which included an Interpretative Communication on the Union's accounting and prudential frameworks ('Supporting businesses and households amid COVID-19')[1], as well as targeted 'quick fix' amendments[2] to EU banking prudential rules (the Capital Requirements Regulation (CRR)[3]), aimed at ensuring that banks were able to continue lending to households and to businesses during the most acute phase of the crisis. Banks are in fact part of the solution today, largely reflecting their strong capital position following the significant reforms carried out after the 2008 financial crisis. **Member States have also taken decisive action, with support schemes to alleviate liquidity difficulties affecting households and businesses**. These schemes typically involve public guarantee schemes and/or payment deferrals ('moratoria'). These measures help borrowers with temporary liquidity problems and prevent a surge in non-performing loans (NPLs). In this respect, the European Banking Authority (EBA) has recently decided to reactivate its Guidelines on legislative and non-legislative moratoria.[4] The Commission has also adopted

[1] COM(2020) 169 final.

[2] The amendments entered into application on 26 June 2020, in time for banks' financial reporting on the second quarter. See Regulation (EU) 2020/873 as regards certain adjustments in response to the COVID-19 pandemic (OJ L 204, 26.6.2020, pp. 4–17).

[3] Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (OJ L 176, 27.6.2013, p. 1).

[4] See https://eba.europa.eu/eba-reactivates-its-guidelines-legislative-and-non-legislative-moratoria.

a Temporary Framework to enable Member States to use the full flexibility foreseen under State aid rules to support the economy in the context of the COVID-19 outbreak.

The financial health of the EU banking sector remains strong after the initial economic and financial shock caused by COVID-19, yet risks are tilted to the downside. In Q2-2020, the average Tier 1 capital ratio for all EU banks amounted to 16.4%, and the average NPL ratio stood at 2.8%. The liquidity coverage ratio for significant financial institutions stood at a comfortable 165.5%. However, despite extensive support measures at EU and Member State level, the pandemic has hit the economy hard, with all Member States now in recession.[5] Banks are exposed to companies and individuals that have become financially more vulnerable, in particular small and medium-sized enterprises (SMEs) whose income and financing sources are less diversified, and specific industries (e.g. transport, tourism and hospitality). It is therefore vital to closely monitor the situation and possible risks to financial stability as well as ensure that banks can continue to play a constructive role in the recovery following the economic downturn. Further structural measures could be needed to prevent the accumulation of NPLs on banks' balance sheets over the medium term. The Commission recommends that financial institutions, supervisors and policy makers at Union and Member State level jointly take resolute action to increase the financial system's preparedness, thereby supporting financial stability and the economic recovery.

Addressing a renewed build-up of NPLs on banks' balance sheets as early as possible is a key lesson from the last economic crisis. The Commission therefore organised a roundtable with public and private stakeholders on tackling NPLs in the aftermath of the COVID-19 pandemic in September 2020 in order to discuss different elements that could constitute an effective strategy. Based on the exchanges in this roundtable, the Commission believes that an effective strategy should focus on a mix of complementary policy actions in order to: (i) further develop secondary markets for distressed assets[6], which would allow NPLs to be moved off the banks' balance sheets while ensuring adequate protection for debtors; and (ii) reform the insolvency and debt recovery frameworks, ensuring an appropriate balance of interests between creditors and debtors.

5 European Commission, 'Autumn 2020 Economic Forecast'. See: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2021.

6 To this end, measures should be taken at national and at Union level, as appropriate.

Secondary markets and insolvency frameworks also already constituted an important part of the 2017 Council Action Plan on NPLs[7]. Despite significant progress on implementation, key measures, in particular the Commission's proposal for a Directive on credit servicers, credit purchasers and for the recovery of collateral[8], have not yet been adopted by the European Parliament and Council. Moreover, the Recovery and Resilience Facility (RRF) can provide substantial support to reforms to reduce NPLs, in particular to improve insolvency, judicial and administrative frameworks that underpin efficient NPL resolution. Lastly, banks should be incentivised as much as possible to apply a proactive approach to engage with their debtors early and constructively. The Commission would further support Member States, through the Technical Support Instrument[9], in preparing their national framework and bolstering their supervisors' capacity to deal with rising levels of NPLs.

Building on the 2017 Council Action Plan, further targeted measures are needed to address a possible accumulation of NPLs over the medium term as a result of the COVID-19 pandemic. In this Communication, the Commission therefore proposes a range of new measures to help address the upcoming flows of NPLs.

As there is still considerable uncertainty surrounding the economic outlook under COVID-19, it is important to take stock of the broader policy toolkit to be ready to deal with any potential difficulties with individual banks. To this end, this Communication, building on the Commission's Blueprint on the set-up of asset management companies (AMCs)[10], provides a framework for Member States to deal with the economic consequences of COVID-19, where necessary. This includes how the possible use of precautionary measures, in compliance with the Union's bank resolution and State aid frameworks, can be used to help address the impact of COVID-19 on the economy,

---

7 ECOFIN Council 'Action Plan to Tackle Non-Performing Loans in Europe', July 2017.

8 COM(2018) 135 final - 2018/063 (COD).

9 COM(2020) 409 final.

10 SWD(2018) 72 final. This document was a part of the Commission's package of measures carrying out the elements within its remit of the 2017 Council Action Plan. It was drafted jointly by the Commission, the European Central Bank (ECB), the European Banking Authority (EBA) and the Single Resolution Board (SRB). It clarifies key success factors and the permissible design for such state-sponsored AMCs, consistent with the EU legislative framework, particularly the Bank Recovery and Resolution Directive and the Single Resolution Mechanism Regulation, which are fully in force and aim at limiting government interventions, and State aid rules.

complementing the fiscal support measures deployed, to a varying extent, by Member States to help affected businesses.

When addressing the challenge of tackling NPLs, it is important to ensure that consumers, and especially vulnerable borrowers, are properly protected. Among the measures already put forward, in particular as regards the market for credit servicers and credit purchasers, the Commission has proposed that a transfer of a loan to another investor upholds the protection that the affected borrowers had agreed with the original lending bank.[11] The Commission has also welcomed the 'best practices' agreed by the financial sector, and consumer and business organisations, which outline how different market participants can support citizens and businesses throughout the crisis.[12] Following up on this agreement, the Commission intends to organise a new roundtable meeting to take stock of relief measures offered during the first wave of the pandemic in Member States, as well as to discuss to what extent the best practices were applied on the ground, and whether they proved useful in helping consumers and businesses make use of national relief measures. In taking any additional actions in future, the Commission will continue to maintain a fair, robust and consistently enforced consumer protection regime.

To ensure that the strategy outlined in this Communication is delivered effectively, the Commission will establish an NPL advisory panel consisting of relevant industry stakeholders and consumer organisations. This panel will support the Commission in implementing many of the proposed actions. The purpose of the panel would be to advise the Commission as regards future proposals.

1. RECENT DEVELOPMENTS IN NON-PERFORMING LOANS

After a gradual improvement in recent years, NPL ratios in the EU have seen somewhat of a trend reversal due to the impact of the COVID-19 pandemic. Driven mainly by reduced NPL sales and restructuring activities as well as new defaults, the latest figures show that the gross NPL ratio for **all EU banks** experienced a first uptick, rising to

[11] See COM(2018) 135 final.

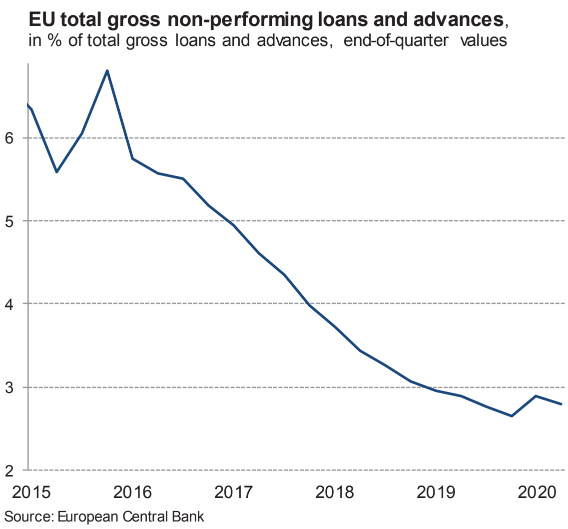
[12] 'Best practices in relation to relief measures offered to consumers and businesses in the context of the COVID-19 crisis', 14 July 2020.

See: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200714-best-practices-mitigate-impact-pandemic_en.pdf.

2.9% in Q1-2020, up from 2.6% in Q4-2019 (see Figure 1). This put an end to the overall downward trend since Q4-2014. In Q2-2020, the average NPL ratio for all EU banks stood at 2.8%. When focusing on **significant institutions**[13], the situation is somewhat different, as the EU NPL ratio amounted to 2.94% in Q2-2020, down slightly from 3.05% in Q1-2020 and 3.22% in Q4-2019. The **provisioning ratio**[14] improved considerably to 63.4% in Q2-2020, up 1.6 percentage points quarter-on-quarter and 4.5 percentage points year-on-year. The **absolute amount of NPLs** (gross value) for all banks in the EU stands at EUR 588 billion (Q2-2020), compared to EUR 585 billion in Q1-2020 and EUR 646 billion in Q4-2019.[15] Table 1 shows that the **situation continues to differ significantly between Member States**.

Most Member States have seen encouraging progress in recent years thanks to a combination of economic growth and determined action by banks, supervisors and policymakers. This has facilitated the reduction in NPL volumes and NPL ratios. Furthermore, the Commission has continued to work constructively with Member States to enable case-specific solutions for banks within the framework of Union State aid and Banking Union crisis management rules.

Figure 1: NPL ratio in the EU



[13] Credit institutions directly supervised by the ECB.

[14] This ratio indicates the extent of funds a bank has kept aside to cover loan losses. Source: ECB. Due to the unavailability of provisioning data for loans, the provisioning ratio for the EU was calculated by considering impairments and NPLs for all debt instruments (loans and debt securities).

[15] Source: ECB.

However, it is important to recognise that in recent years a rather robust economic environment helped tackle NPLs in several Member States. In recent months, the decrease in the volume of NPLs decelerated or has stopped, as a result of the pandemic and the accompanying lockdown measures. Available analysis highlights certain areas of concern in terms of repayment capacity, in particular for SMEs and some specific sectors particularly affected by the pandemic.[16] For the moment, measures adopted at national level in response to the crisis have prevented more widespread defaults on the repayment of loans. This has helped to contain the rise in NPLs. However, there is uncertainty on how the unwinding of measures taken to contain the crisis will affect borrowers and their banks. In addition, while the substantial use of corporate support programmes has shielded banks from COVID-19 losses in several Member States, banks have become the first line of defense in those countries that did not implement such programmes (or only implemented smaller ones).

[16] 'The EU banking sector: First insights into the COVID-19 impacts', EBA thematic note EBA/REP/2020/17, https://eba.europa.eu/covid-19-placing-unprecedented-challenges-eu-banks.

Table 1: NPLs and provisions by Member State[17]

	Gross NPLs and advances (% of total gross loans and advances)		**Private sector NPLs*** (% of private-sector loans)		**Total loss provisions (loans)**** (% of total doubtful and non-performing loans)	
	2020Q2	2019Q2	2020Q2	2019Q2	2020Q2	2019Q2
Austria	2.0	2.3	2.8	3.1	76.5	69.6
Belgium	2.1	2.0	2.8	2.7	58.4	53.7
Bulgaria	6.7	6.9	10.0	10.5	60.6	61.2
Croatia	5.3	6.9	8.3	10.3	86.7	74.2
Cyprus	14.5	19.5	23.3	33.5	55.4	53.2
Czech Republic	1.6	1.8	3.0	3.4	82.2	69.0
Denmark	2.0	1.9	2.4	2.2	45.4	42.1
Estonia	2.1	1.8	2.1	2.3	55.7	42.4
Finland	1.5	1.4	-	-	42.6	34.0
France	2.3	2.6	3.4	3.6	66.2	64.8
Germany	1.2	1.3	2.0	2.0	89.0	85.3
Greece	30.9	39.6	37.0	43.8	47.8	49.7
Hungary	4.0	5.0	5.6	6.5	-	84.1
Ireland	3.5	4.2	6.0	6.8	54.9	37.0
Italy	6.3	8.1	8.2	10.6	59.8	58.5
Latvia	5.3	5.4	5.6	7.5	41.0	38.8
Lithuania	2.7	2.2	2.8	3.0	47.3	36.4
Luxembourg	0.6	0.7	1.8	2.0	55.8	52.0
Malta	3.4	3.1	-	-	50.5	49.3
Netherlands	1.9	1.8	2.8	2.4	40.1	31.6
Poland	6.2	6.2	6.7	6.7	74.0	70.4
Portugal	5.5	8.3	6.6	9.2	66.4	59.2
Romania	4.4	4.8	5.9	6.5	93.0	83.6
Slovakia	2.9	3.1	3.2	3.4	92.9	89.0
Slovenia	3.2	4.5	4.5	5.9	80.1	74.6
Spain	2.9	3.4	4.0	4.4	69.4	63.8
Sweden	1.0	1.1	1.3	-	32.2	-
European Union	**2.8**	**2.9**	**-**	**-**	**63.4**	**58.9**

Source: ECB. Calculations by European Commission.

Now that the economic environment has taken a sharp downturn, it will be crucial for Member States to take further decisive policy action as needed and to address issues in national insolvency frameworks so that banks are able to manage the upcoming flow of new NPLs. This would allow NPLs to be addressed in the most decisive manner possible, in

[17] *Notes:* Figures correspond to domestic credit institutions and foreign-controlled subsidiaries and branches.

* Sector-specific data are unavailable for the EU, Finland, Malta (i.e. for Q2-2019 and Q2-2020) and Sweden (i.e. for Q2-2019). Sector-specific data (i.e. total exposure to households and non-financial corporations) for Bulgaria, Germany and Hungary are only available in carrying amount.

** Data for the provisioning of loans are unavailable for Sweden (i.e. for Q2-2019) and for Bulgaria, Germany, Hungary and the EU. In the latter cases, figures are based on impairments for all debt instruments (i.e. loans and debt securities). Data are unavailable for Hungary (i.e. for Q2-2020).

turn preventing a renewed build-up of NPLs on banks' balance sheets. As a basis for this, the proper recognition and management of NPLs by banks will continue to be important.[18] The sooner banks identify and provision for potential NPLs, the faster and smoother the NPL resolution and disposal process will be, averting damaging hangover effects in the future. Banks should also be encouraged to identify debtor distress early and engage proactively with their debtors in timely and appropriate restructuring when needed. When it comes to companies in particular, banks should be expected to develop capacity to promptly assess changes in their debt servicing abilities and differentiate between liquidity and solvency needs.

2. DEVELOPMENT OF SECONDARY MARKETS FOR DISTRESSED ASSETS

A deep and liquid secondary market for distressed assets would provide banks with the possibility to reduce their NPLs by selling them to third-party investors. This would help banks focus on their core activities by freeing up space in banks' balance sheets for new lending, enabling them to fund the economic recovery. Easier market entry and participation should be encouraged, especially for smaller sellers and buyers who may be crucial for local-level NPL resolution.

One vital step is to quickly reach an agreement on the Commission's proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral adopted in March 2018[19]. This proposal seeks to open up markets whilst ensuring that the debtor protection across the single market is not weakened in case of sale of the loan in respect to the protection that the initial lending bank offered. It would ensure that consumer protection obligations are upheld irrespective of how NPLs are resolved. The Council reached a negotiating mandate on the proposal, but the European Parliament is not yet ready to start inter-institutional negotiations.

To prevent a renewed accumulation of NPLs on banks' balance sheets over a longer time period, the Commission also proposed targeted improvements to the

[18] See the EBA's 'Guidelines on management of non-performing and forborne exposures', EBA/GL/2018/06.
[19] COM (2018) 0135 final – 2018/063 (COD).

securitisation framework for banks' non-performing exposures (NPEs[20]).[21] The Commission welcomes the agreement reached by the co-legislators in December 2020. These improvements will provide crucial support in tackling the fallout of the COVID-19 crisis. Removing existing regulatory obstacles and amending the securitisation framework to cater for the special characteristics of NPE securitisations, while maintaining high prudential standards, will enable the broader use of this tool by banks to free their balance sheets from NPEs.

2.1. Improving data quality and data comparability

Further improving the quality and comparability of data on NPLs would be a key action in cultivating secondary markets for such NPLs. The data templates that the EBA developed in 2017 provide a good starting point for a common dataset for NPL transactions in the EU, facilitating financial due diligence and the valuation of NPL transactions. These templates aim to reduce information asymmetries in EU NPL markets and could be a starting point for a common data standard for transactions, enabling NPLs to be compared, also across jurisdictions.

However, these templates are not widely used yet by market participants due to their voluntary nature and complexity, making it important to explore ways to expand their use. **The Commission would therefore aim at mandating, in early 2021, the EBA to review the templates based on a consultation with market participants, both on the buyer and seller side, to take place in the course of 2021**. The review should seek to better distinguish between critical and non-critical data based on practical experience from past NPL transactions and address the needs of buyers whilst taking into account existing data and data processing costs for sellers. This was clearly signalled in the discussions with stakeholders in the Commission's NPL roundtable in September 2020. The overall timing of that initiative would depend on the adoption of the proposed directive on credit servicers and credit purchasers, which would allow to turn the revised, more proportionate and simpler EBA data template into implementing technical standards.

---

[20] NPLs are part of a wider set of NPEs. For instance, beyond loans, such exposures could include other debt instruments, such as a debt security, an advance and a demand deposit.

[21] COM(2020) 282 final and COM(2020) 283 final.

To expand the use of the template by market participants and thereby improve data comparability and quality, the template could become mandatory, initially only for new NPLs, i.e. for loans that turn non-performing after a specific cut-off date. The data standard would be obligatory, but there could be some flexibility on the data fields that must be populated. In this respect, the EBA would need to give guidance on what information is considered critical, after consultations with stakeholders. Moreover, banks should not be penalised if they do not have non-essential data. Hence, the secondary market for NPLs would be best supported by making the use of the template mandatory, yet allow data providers to use a no-data option, if needed and for specific non-essential data fields.

2.2. Data infrastructure

To increase market transparency at granular level, the Commission considers that there would be merit in establishing a central data hub at EU level. Such a hub would act as a data repository underpinning the NPL market. It would operate a comprehensive electronic database (updated regularly), assess the information and provide access to market participants, notably credit sellers, credit purchasers, credit servicers, NPL sellers and private NPL platforms. The hub would offer a platform for cooperation and coordination with a pan-European scope.[22] The hub could help establish a common data standard (increasing the use of the EBA data template as the standard for conducting NPL transactions), offer data quality checks and automated validation, and assist sellers with their data preparation for reporting.

On the basis of a public consultation, which would be planned for the first half of 2021, the Commission would explore several alternatives for establishing a data hub at European level and determine the best way forward. For instance, one of the options could be to establish the data hub by extending the remit of the existing European DataWarehouse (ED).[23]

---

[22] It would be ensured that such cooperation/coordination complies with EU antitrust rules, notably when it comes to exchanges of confidential information.

[23] The European DataWarehouse (ED) is part of the asset-backed securities (ABS) Loan Level Data initiative established by the ECB. It provides a centralised securitisation repository for collecting, validating and distributing detailed, standardised and asset class specific loan-level data for ABS and private whole loan portfolios in Europe. It stores loan-level data and corresponding documentation for investors and other market participants. It has a narrowly targeted mandate and is not allowed to compete with its stakeholders, mainly European banks.

The data hub at European level would collect and store anonymised data on NPL transactions that have taken place and provide such post-trade transaction details and sale prices to market participants.[24] This would allow market participants to compare transactions and gain insights into the actual pricing of assets and market liquidity on a systematic basis. The data hub could also provide information on investors, their preferences and profiles as well as general information on judicial processes.

Going beyond information on transactions themselves, post-trade information provided by NPL buyers on workout cash flow for the assets that they have purchased could deliver crucial insights into the market for NPLs.[25] Performance data are key information that investors currently lack publicly in the market. In particular, information on recovery and expense cash flows would support the decision-making process of investors interested in similar assets and would help them in determining the prices they are willing to pay and helps diminish uncertainty. The incentive for NPL buyers to submit this information *ex post* would mainly be the prospect that they would gain access on the other side, providing them with insights into performance in the workout of comparable assets. This would provide a benchmark and would improve their estimations of fair prices/bids in future transactions.

Delivering more transparency in this manner would be key to supporting price discovery and thereby rendering markets more efficient. This would help narrow the often high bid-ask spread, which remains a material hurdle that prevents many transactions from happening. Banks, credit servicers, AMCs and potentially credit purchasers would share information with the data hub on transactions and on the post-trade performance of assets. In return, these data providers would gain access to the pool of anonymised data and to the analytical services offered by the data hub. This is important as stakeholders tend to deliver/share data, so they can gain access on the other side. If such post-trade data could be consolidated in a single location, it would mitigate this issue for the secondary market. Detailed data on recovery rates and workout timing by asset class, legal process and jurisdiction would certainly help investors broaden their activities across the EU. Existing

---

[24] At a later stage, it could be explored under what circumstances banks (and other data owners) would feel comfortable with also sharing pre-trade information on NPLs.

[25] Ongoing workout data could be shared in the form of the EBA NPL data template or ESMA NPL securitisation template. These portfolios could be reported in the same way as securitisation portfolios, requiring very limited adjustment to the existing data infrastructure.

data pooling initiatives clearly demonstrate the need for additional workout data. The data hub could therefore provide a key market utility in this respect, delivering increased transparency and secondary market information on NPLs. This initiative would need to comply with the EU General Data Protection Regulation (GDPR) and would need to guarantee that the information provided to third parties would only be used to promote the NPL secondary market and not to collect data on banks' balance sheets for other purposes (e.g. M&A processes).[26]

2.3. Leveraging existing data sources

Market participants can be more active and efficient if they are given more and better data. Anonymised data, if granular enough, can be used to derive useful aggregates in addition to the aggregate information already provided on the basis of the Pillar 3 disclosures[27] by banks using the standards developed by the EBA. In order to optimise resources, the reporting could usefully be integrated in the existing EBA data point model and developed in close collaboration with the competent authorities.

There are a number of data sources that in fact already exist and could form the basis for regular reports on aggregate information that would be made available to secondary market participants. The entities that collect and store the information would take care of reporting, thereby avoiding any additional reporting burden on e.g. banks. The Commission would explore in early 2021, together with relevant stakeholders, how these existing datasets could be mobilised and made available to market participants in suitably aggregated forms to ensure bank and borrower confidentiality. This would be a quick win at low cost. If done at a suitable level of granularity, this could improve the information available to new investors and the ability of investors to participate in countries outside their core expertise.[28] Furthermore, the Commission would explore how cooperation and

---

[26] The data would also need to be anonymised in the sense of the General Data Protection Regulation (GDPR). Recital 26 of the GDPR clarifies when data can be considered anonymous.

[27] Pillar 3 of the Basel Framework lays out a comprehensive set of public disclosure requirements that seek to provide market participants with sufficient information to assess an internationally active bank's material risks and capital adequacy.

[28] For example, reporting recovery rates and workout timing by NUTS 3 region, borrower type (corporate individual) and asset class (e.g. unsecured, secured with residential or commercial real estate for different loan-to-value bands).

connections could be cultivated between the data hub at European level and these data sources.

Key examples of existing data sources include:

- The ECB's 'Analytical Credit Dataset' ('AnaCredit'), which collects and shares granular credit risk data within the EU banking sector.
- Securitisation repositories, which centrally collect and maintain the records of securitisation instruments and underlying assets. They therefore possess good loan-level data, which can also provide NPL secondary market participants with valuable insights.
- Data reporting by banks on the time to recovery and recovery rates (gross and net of recovery costs): following up on the Capital Markets Union (CMU) Action Plan of 24 September 2020[29], the Commission would first assess the feasibility of recurrent reporting, using existing data points as far as possible.

Lastly, the Commission would consult stakeholders within the first half of 2021 on the potential review of Pillar 3 disclosure requirements under the CRR. Examples of further disclosures benefiting markets may include cure rate, time to recovery, recovery rate, etc. The release of such additional information should not pose any disadvantage to banks, as the information could further increase transparency on NPLs to the benefit of secondary markets. Keeping in mind the potential overlap with the NPL data templates, the EBA would be invited to look into this in detail to ensure an efficient and proportionate development of disclosure requirements.

2.4. 'Best execution' sales process

The Commission would aim to develop guidance, by the third quarter of 2021, for sellers of NPLs, in cooperation with the EBA and in discussion with other relevant stakeholders. This would include recommendations on what constitutes a 'best execution' sales process for the transactions on the secondary markets. This would encourage good sell-side processes across the board and might help smaller banks or sellers in particular, which may have less experience with secondary market transactions. The guidance could outline some conditions for helping to secure a successful outcome, which might include: ensuring a non-discriminatory/neutral sales process, the need to advertise widely, a common set of due diligence materials, accepting bids electronically, the use of

[29] Communication from the Commission on a Capital Markets Union for people and businesses – new action plan, COM(2020) 590 final. See Action 11/B.

EBA data templates, etc. Market participants would not be obliged to follow the recommendations formulated in this document, which would serve instead as a tool to guide good sales processes.

The guidance could also provide information on the possible value added of NPL transaction platforms in the sales process. This could help banks, particularly smaller ones, decide whether to use transaction platforms and whether to use them to support their objectives. This best execution sales process could therefore provide for an indirect push towards the use of such platforms.

2.5. Address regulatory impediments to NPL purchases by banks

One of the remaining impediments for banks buying NPLs in the secondary market relates to the regulatory treatment of purchased defaulted assets and the risk weights that banks need to apply to calculate capital requirements under the Standardised Approach for credit risk. Article 127 of the CRR states that if a defaulted unsecured exposure is provisioned/written down by more than 20%, the risk weight should be 100%, otherwise 150%. However, only provisions/write-downs (so-called 'credit risk adjustments') made by the institution itself can be accounted for, not write-downs accounted for in the transaction price of the exposure. In practice, this can lead to a situation where NPL buyers need to apply a higher risk weight to the same unsecured NPLs than the seller did. Addressing this issue would mostly benefit smaller banks purchasing NPLs – including some specialised NPL buyers that have a banking licence – as these usually employ the Standardised Approach for credit risk. This measure would help increase competition on the buy-side.

The Commission intends to develop in early 2021, together with the EBA, a suitable approach, which would reduce the risk weight on purchased defaulted assets to an appropriate level. Such an approach would need to be consistent with the overall regulatory framework, and, if necessary, with appropriate safeguards to avoid underestimation of risk.

3. ASSET MANAGEMENT COMPANIES

Asset management companies (AMCs) offer a number of benefits for dealing with

NPLs. They provide a very effective measure in specific circumstances, namely when impaired assets affect a large part of the domestic banking system and mainly cover loans secured by commercial real estate and large corporate exposures. Their primary goal is to remove NPLs from banks' balance sheets and extract the most value from them by active workouts and a recovery in asset prices over time.

It is important to note that AMCs can be private or (partly) publicly funded. Even when (some) public funding is involved, it would not be State aid if the State can be considered to be acting in a similar way to a market economy operator. The option of an AMC involving State aid should not be seen as the default solution since AMCs can take multiple forms and can be structured and financed in several ways. AMCs can be decentralised, offering targeted, bank-specific approaches. Alternatively, AMCs can be established at national level. Such national AMCs could procure and centralise expertise, benefit from economies of scale and creditor coordination at a higher level, and provide relief to affected banks that are struggling to manage their NPLs. This would help the banks refocus on lending to viable companies and households. Beyond AMCs, several alternative impaired asset measures have been implemented with success in recent years by various Member States. Alternative impaired asset measures may include, among others, bank-driven initiatives, securitisation-based approaches, guarantees or asset protection schemes (APSs) as well as ad-hoc AMCs common to one or a limited number of banks. AMCs and APSs pursue similar goals, and they can complement each other, thereby allowing for tailored approaches to the specific impaired asset situation in a Member State. In this respect, some Member States are already working with systemic securitisation solutions, such as the *Garanzia sulla Cartolarizzazione delle Sofferenze* (GACS) no-aid scheme in Italy, and the no-aid Hercules scheme in Greece, both of which have been successful and where new transactions are being planned.

AMCs would need to have sufficient financial firepower in terms of loss-absorbing capacity/equity in order to make a meaningful contribution to tackling COVID NPLs. When focusing on the possibility of establishing AMCs at national level, they would therefore need to be endowed with a substantial financial envelope from the start. In the case of public AMCs, this contribution would likely take the form of an equity injection combined with guarantees on the AMC's funding. Market funding without a guarantee should be explored as part of the design process and, if feasible, may be preferred over government-guaranteed funding. However, even if private capital and funding could be attracted, sizeable public funding would probably be needed in most cases, which would necessitate a State Aid assessment.

National AMCs can be set up according to the needs of the domestic banking sector. The asset perimeter could be defined in such a way as to maximise potential and upside. This flexibility on asset perimeter should be framed by the Commission's AMC Blueprint guidance as some asset classes are more difficult to manage and it may be challenging to recover value from them. The scope of assets to be transferred to an AMC should always be developed in such a way that the AMC's overall effectiveness is not impaired.

In order to boost cooperation among national AMCs and create valuable synergies, a cross-border network could be enabled at EU level. National AMCs could exchange best practices and experience, implement data and transparency standards and coordinate creditor actions where necessary. This network could therefore increase the collective effectiveness of national AMCs across the EU.

The biggest benefit of such cooperation would be to take advantage of economies of scale in dealing with information. It may be considered that the aforementioned data hub at European level could be suitable to provide a dedicated platform for coordination and cooperation between national AMCs. Furthermore, by linking up the AMCs with the data hub, it would be possible to fill some significant data gaps and add transparency to the market. This is important as AMCs possess a wealth of data that could be valuable to the wider market. National AMCs could therefore collect and publish NPL-related (pre-trade) data in standard formats for increased market transparency, while complying with GDPR requirements. Disclosing the holdings and performance of NPLs held by AMCs via the data hub at European level would allow investors and transaction platforms to compete more efficiently for the assets of AMCs and to more accurately price NPLs. In addition, the AMCs may, where appropriate, combine efforts to establish a joint transaction platform at European level. As many individual AMCs establish such platforms by themselves to facilitate sales and reach a wider investor base, these efforts could be combined to set up a single transaction platform dedicated to sales by participating AMCs. This could also further improve cooperation with relevant third-party service providers.

The benefits of a network approach depend on the degree of homogeneity and number of national AMCs. First, each national AMC would need to be set up properly to ensure efficiency within the network. Discrepancies in AMC designs, operations, practices, etc. could have significant negative effects on possible cooperation between AMCs. The Commission will therefore actively encourage proper implementation of the AMC Blueprint on these matters. Second, a more limited number of national AMCs could hinder some of the positive network effects that could result from enhanced cooperation among AMCs. Nevertheless, it would still be useful to link these AMCs to the data hub at European level. They could then use it to coordinate and cooperate with each other in order to share best practices and information on investors, debtors and servicers. AMCs would be able to develop a better overview of differences in performance in terms of recovery across Member States, enabling various lessons to be learned when comparing the successes and shortcomings of these jurisdictions.

The Commission stands ready to support Member States in setting up national AMCs – if they wish to do so[30] – and would explore how synergies and cooperation could be cultivated by establishing an EU network of national AMCs[31], jointly with existing national AMCs, the ECB and the EBA. If several Member States forged ahead, the network could be built gradually, depending on the speed and extent to which banks would be hit in different Member States.

4. INSOLVENCY, DEBT RECOVERY AND DEBT RESTRUCTURING FRAMEWORKS

In the short term, the Commission urges the European Parliament and the Council to swiftly reach an agreement on the legislative proposal[32] for minimum harmonisation rules on accelerated extrajudicial collateral enforcement, with the total exclusion of consumers from this procedure. While the Council provided a negotiating mandate, inter-institutional negotiations have still not started. Given that this measure would help in the recovery by facilitating SME access to bank finance, its adoption should be a priority.

---

[30] The AMC Blueprint explains how an AMC can be set up under the current crisis management framework and State aid rules, but the same principles can also be applied to APSs guaranteeing NPLs. The Commission stands ready to advise Member States with concrete questions on this.

[31] It would be ensured that such a network complies with EU antitrust rules notably on exchange of confidential information.

[32] COM (2018) 0135 final – 2018/063 (COD).

The benchmarking exercise of loan enforcement regimes (which was part of the 2017 Council NPL Action Plan) has been finalised.[33] In this context, data has been collected on the recovery rate and speed that banks experience in practice when trying to enforce NPLs in Member States. The outcome of the exercise provides a snapshot of insolvency outcomes in terms of delays and value recovery in national proceedings from the perspective of bank loan enforcement. Responding to a Call for Advice from the Commission, the EBA gathered data from banks in all Member States that contributed voluntarily, improved the representativeness of the sample and increased data quality with national competent authorities. The final report provides a wide range of useful data, including recovery rates, time to recovery and cost of recovery by country and asset class, although some Member States' data suffered from lower representativeness.

The exercise enables a better assessment of the efficiency of the legal framework in Member States in terms of defaulting or insolvent debtors in relation to bank loans. As indicated in the 2017 NPL Action Plan, stronger focus on the improvement of insolvency frameworks should be given in the country-specific recommendations, especially in those countries where high levels of NPLs prevail.

In light of the experience with the exercise and the accessibility of data, the Commission will carefully analyse whether it is appropriate to make insolvency benchmarking a more regular exercise.[34] The CMU Action Plan put forward an action whereby data gathering exercises may be carried out regularly (based on reporting obligations), with the objective of feeding these results into the European Semester. Special attention will be paid to avoid any unnecessary burden on banks.

The transposition of the Directive (EU) 2019/1023 on preventive restructuring frameworks[35] should also aid in preventing the build-up of NPLs. The enhancement of preventive restructuring frameworks would ensure that action is taken before enterprises default on their loans, thereby helping to reduce the risk of loans becoming non-performing

---

[33] 'Report on the benchmarking of national loan enforcement frameworks', EBA/Rep/2020/29.

[34] This type of information is not supervisory information. At the same time, any reporting requirement on banks to competent authorities, even if not supervisory reporting in the strict sense, will have to be assessed in light of the burden already imposed by existing supervisory reporting requirements.

[35] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

in cyclical downturns and mitigating the adverse impact on the financial sector. At the same time, non-viable businesses with no prospect of survival should be liquidated as quickly as possible. Member States shall adopt and publish the laws, regulations and administrative provisions necessary to comply with this Directive by 17 July 2021[36].

The Recovery and Resilience Facility (RRF) will incentivise and support reforms to reduce NPLs, in particular to improve the efficiency of national insolvency frameworks and administrative and judicial systems, including through capacity-enhancing investments. This will be of particular relevance for Member States whose reform needs in these areas have been identified in 2019 and 2020 Country Specific Recommendations in the context of the European Semester.

The benchmarking results are also one of the elements that should feed into the preparatory work for a legislative or non-legislative action on targeted convergence of national non-bank insolvency frameworks under the new CMU Action Plan. The measures suggested under such initiative would address the aspects of insolvency proceedings that have been identified as barriers to cross-border investment. As announced in the 2020 Capital Markets Union Action Plan, the Commission will work towards targeted harmonisation or convergence of core aspects of substantive insolvency law, such as triggers for opening insolvency proceedings, the ranking of claims, avoidance actions, the identification and tracing of assets belonging to the insolvency estate and asset valuation. The Commission will, inter alia, also build on the results of a previous comparative study on substantive insolvency law in the EU in 2016, which revealed vast differences in national insolvency frameworks and raised issues that are deemed appropriate for the EU legislator to consider[37], and will work with a group of independent experts. An Inception Impact Assessment was published in November 2020[38]; a public consultation will follow suit, and a group of experts will also undertake technical work.

---

36 Pursuant to article 34, paragraph 2, Member States that encounter particular difficulties in implementing this Directive could benefit from an extension of one year of the implementation period. Member States shall notify to the Commission the need to make use of this option by 17 January 2021 (some Member States have already requested such extension).

37 Available at: https://ec.europa.eu/info/sites/info/files/insolvency_study_2016_final_en.pdf

38 See https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Enhancing-the-convergence-of-insolvency-laws-.

5. TACKLING NPLS IN THE AFTERMATH OF THE COVID-19 PANDEMIC UNDER THE EU BANK CRISIS MANAGEMENT AND STATE AID FRAMEWORKS

5.1. Precautionary public support measures in the COVID-19 context

While the EU banking sector is generally in a much sounder position than in 2008 and several policy measures mitigate the potential impacts of COVID-19 on the sector, both the scale of the national policy responses to the impacts of the pandemic and the degree of severity of such impacts across economic sectors is diverse. As a result, available analyses point to the aggregate resilience of the EU banking sector to pandemic-induced stress[39] [40], but also indicate that if the situation worsens, some banks might need to take action[41].

Authorities might therefore need to be able to intervene in order to avoid impediments to the post-COVID economic recovery. Market-based solutions should remain the first and primary tool for addressing NPLs, and the strategy that this Communication lays down aims to facilitate them and exploit their full potential. However, if there are indications that the effects of the pandemic could cause distress to banks and pose financial stability concerns that exceed the capacity of available market-based solutions, the Union bank crisis management[42] and State aid[43] frameworks allow that, in such extraordinary circumstances, precautionary public support can be provided in order to enable continued lending to the real economy, support the recovery and cushion the social impacts of the crisis.

As the Commission acknowledged in its Communication of March 2020[44], banks have a key role to play in dealing with the effects of the COVID-19 crisis by maintaining the flow of credit to the economy. Support to the banking sector is meant to incentivise the continued funding of economic activity in the EU. In their policy responses to support the real economy (through moratoria, guarantees, etc.), many Member States have indirectly

---

[39] EBA thematic note EBA/REP/2020/17.

[40] ECB's COVID-19 vulnerability analysis, https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200728~7df9502348.en.html

[41] ECB's COVID-19 vulnerability analysis.

[42] Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (OJ L 173, 12.6.2014, p. 190–348), and Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (OJ L 225, 30.7.2014, p. 1–90).

[43] The framework established by Articles 107, 108 and 109 TFEU and regulations and all Union acts, including guidelines, communications and notices, made or adopted pursuant to Article 108(4) or Article 109 TFEU.

[44] Communication from the Commission, Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, 2020/C 91 I/01, and subsequent amendments.

shielded banks from potential credit losses. Similarly, direct precautionary public support from Member States to banks, which would otherwise be solid without the COVID-19 shock, would seek to minimise the ultimate cost for taxpayers and possible repercussions on the real economy. At the same time, application of the Union bank crisis management and State aid frameworks would ensure that any support remains targeted and limited and would not result in a bailout of banks that were already experiencing viability problems before the COVID-19 crisis. For institutions that are failing or likely to fail, the Union crisis management framework provides for a set of tools including, in resolution, bail-in.

Precautionary measures by Member States to support liquidity or capital can take different forms as alternative or complementary solutions. Capital support can take the form of a direct injection of capital, but may also be effected through other types of measures that can help preserve the lending channel. In particular, the Commission has already confirmed the possible use of precautionary measures to finance the transfer of NPLs to an AMC in its AMC Blueprint, provided that such transactions pursue the same objectives of capital injections and meet the same conditions, as is the case with APSs, i.e. public guarantees on a portfolio of assets on a bank's balance sheet. It is therefore possible to also implement APSs as precautionary measures under the Bank Recovery and Resolution Directive (BRRD)[45], taking into account the relevant safeguards needed to ensure compliance with the applicable legal requirements, as clarified in the AMC Blueprint.

5.2. Application of precautionary measures under the BRRD and the State aid framework

The Union crisis management framework provides a set of tools for institutions that are failing or likely to fail, including, in resolution, the bail-in of shareholders and creditors. As a rule, this applies to any bank that requires extraordinary public financial support in order to preserve its viability, liquidity or solvency. However, the BRRD acknowledges the existence of exceptional situations where the need for extraordinary public financial support will not trigger a declaration that an institution is failing or likely to fail. The exceptions are listed in points (i) to (iii) of Article 32(4)(d) BRRD. In particular, an

[45] Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (OJ L 173, 12.6.2014, pp. 190–348).

injection of own funds in or a purchase of capital instruments from a solvent institution to address a capital shortfall resulting from stress tests, asset quality reviews or equivalent exercises does not automatically trigger the declaration that an institution is failing or likely to fail, if it remedies, on a temporary basis, a serious disturbance in the economy of a Member State and preserves financial stability.

The measure may be granted only to solvent banks. The condition of solvency is to be assessed by the competent authority, and should be met at the time when the measure is granted.

The Commission considers that the exception in Article 32(4)(d)(iii) BRRD may be applied during the COVID-19 crisis. This exception could apply to banks that are financially viable but may be impacted by a system-wide event such as an EU-wide crisis or a Member State-wide crisis. The objective of this provision is to allow Member States to provide institutions with a temporary capital buffer to deal with severe adverse conditions in order to boost confidence in the banking sector and strengthen financial stability. In its Temporary Framework for State aid measures to support the real economy[46], the Commission already recognised that the COVID-19 crisis is a serious disturbance to the economy that can fall within the scope of the 2013 Banking Communication[47]. Measures taken to remedy such serious disturbance in the economy can fall under the exception provided for in the BRRD.

The amount of the support measure is to be determined on the basis of a stress test or equivalent exercise. As provided for by Article 32.4 (d) of the BRRD, the measure shall be confined to solvent institutions and shall be conditional on final approval under the Union State aid framework, according to the established practice of the Commission. It is for the authorities conducting the stress test or equivalent exercise to determine the applicable methodology. The validity period of the stress test or equivalent exercise is 1 year in principle. As a general rule, the Commission intends to presume that institutions' accounts are correct. However, it may request further verifications by the competent authority on a case-by-case basis, at the time of the granting of the State aid, in order to confirm the

[46] Communication from the Commission Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, 2020/C 91 I/01, and subsequent amendments.

[47] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 216, 30.7.2013, pp. 1–15.

absence of hidden likely or incurred losses (e.g. related to misclassifications or the under-provisioning of loans at the cut-off date of the stress test)[48]. For the Banking Union, the ECB already completed a vulnerability analysis in July 2020. The results of such analysis could be a starting point to inform the assessment of capital shortfalls leading to support measures pursuant to Article 32(4)(d)(iii) BRRD.[49] Similar considerations would apply to stress tests, such as the 2021 EU-wide stress test, or exercises that national competent authorities or the ECB may conduct in accordance with the same methodology or a similar one[50].

From a State aid point of view, public guarantees on a portfolio of assets on a bank's balance sheet as well as NPL transfers to a publicly backed AMC are considered impaired asset measures (IAMs), which are governed by the Commission's guidelines on State aid to banks[51]. In particular, to be compatible with the applicable State aid rules, the NPL transfer price can as a rule not exceed the Real Economic Value (REV), which should reflect the underlying long-term economic value of the assets on the basis of underlying cash flows and broader time periods[52], to be assessed by independent experts.

The Commission will consider whether a simplified approach to determining the real economic value could possibly be used. This will take into account the strengthening of capital and loss absorption requirements, the accounting standards applied by the banks and the assessment by the supervisors of their provisioning policy.

---

[48] No deduction would be required for the losses booked between the cut-off date of the equivalent exercise and the date of the measure if it can be reasonably concluded that the accounts are correct and that there are no hidden likely or incurred losses, the institution is solvent and it is reasonably assumed that likely or incurred losses have been fully absorbed by private means without implying a breach of the solvency threshold. However, if the competent authority identifies hidden likely or incurred losses arising from misclassifications or under-provisioning at the cut-off date of the stress test or equivalent exercise, these should have to be deducted from the precautionary recapitalisation amount.

[49] The vulnerability analysis does not equate to a stress test or AQR, but could be considered as an equivalent exercise.

[50] Any new stress test or equivalent exercise would need to consider, for the purposes of the definition of the scenarios, the circumstances prevalent at the time it is performed.

[51] As laid down in the Impaired Assets Communication (IAC): Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C 72, 26.3.2009, pp. 1–22.

[52] See paragraph 40 of the IAC.

6. CONCLUSIONS

Depending on the shape and speed of the economic recovery and the phasing-out of the support measures to businesses and households, banks' asset quality – and in turn their lending capacity – could deteriorate as a result of the COVID-19 crisis. History has shown us that it is best to tackle NPLs early and with decisive action, while ensuring robust consumer protection, to allow the banking sector to play its role in supporting the economic recovery.

Building on the measures presented by the Council in 2017, further structural measures are needed to address a possible accumulation of NPLs over the medium term. This Communication presents an EU-wide strategy to anticipate a future build-up of NPLs on banks' balance sheets, while ensuring a high degree of consumer protection. The strategy focuses on reducing risks (i.e. by tackling NPLs early, thus avoiding a possible renewed build-up on banks' balance sheets in the future) and, thereby, on making sure that banks are in a position to support the economic recovery. This new approach builds on the actions that were endorsed by Finance Ministers in 2017, finalising some of the elements that have not been implemented yet. It would use these actions as a foundation for further measures. All of these would be complementary in nature and would have more effect when implemented together.

The Commission stands ready to provide support to Member States through the Technical Support Instrument in, amongst others, the following areas: (i) development of national NPL strategies; (ii) bolstering supervisors' capacity to deal with rising levels of NPLs; (iii) establishing a national AMC, in line with the AMC Blueprint and best practices; (iv) developing and improving supervisory data management architecture and pursue innovation in the area of SupTech; and (v) strengthening the frameworks governing debt collection, insolvency and debt restructuring.

The Commission calls on the European Parliament, the Council and Member States to ensure that the strategy to address NPLs is implemented at the Union and national levels in a coordinated manner. It calls for a swift adoption of the measures that have already been put forward. This includes the proposal for a directive on credit servicers, credit purchasers and for the recovery of collateral. The Commission also calls for constructive support in the implementation of the measures outlined in this Communication, and for a proactive approach by Member States to addressing any shortcomings in national frameworks. This would help banks in preparing to manage a possible increase in NPLs as effectively as possible.

While structural policy measures are taken for the economy as a whole, the Union bank crisis management and State aid frameworks have the tools to address specific difficulties that may emerge in the banking sector due to COVID-19. In particular, precautionary recapitalisation measures can be deployed for viable banks to respond to the possible impacts of COVID-19 and allow the banking sector to continue to be part of the solution to the crisis.