Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures (Text with EEA relevance)

REGULATION (EU) 2019/630 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

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(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank[(1)],

Having regard to the opinion of the European Economic and Social Committee[(2)],

Acting in accordance with the ordinary legislative procedure[(3)],

Whereas:

(1) The establishment of a comprehensive strategy to address non-performing exposures (NPEs) is an important goal for the Union in its attempt to make the financial system more resilient. While addressing NPEs is primarily the responsibility of banks and Member States, there is also a clear Union dimension to reducing the current high stock of NPEs, to preventing any excessive build-up of NPEs in the future and to preventing the emergence of systemic risks in the non-banking sector. Given the interconnectedness of the banking and financial systems across the Union, where banks operate in multiple jurisdictions and Member States, there is significant potential for spill-over effects for Member States and for the Union as a whole, both in terms of economic growth and financial stability.

(2) The financial crisis led to the build-up of NPEs in the banking sector. Consumers were significantly affected by the subsequent recession and the drop in housing prices. Safeguarding consumers' rights in line with relevant Union law such as Directives 2008/48/EC[(4)] and 2014/17/EU[(5)] of the European Parliament and of the Council is essential when tackling the issue of NPEs. Directive 2011/7/EU of the European Parliament and of the Council[(6)] encourages prompt payment by both enterprises and public authorities and helps prevent the kind of build-up of NPEs that occurred during the years of the financial crisis.

(3) An integrated financial system will enhance the resilience of the Economic and Monetary Union to adverse shocks by facilitating cross-border private risk-sharing, while at the same time reducing the need for public risk-sharing. In order to achieve those objectives, the Union should complete the banking union and further develop a capital markets union. Addressing possible future NPE accumulation is essential to strengthening the banking union as it is essential for ensuring competition in the banking sector, preserving financial stability and encouraging lending, so as to create jobs and growth within the Union.

(4) In its 'Action plan to tackle non-performing loans in Europe' of 11 July 2017, the Council called upon various institutions to take appropriate measures to further address the high number of NPEs in the Union and to prevent their build-up in the future. The action plan sets out a comprehensive approach that focuses on a mix of complementary policy actions in four areas: (i) supervision; (ii) structural reforms of insolvency and debt recovery frameworks; (iii) development of secondary markets for distressed assets; (iv) fostering restructuring of the banking system. Actions in those areas are to be taken at Union and at national level, where appropriate. The Commission announced a similar intention in its 'Communication on completing the Banking Union' of 11 October 2017, which called for a comprehensive package on tackling non-performing loans (NPLs) within the Union.

(5) Regulation (EU) No 575/2013 of the European Parliament and of the Council[(7)] forms, together with Directive 2013/36/EU of the European Parliament and of the Council[(8)], the legal framework governing the prudential rules for credit institutions and investment firms (referred to collectively as 'institutions'). Regulation (EU) No 575/2013 contains, inter alia, provisions directly applicable to institutions for determining their own funds. It is therefore necessary to complement the existing prudential rules in Regulation (EU) No 575/2013 relating to own funds with provisions requiring a deduction from own funds where NPEs are not sufficiently covered by provisions or other adjustments. Such requirement would effectively amount to creating a prudential backstop for NPEs that would apply uniformly to all institutions in the Union, and would also cover institutions which are active on the secondary market.

(6) The prudential backstop should not prevent competent authorities from exercising their supervisory powers in accordance with Directive 2013/36/EU. Where competent authorities ascertain on a case-by-case basis that, despite the application of the prudential backstop for NPEs established by this Regulation, the NPEs of a specific institution are not sufficiently covered, it should be possible for them to make use of the supervisory powers provided for in Directive 2013/36/EU, including the power to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements. Therefore, it is possible, on a case-by-case basis, for the competent authorities to go beyond the requirements laid down in this Regulation for the purpose of ensuring sufficient coverage for NPEs.

(7) For the purposes of applying the prudential backstop, it is appropriate to introduce in Regulation (EU) No 575/2013 a clear set of conditions for the classification of NPEs. As Commission Implementing Regulation (EU) No 680/2014[(9)] already lays down criteria

concerning NPEs for the purposes of supervisory reporting, it is appropriate that the classification of NPEs build on that existing framework. Implementing Regulation (EU) No 680/2014 refers to defaulted exposures as defined for the purpose of calculating own funds requirements for credit risk and impaired exposures pursuant to the applicable accounting framework. As forbearance measures might influence whether an exposure is classified as non-performing, the classification criteria are complemented by clear criteria on the impact of forbearance measures. Forbearance measures should aim to return the borrower to a sustainable performing repayment status and should comply with Union consumer protection law and in particular with Directives 2008/48/EC and 2014/17/EU, but might have different justifications and consequences. It is therefore appropriate to provide that a forbearance measure granted to a non-performing exposure should not discontinue the classification of that exposure as non-performing unless certain strict discontinuation criteria are fulfilled.

(8) The longer an exposure has been non-performing, the lower the probability for the recovery of its value. Therefore, the portion of the exposure that should be covered by provisions, other adjustments or deductions should increase with time, following a pre-defined calendar. NPEs purchased by an institution should therefore be subject to a calendar that starts to run from the date on which the NPE was originally classified as non-performing, and not from the date of its purchase. For that purpose, the seller should inform the buyer of the date of the classification of the exposure as non-performing.

(9) Partial write-offs should be taken into account when calculating the specific credit risk adjustments. In order to avoid any double counting of the write-off, it is necessary to use the original exposure value prior to the partial write-off. The inclusion of partial write-offs in the list of items that can be used to meet the requirements of the backstop should encourage institutions to recognise write-offs in a timely manner. For NPEs purchased by an institution at a price lower than the amount owed by the debtor, the purchaser should treat the difference between the purchase price and the amount owed by the debtor in the same way as a partial write-off for the purpose of the prudential backstop.

(10) Secured NPEs are generally expected to result in a less significant loss than unsecured NPEs, as the credit protection securing the NPE gives the institution a specific claim on an asset or against a third party in addition to the institution's general claim against the defaulted borrower. In the case of an unsecured NPE, only the general claim against the defaulted borrower would be available. Given the higher loss expected on unsecured NPEs, a stricter calendar should be applied.

(11) An exposure which is only partly covered by eligible credit protection should be considered as secured for the covered part, and as unsecured for the part which is not covered by eligible credit protection. In order to determine which parts of NPEs are to be treated as secured or unsecured, the eligibility criteria for credit protection and for fully and completely securing mortgages used for the purposes of the calculation of own funds requirements should be applied in accordance with the relevant approach under Regulation (EU) No 575/2013, including applicable value adjustment.

(12) The same calendar should be applied irrespective of the reason for which the exposure is non-performing. The prudential backstop should be applied at an exposure-by-

exposure level. A calendar of three years should apply for unsecured NPEs. In order to allow institutions and Member States to improve the efficiency of restructuring or of enforcement proceedings, as well as to recognise that NPEs secured by immovable collateral and residential loans guaranteed by an eligible protection provider as defined in Regulation (EU) No 575/2013 will have a remaining value for a longer period of time after the loan has been classified as non-performing, it is appropriate to provide for a calendar of nine years. For other secured NPEs a calendar of seven years should apply in order to build up full coverage.

(13) It should be possible to take forbearance measures into account for the purpose of applying the relevant coverage factor. More precisely, the exposure should continue to be classified as non-performing but the coverage requirement should remain stable for one additional year. Therefore, the factor that would be applicable during the year in which the forbearance measure has been granted should be applicable for two years. Where, upon the expiry of the additional year, the exposure is still non-performing, the applicable factor should be determined as if no forbearance measure had been granted, taking into account the date on which the exposure was originally classified as non-performing. Given that granting forbearance measures should not lead to any arbitrage, that additional year should only be permitted in respect of the first forbearance measure that has been granted since the classification of the exposure as non-performing. In addition, the one-year period during which the coverage factor remains unchanged should not lead to the extension of the provisioning calendar. As a result, any forbearance measure granted in the third year after the classification as NPE for unsecured exposures, or in the seventh year after the classification as NPE for secured exposures, should not delay the full coverage of the NPE.

(14) In order to ensure that the credit protection valuation of institutions' NPEs follows a prudent approach, the European Supervisory Authority (European Banking Authority) (EBA) should consider the need for, and if necessary develop, a common methodology, in particular regarding assumptions pertaining to recoverability and enforceability, and possibly including minimum requirements for re-valuation of the credit protection in terms of timing.

(15) In order to facilitate a smooth transition towards the new prudential backstop, the new rules should not be applied in relation to exposures originated prior to 26 April 2019.

(16) In order to ensure that the amendments to Regulation (EU) No 575/2013 introduced by this Regulation apply in a timely manner, this Regulation should enter into force on the date following that of its publication in the *Official Journal of the European Union*.

(17) Regulation (EU) No 575/2013 should therefore be amended accordingly,

HAVE ADOPTED THIS REGULATION:

Article 1

Regulation (EU) No 575/2013 is amended as follows:

(1) in Article 36(1), the following point is added:

(m) the applicable amount of insufficient coverage for non-performing exposures.;

(2) the following Articles are inserted:

Article 47a

Non-performing exposures

1 For the purposes of point (m) of Article 36(1), exposure shall include any of the following items, provided they are not included in the trading book of the institution:

a a debt instrument, including a debt security, a loan, an advance and a demand deposit;

b a loan commitment given, a financial guarantee given or any other commitment given, irrespective of whether it is revocable or irrevocable, with the exception of undrawn credit facilities that may be cancelled unconditionally at any time and without notice, or that effectively provide for automatic cancellation due to deterioration in the borrower's creditworthiness.

2 For the purposes of point (m) of Article 36(1), the exposure value of a debt instrument shall be its accounting value measured without taking into account any specific credit risk adjustments, additional value adjustments in accordance with Articles 34 and 105, amounts deducted in accordance with point (m) of Article 36(1), other own funds reductions related to the exposure or partial write-offs made by the institution since the last time the exposure was classified as non-performing.

For the purposes of point (m) of Article 36(1), the exposure value of a debt instrument that was purchased at a price lower than the amount owed by the debtor shall include the difference between the purchase price and the amount owed by the debtor.

For the purposes of point (m) of Article 36(1), the exposure value of a loan commitment given, a financial guarantee given or any other commitment given as referred to in point (b) of paragraph 1 of this Article shall be its nominal value, which shall represent the institution's maximum exposure to credit risk without taking account of any funded or unfunded credit protection. The nominal value of a loan commitment given shall be the undrawn amount that the institution has committed to lend and the nominal value of a financial guarantee given shall be the maximum amount the entity could have to pay if the guarantee is called on.

The nominal value referred to in the third subparagraph of this paragraph shall not take into account any specific credit risk adjustment, additional value adjustments in accordance with Articles 34 and 105, amounts deducted in accordance with point (m) of Article 36(1) or other own funds reductions related to the exposure.

3 For the purposes of point (m) of Article 36(1), the following exposures shall be classified as non-performing:

a an exposure in respect of which a default is considered to have occurred in accordance with Article 178;

b an exposure which is considered to be impaired in accordance with the applicable accounting framework;